On December 2, 1996, the Section submitted comments to the Cost Accounting Standards Board (Board) regarding its Notice of Proposed Rulemaking (NPRM) on "Changes in Cost Accounting Practices." The Section observed generally that the NPRM: (a) broadened the definition of "cost accounting practice" while simultaneously adding to notice and recordkeeping requirements; (b) required additional levels of administrative action; and (c) addressed topics that are unnecessary and addressed them in too much detail. The Section stated that this NPRM went too far in subject matter, approach, and content, resulting in confusion, increased paperwork requirements, and increased cost both to contractors and the Government.

The Section offered several specific recommendations to improve the NPRM. The NPRM, while broadening the definition of "cost accounting practice" to include most accounting changes resulting from contractor organizational changes, would add an exception for the transfer of an existing function to a different cost pool back to the same pool and an exemption for cost pool changes with a rate impact of a plus or minus 1% corridor. The Section noted that the new exception and exemptions are too narrowly defined and would apply in very few situations in actual practice. The Section, therefore, suggested that the definition of the proposed exception and exemptions be broadened. Specifically, the Section recommended that the new exception for cost allocated back to the same pools not be limited to costs that are "directly allocated." In addition, the Section recommended that the corridor for the new exemption for cost allocated back to the same pools should be expanded.

Regarding the new exemption for changes that produce cost savings, the Section recommended several changes in the language of the NPRM. These changes would ensure that this exemption is implemented in a manner that broadly exempts restructuring and other contractor actions from contract price or cost adjustments under the expanded definition of "cost accounting practice" proposed in the NPRM.

Next, the Section observed that the standards in the NPRM that entitle a contractor to an equitable contract price adjustment are too narrow. Such price adjustments would be available when a cognizant federal agency official has made a finding that a voluntary change in a cost-accounting practice is "desirable."

The Section recommended that the definition of desirable be broadened to include "appropriate, warranted, equitable, fair or reasonable." In addition, the Section recommended changing the language of the NPRM from merely recommending that a contracting officer determine a change is desirable, if appropriate. Instead, the Rule should direct a finding of "desirable" when there is a reasonable expectation that benefits will incur to the Government in future contract awards.

The Section also recommended changes in the process set forth in the NPRM by which a contractor implements a new accounting practice. The Section suggested that the contractor be allowed to prepare cost proposals and negotiate contracts based on the new accounting practice during the period between the notification date and the effective date. The Section noted that the NPRM, as currently worded, actually permits the Government to reduce the price twice due to the change -- once during the negotiation and the second time during the cost impact process. The Section also recommended deleting the provision of the NPRM that takes a prospective look at increased costs because such a look is speculative and confusing. The Section also suggested that the Board should allow for the use of both the estimates-to-complete approach and the original estimate approach to compute the cost impact on firm fixed-price contracts.
Finally, the Section suggested that the Board revise the NPRM to decrease the administrative burdens by lowering the number of change actions and contractor recordkeeping requirements.

December 2, 1996

Mr. Rudolph J. Schuhbauer  
Project Director  
Cost Accounting Standards Board  
Office of Federal Procurement Policy  
725 17th Street, N.W., Room 9001  
Washington, D.C. 20503

Attn: CASB Docket No. 93-01N

Re: Cost Accounting Standards Board Notice of Proposed Rulemaking: "Changes In Cost Accounting Practices;"  
61 Fed. Reg. 49196 (Sep. 18, 1996)

Dear Mr. Schuhbauer:

On behalf of the Section of Public Contract Law (the "Section") of the American Bar Association (the "Association"), I am submitting comments on the above-referenced Notice of Proposed Rulemaking ("NPRM"). The Section consists of attorneys and associated professionals in private practice, industry and Government service. The Section's governing Council and substantive committees contain a balance of members representing these three segments to ensure that all points of view are considered. In this manner, the Section seeks to improve the process of public contracting for needed supplies, services and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the Association, and, therefore, should not be construed as representing the policy of the Association.

In providing these comments concerning the above-referenced NPRM, the Section notes that the NPRM and accompanying comments are lengthy (filling 33 pages in the Federal Register) and cover a substantial number of individual subjects. In light of the limited time available to provide these comments, the Section has elected to focus upon significant items of particular interest to the legal profession.

I. Introduction

Like the ANPRM which preceded it, the NPRM addresses two broad topics: (1) the definitions of "cost accounting practice" and "change to a cost accounting practice"; and (2) the administration of the cost accounting practice change and cost impact process. By letter dated July 10, 1995, the Section supplied comments to the Board's ANPRM (See 60 Fed. Reg. 20252). The Board's September 18, 1996 NPRM makes a number of substantial revisions to the earlier ANPRM, some of which address our earlier concerns. To the extent practical, the comments which follow concentrate on the revisions made by the Board to the ANPRM.

However, certain of the Section's earlier comments on the ANPRM bear brief repetition because they...
pointed out problems that have not been fixed in the NPRM. The Section observed generally that the ANPRM: (a) broadened the definition of "cost accounting practice" while simultaneously adding to notice and recordkeeping requirements; (b) required additional levels of administrative actions; and (c) addressed topics that are unnecessary and addressed them in too much detail. The resulting document went too far in subject matter, approach, and content, resulting in confusion, increased paperwork requirements, and increased cost both to contractors and the government. The same observation, unfortunately, remains true of the NPRM. While limited clarification of the current regulations may be appropriate, the NPRM -- like the ANPRM -- is unnecessarily long and complicated and in the long run will achieve confusion rather than clarification.

II. The Definition Of "Cost Accounting Practice," Including The New Exception And Exemptions

The NPRM, like the earlier ANPRM, effectively broadens the definition of "cost accounting practice" to include most accounting changes resulting from contractor organizational changes. See, e.g., proposed FAR 9903.302-3, Illustrations 4-7 [61 Fed. Reg. at 49211]. As a result, additional events will qualify as "changes to cost accounting practice." The broadening of the definition is accomplished through a new definition of the phrase "allocation of cost to cost objectives" provided in proposed FAR 9903.302-1(c) [61 Fed. Reg. at 49209]. Without so stating, the practical effect of the new definition provided in the NPRM is to reverse the decision of the Armed Services Board of Contract Appeals and Court of Appeals for the Federal Circuit in Martin Marietta Corp., ASBCA Nos. 38920 and 41565, 92-3 BCA 25,175, aff'd sub nom, Perry v. Martin Marietta Corp., 47 F.3d 1134 (Fed. Cir. 1994).

At the same time, the NPRM adds (i) an exception for the transfer of an existing function to a different cost pool when the costs of that function are "directly allocated" back to the original pool for reallocation to cost objectives and (ii) provides two new exemptions from cost and price adjustments when there is a change to a cost accounting practice under the broadened definition. See proposed FAR 9903.302-2(b) and (c) [61 Fed. Reg. 49210]. The first of these new exemptions applies when an organizational change is undertaken for "improved management efficiencies and effectiveness and which involve the physical realignment or reduction of facilities and personnel." See proposed FAR 9903.302-2(c)(1). The second exemption provides a "safe harbor" for changes to cost pools with similar proportional relationships, where indirect expense rates for all cost pools before and after the change fall within a plus or minus 1% rate corridor. See proposed FAR 9903.302-2(c)(2). But for the broadened definitions, there would be no need for the new exception and exemptions.

In making the changes to the definitions of "cost accounting practice" and "change to a cost accounting practice," the Board has not supplied a rationale for the new definitions, while simultaneously attempting to mitigate the perceived inequities inherent in the new definitions by creating an exception and exemptions to deal with certain situations. The Section believes it is important for the Board to clearly articulate the accounting rationale behind its belief that there is a need for the new definitions and the corresponding new exception and exemptions, at a minimum. If the Board cannot articulate an accounting rationale for the changes, they should be withdrawn.

A. The New Exception (For Changes Where Costs Are Allocated Back to Original Pools) and Exemption (For Cost Pool Changes With No Rate Impact) Have Limited Potential Use And Are Too Narrow

The new exception and exemptions are apparently intended to reduce the administrative burden for contractors and the Government. However, the Section questions the utility of the proposed exception (See proposed FAR 9903.302-2(b)(4)) and one exemption (See proposed FAR 9903.302-2(c)(2)). Because they are too narrowly defined, there appear to be very few applications for the new exception and one of the two exemptions in actual practice. To effectively reduce the number of cost impact proposals that will be required under this proposal, the newly proposed exception and exemptions need to be broadened.

1. The New Exception for Costs Allocated Back to the Same Pools

This exception appears in the proposed FAR 9903.302-2(b)(4) and is described as follows:
The transfer of an existing ongoing function from a segment's existing overhead or G&A indirect cost pool to a different pool is not a change in cost accounting practice provided:

(i) The ongoing costs are directly allocated back to the original pool for reallocation to final cost objectives, and

(ii) The segment continues to identify and accumulate the directly allocated cost of the function within the same pool in the same manner as was done before the change. (emphasis supplied)

The Illustrations (See proposed FAR 9903.302-4(h)(1) and (h)(2)) [61 Fed. Reg. at 49213] make it clear that the exception is intended to apply when a contractor consolidates functions and "directly allocates" costs from the new centralized activity back to the same cost pools of the segments. However, the proposal does not provide a conceptual framework for the proposed exception. As a result, the proposed exception provides a very limited basis for determining its intended application beyond those narrow circumstances specifically described in the Illustration.

For example, it is not clear whether the Board envisions the exception to apply when functions are simply transferred between pools. Although it might apply in this circumstance, frequent use would be not be likely. A contractor, having transferred a function within the organization, would generally want the accounting and cost allocations to reflect the new organizational relationships. Still, the language of the proposal would appear to permit an allocation back to the original cost pool, allowing the parties to avoid the cost impact proposal process. The Section believes it would be useful for the Board to provide specific rationale for the exception that can be used to address circumstances, such as that described, that are not illustrated in the proposed regulations. Otherwise, the Section believes disagreements on appropriate application are likely.

There are many situations where a function (e.g., accounting) consolidated at a segment or a home office can appropriately be allocated back to segments using an allocation base that reflects the activity of the segment. [See CAS 9904-418.50(e) which allows use of "surrogate" allocation bases]. Again, without establishing a conceptual framework or providing rationale, the NPRM limits the proposed exception to situations in which the costs are "directly allocated" back to the original pool. Unless a contractor were to organize the consolidated function in "segment silos" (allowing costs to be specifically identified to segments - an expensive accounting requirement in terms of operational efficiency) there will be commingling of the consolidated activities and costs before they are allocated back to segments.

Whether the costs are allocated back to segments based upon a measure of activity or are "directly" allocated based on usage, they can be allocated at the segment using the original cost pool. In either case, the circumstance of a new organization and consolidated activities will have changed both how costs are incurred and their flow to cost objectives. There is no apparent reason why the exception should be limited to costs that are "directly allocated." As long as the allocated costs are charged back to their original pool at the segments level, there will have been no change in the cost accounting practice used to allocate the costs to segment final cost objectives.

2. The New Exemption for Costs Allocated Back to the Same Pools

Where cost pools are merged or split out, the resulting change to a cost accounting practice under the proposed definitions is exempt from contract price and cost adjustment where the pools have similar proportional relationships. See proposed FAR 9903.302-2(c)(2). The proposed exemption applies when the merged or split-out pools "involve allocation of similar pooled overhead or G&A to similar final cost objectives." Id. The NPRM further provides; however:

Pools shall be considered similar if, after the change, the resultant pools are homogeneous (see 9904.418-50(b)) and
the rates (or rate) used to allocate pooled indirect costs to final cost objectives fall within a corridor of plus or minus one percent of the rate (or rates) that would have resulted if the combination or expansion had not occurred. (emphasis supplied)

Id.

The proposed exemption would provide a "safe harbor" from application of contract cost and price adjustment under the defined circumstance. The proposal should indicate if the rationale for the exemption is a view that a greater than 1% change would produce materially different allocation results, or some other rationale. Regardless, the corridor proposed is so narrow that the Section believes that the proposed exemption in actual practice will have little utility in diminishing the number of cost impact studies required under the broadened definition of change to a cost accounting practice. The Section believes that to be effective the corridor for the exemption should be expanded. In addition, if the percentage corridor is intended to serve as a measure of "materiality," this represents a significant break from the Board’s prior reluctance to place a specific numeric value on materiality as opposed to the non-numeric criteria that currently define "materiality" in the Board's regulations. (See FAR 9903-305).

B. The New Exemption For Changes that Produce Cost Savings

The NPRM proposes to exempt from the contract price and cost adjustment procedures (See proposed FAR 9903.302-2(c)(1)):

Changes in cost accumulation practices that result due to a transfer of functions or merger of cost pools which are undertaken for improved management efficiencies and effectiveness and which involve the physical realignment or reduction of facilities or personnel. (emphasis supplied).

The proposed exemption is intended to respond to concerns that contract price and cost adjustments are an impediment to contractor implementation of more efficient and economical operations. The Section believes that this exemption will produce the desired effect if it is implemented in a manner that broadly exempts restructuring and other contractor actions from contract price or cost adjustments under the expanded definition of "cost accounting practice" proposed in the NPRM.

As worded, however, the exemption would apply only to changes in "cost accumulation practices." See proposed FAR 9903.302-2(c)(1). To exempt only cost accumulation changes and require contract cost and price adjustments when, for example, a contractor changes a cost allocation base to implement restructuring appears to defeat the Board's expressed intent to remove impediments to restructuring. It is not uncommon for two segments being consolidated into a single, more efficient unit to have different cost allocation bases. Under this circumstance, there would be a change to cost accounting practice (allocation base) for contracts of at least one of the prior segments. To achieve the desired effect, the exemption should be expanded to include any change to a cost accounting practice produced by a restructuring or other cost efficiency initiative.

The proposed exemption would apply, without restriction, where the changes are undertaken for the purpose of achieving improved management efficiencies and effectiveness, and the changes involve the physical realignment or reduction of facilities or personnel. However, the Board's introductory comments suggest the exemption may not apply in all such cases. Specifically, the Board notes that application of the exemption will be on a case-by-case basis and refers to application in situations "where significantly lower levels of operating costs . . . , are reasonably expected. . ." (emphasis added). See 61 Fed. Reg. at 49201. The Section believes that the difference between the Board's comments and the language of the exemption itself should be reconciled or clarified. In addition, the word "significant," as used in the Board's Comments, is a term that does not have a defined meaning or criteria within the Cost Accounting Standards. By contrast, criteria for "materiality" are provided in the CAS regulations. To the extent it is relevant and to minimize potential disagreements over what constitutes "significant," the exemption should state that

expected savings must be material in amount.

Some streamlining actions taken by contractors involve changes to the contractor's organization, but not a change in the facilities. To make it very clear that the exemption applies to this type of circumstance the Board should provide an illustration of contractor actions not involving changes in plant or physical location of operations. For example, a reorganization may eliminate a layer of corporate management (a reduction in personnel) and produce a change in segments reporting to existing or newly established home offices. Even though there is no physical change in operations, the savings that could be expected would make the change exempt from the NPRM's contract price and cost adjustment practices.

C. The Relationship Between The Definition Of "Cost Accounting Practice" And The Definition Of "Desirable Changes"

Proposed FAR 9903.405-1 provides that a voluntary change in cost accounting practice, for which the cognizant Federal agency official has made a finding that the change is desirable, is subject to an equitable contract price adjustment. Stated differently, a voluntary change in accounting practice found to be a desirable change is not subject to the prohibition of the payment of increased costs by the United States. Proposed FAR 9903.405-2(e) directs the contractor to request that a voluntary change be deemed desirable and provide rationale demonstrating that the accounting change is desirable and not detrimental to the Government's interest.

The determination as to whether a change in accounting practice is desirable is to be made on a case-by-case basis in accordance with, but not limited to, the following criteria: (1) the cognizant Federal agency official determines that, for a Cost Accounting Standard with which the contractor has complied, the change is necessary for the contractor to remain in compliance, or (2) the change from one compliant practice to another compliant practice was recommended in writing by the cognizant Federal agency official and the Contractor agrees to make the change. See proposed FAR 9903.405-1, and 9903.201-6. The proposed regulations provide that the cognizant Federal agency official's finding should not be made solely because of the financial impact of the proposed change and that a change may be desirable and not detrimental even though costs of existing contracts increase, if there is a reasonable expectation benefits will accrue to the Government in future awards. See proposed FAR 9903.201-6(b)(3).

The stated criteria for determining whether a change in accounting practice is desirable are too narrow in that the examples do not reflect previous guidance from the Cost Accounting Standards Board that alternative words for "desirable" include "appropriate, warranted, equitable, fair or reasonable."

As noted in the Section's July, 10, 1995 comments on the ANPRM, the proposed expanded definition of "cost accounting practice" will primarily affect contractor initiated changes – "voluntary" changes. The Board itself recognized in the ANPRM that contracting officers seldom find a voluntary change "desirable" and thereby avoid the need to recognize increased costs on current contracts. In the ANPRM the CAS Board broadened the definition of "desirable" and directed a finding of desirability based on certain criteria provided. (See ANPRM at 54, "the Federal agency official should determine").

Because of the proposed exemption for restructuring type actions, the Board narrowed the definition of a "desirable" change to a cost accounting practice, by eliminating changes related to restructuring. Moreover, the previously proposed direction to find desirability under defined circumstances has been eliminated. The current proposal provides only that a contracting officer may determine a change to be desirable, even when there is a reasonable expectation that benefits will accrue to the Government in future contract awards. (See proposed FAR 9903.201-6(b)(3)). The currently proposed changes are a step backward from the ANPRM. The Section believes greater use of equitable adjustment procedures is warranted and in many cases will provide the contracting parties the flexibility needed to negotiate appropriate settlements for a change to cost accounting practices with minimum administrative cost and effort.

For example, consider the circumstance of a contractor segment that only performs flexibly priced CAS-covered contracts. A change to a cost accounting practice may produce increased costs allocated to existing flexibly priced contracts and a corresponding decrease in costs allocated to CAS-covered contracts forecast to be awarded later in the year, or in subsequent years, as follows:
### III. The Contract Adjustment And Cost Impact Process

#### A. General -- The Relevant Statutory Guidance

The statute which established the Cost Accounting Standards Board provides for a contract price or cost adjustment "for any increased costs paid" by the United States due to a contractor’s failure to comply with Cost Accounting Standards or to follow consistently disclosed accounting practices. 50 App. U.S.C. § 2168(h)(1) (1982). The regulations implementing this statute recognize that increased costs under one or more contracts due to a change in cost accounting practice or the failure to follow consistently an accounting practice should be offset by cost decreases under other affected contracts. 4 C.F.R. § 331.70(f). This concept of offsets was reaffirmed in the 1988 statute which re-established the CAS Board and states that contract price adjustments are to be made on relevant contracts "subject to the cost accounting standards so as to protect the United States from payment, in the aggregate, of increased costs." 41 U.S.C. § 422(h)(3) (1988).

The goal of the cost impact process, as stated in the statute, is to ensure that the United States does not pay increased costs -- in the aggregate -- due to a noncompliance or failure to follow consistently a disclosed cost accounting practice. The NPRM is unduly complicated and inconsistent with this objective. The NPRM permits offsets within the same contract type, but appears to prohibit or limit offsets between different contract types. For example, if the net effect of a noncompliance is to shift costs of $100,000 from a firm-fixed-price contract (an "increase" in costs as defined in the regulations) to a cost-type contract, the proposed regulations may preclude an offset between these two contract types. If this interpretation is adopted, the Government would be provided with a windfall because the Government would refuse to pay the increased costs of $100,000 on the cost-type contract and receive a $100,000 downward price adjustment for the "increased" costs on the firm-fixed-price contract. Such a result is contrary to the statutory direction that contract price adjustments protect the Government from paying aggregate increased...
The NPRM does provide for a netting process that can be interpreted as allowing the netting of a higher allocation of contract costs by contract type against a lower allocation of costs to other contract types. However, even if this interpretation is correct, this netting process between types of contracts appears to be limited to voluntary accounting changes not deemed to be desirable. This would establish different treatment for noncompliance adjustments vs. adjustments for voluntary changes in accounting practices and, in effect, create an apparent penalty for noncompliances. This result is contrary to law, because the statutory language concerning the Government's payment of increased costs includes both noncompliances and failures to follow consistently a disclosed accounting practice, and makes no distinction between the two. In addition, the proposed regulations include definitions for increased costs on flexibly priced contracts and firm-fixed price contracts without corresponding definitions of decreased costs. This failure to consider decreased costs on an equal footing with increased costs ignores the fact that the goal of the statute is not to provide the Government a benefit, but to ensure only that the Government does not suffer a detriment.

B. Implementation Of A New Accounting Practice

Proposed FAR 9903.405-2(b) requires a contractor to notify the Government at least sixty days prior to first implementing a required, voluntary, or desirable change. Proposed FAR 9903.405-2(f) precludes a contractor from implementing such a new cost accounting practice until the earlier of (i) the Government's determination of adequacy and compliance or (ii) sixty days following the notification date. However, proposed FAR 9903.405-3 has the very real potential to make the "notification date" a moving target, delaying implementation to the detriment of the contractor.

In this regard, proposed FAR 9903.405-3 provides that, upon receipt of the contractor's notification, the Government shall review the planned change for adequacy and compliance. If the Government determines that there is an "inadequacy," the Government will notify the contractor. In such a circumstance, the NPRM states that "[t]he notification date will then be revised to the date of receipt of a revised description of a planned change that is subsequently deemed adequate and compliant." (Emphasis added.)

The potential impact of this provision on a contractor is shown in the following illustration which the Section submits is a more likely real world scenario than those set forth in the NPRM:

Illustration: On March 1, the contractor notifies the contracting officer of a planned change that it intends to implement on May 15. The contractor also has a proposal for a very large and critical procurement due on May 15, in which it intends to use the new practice for estimating. Due to other pressing requirements, the auditor does not commence the review until April 1 and the audit is not completed until April 15. On April 28, the contracting officer notifies the contractor that its notification is inadequate. On May 5, the contractor submits a revised notification. Under proposed FAR 9903.405-3, May 5 now becomes the new "notification date," triggering a new sixty-day period during which the contractor is precluded from using the new practice under proposed FAR 9903.405-2(f). Because it cannot use the new practice on the May 15 proposal, the contractor estimates its proposal based on its existing practices. However, the contractor is aware that, under the holding in McDonnell Douglas Corp., ASBCA No. 44637, 95-2 BCA 27,858, it may be liable for defective pricing if it fails to disclose the pending voluntary change, so the contractor does so. The Government negotiates the price of the contract based on the assumption that the contractor will perform the contract using the new practice. Shortly after the contract is awarded, the May 5 cost accounting change notification is determined to be adequate and compliant. Thereafter, the Government seeks to reduce the price of the newly awarded contract in accordance with proposed FAR 9903.405-5(d)(7).

In the illustration, the Government actually reduces the price twice due to the change -- once during the negotiation and a second time during the cost impact process. This inequitable result is consistent with proposed FAR 9903.405-5(d)(7), which refers to adjustments to contract prices negotiated between the notification date of a voluntary change and the effective date on which "the estimated contract costs were based on the previous cost accounting practice" and is not addressed by the Illustrations in the NPRM. If, under the proposed rules, a contractor is precluded from basing its estimate on a new practice until that practice has been determined adequate and compliant, the Government should be precluded from taking
the benefit of that proposed practice by negotiating a contract price based on that unapproved practice.

The Section also believes the rule is both cumbersome and overly restrictive. The contractor should be allowed to prepare cost proposals and negotiate contracts based on the new accounting practice during the period between the notification date and the effective date. A contractor is not prohibited from adopting an accounting change even if the change is not accepted by the cognizant Federal agency official. The contractor's obligation is limited to accepting an adjustment in contract price or cost to prevent the United States from paying increased costs. Accordingly, the logical sequence of events is for the contractor to use the proposed change in accounting practice to price proposals and negotiate contracts and then accept a reduction in contract price for a change not deemed desirable to the extent necessary to prevent the United States from paying increased costs.

C. "Will Result" In Increased Costs

Amendments to the Cost Accounting Standards clauses (full coverage and modified coverage) have been proposed to provide that the contractor will agree to an adjustment of the contract price or cost if the contractor or a subcontractor fails to comply with an applicable cost accounting standard or to follow a cost accounting practice consistently and such failure results or will result in any increased costs paid by the United States. The addition of the phrase "will result" has not been explained and it is unclear whether this change refers to prospective increased costs that can be verified and quantified at the date of noncompliance or failure to follow consistently a disclosed cost accounting practice, or if this requires a speculative analysis as to the potential for increased costs. Similarly, it is unclear whether the prospective look at increased costs is limited to contracts that have been awarded by the date of the alleged failure or if this new language requires a projection based on anticipated contract awards. The Section believes that the potential for confusion is so high that this revision to the clause should not be retained.

D. Limitation On The Method Of Computing The Cost Impact

The NPRM appears to require the use of estimates-to-complete ("ETCs") rather than original cost estimates to compute the cost impact on firm-fixed price contracts resulting from a compliant change in cost accounting practice. In response to comments on the ANPRM, the Board reaffirmed its support for the ETC approach, stating that (1) unlike the original estimate method, the new practice is applicable only to the contract effort for which the new practice will be used for cost accumulation purposes; (2) distortions between planned and actual performance lead to distorted cost impact computations if original estimates are used; and (3) the ETC approach is consistent with change order pricing techniques. See 61 Fed. Reg. at 49204.

The Board should reconsider its view on all of these points. First, the Board mistakenly believes original cost estimates cannot be applied to contract effort performed under the new practice. This can be accomplished by simply using that portion of the original cost estimate relevant to the period encompassed by the effort under the new practice. Second, distortions between planned and actual performance support the use of the original estimate method. Differences in projected vs. actual business base, exclusion of certain costs from a proposal, and unplanned loss contracts are just a few examples of typical "distortions" which make original estimates the appropriate basis for measuring increased costs on firm fixed price contracts. These distortions should be removed from the cost impact calculation because at the time of the original bid they were not considered in determining the price to be paid by the Government. Finally, the Board's reference to change order pricing as support for its position is inappropriate. Change order pricing represents a new negotiation. The cost impact calculation process on a firm fixed-price contract is intended to determine how much the Government would have paid in the original negotiation if it had known about the change.

Despite the theoretical appropriateness of the original estimate method, contracting officers, DCAA, and contractors have used the ETC method for reasons of administrative convenience and otherwise. Accordingly, the Section believes the Board should allow for use of both the ETC approach and the original estimate approach based on the facts and circumstances of each case.

IV. Increased Administrative Burden
At a time when the Congress, the President, and the OFPP Administrator are promoting the increased use of commercial contracting practices, decreased Government regulation and micro-management, and increased reliance on the judgment of Government contracting officials, the CASB's NPRM appears to be marching in a different direction. The proposed regulation is fundamentally inconsistent with the concept of commercial practices, could serve as a paradigm of over-regulation and micro-management, and virtually eliminates the discretion of contracting officers, e.g., with respect to determining the "materiality" of a change.

A. The NPRM Will Increase The Number Of Change Actions And Contractor Recordkeeping Requirements

As described above, the new regulations will significantly increase the number of contractor actions which will qualify as cost accounting practice changes, and thereby increase the administrative burden placed on contractors with CAS-covered contracts by increasing the frequency with which contractors will be required to comply with the notice and contract price adjustment provisions of the NPRM. Further, this increased burden will not be borne by industry alone since every such contractor action will require Government auditors and contract officials to perform the detailed review procedures set forth in the NPRM.

Proposed FAR 9903.401-1(b) also imposes upon a contractor receiving a CAS-covered contract a requirement to maintain a system for identifying CAS-covered contracts and subcontracts by period of performance. As the Section's July 10, 1996 comments on the ANPRM observed, in many cases it is difficult for a contractor to ascertain whether a prime contract is CAS-covered. Further, because CAS coverage at a subcontract level derives from coverage of the related prime contract or a higher-tier subcontract, it generally is even more difficult to determine whether a subcontract is CAS-covered.

In view of this recordkeeping requirement, as well as the increased number of contractor actions that now will be treated as cost accounting practice changes with the related notice and cost impact submissions, the Section questions the CASB's determination regarding the Paperwork Reduction Act. The Section questions the Board's conclusion that this complex rule will "impose no paperwork burden" on contractors or will "decrease the current burdens." To the contrary, this proposed rule on its face imposes new paperwork requirements and, in practice, will increase the current burdens.

B. The Determination To Require A Detailed Cost Impact Proposal Should Be Made In A Formal Written Document

The NPRM attempts to promote the use of a less detailed "General Dollar Magnitude" ("GDM") and related "Cost Impact Settlement Proposal" in lieu of the current "Detailed Cost Impact Proposal" to resolve the cost impact of a change. However, proposed FAR 9903.405-4(b)(4) places little, if any, restriction on the Government's right to demand a detailed cost impact proposal and further provides that the decision to request a detailed cost impact proposal "is final and binding, and not subject to the Disputes clause of the contract."

As a matter of historical record, officials negotiating contract price adjustments are rarely satisfied with less data when a mechanism is available to secure additional data. For example, the Director of Defense Procurement has had to direct contracting officers twice within the past few years to cease the practice of demanding cost or pricing data on competitive procurements. The Section doubts that Government officials will be any more inclined to settle cost impacts without submission of detailed cost impact proposals. As a consequence, contractors will be forced in the future to make two submissions rather than the current single submission, and the Government will have to make additional reviews as well.

The Section recommends that, at a minimum, the proposed rule should be revised to require the official to document, in writing, the reasons that the cost impact cannot be negotiated without submission of a detailed cost impact proposal. Further, the rule should require that the determination be approved by an official at least one level higher in the agency. Finally, the Section questions the authority of the CASB to exempt by regulation an issue which, as a matter of law, may properly be subject to the Disputes provision of a contract.
C. The Proposed Rule Does Not Adequately Address The Actions To Be Taken If A Contractor Disputes A Noncompliance Allegation

Proposed FAR 9903.406-2(f) states correctly that a contractor's disagreement with a determination of noncompliance is a dispute under the Disputes clause of the affected contract or contracts. However, the NPRM then appears to require that, notwithstanding this dispute, upon receipt of such a final determination, the contractor must change its accounting practice and submit a cost impact proposal.

As written, the NPRM therefore assumes that the Government's position will be sustained in every disputed noncompliance. That is not correct, and, if it were, there would be no reason to incorporate the Disputes clause into contracts. Under the CASB's proposal, a contractor that successfully challenges a noncompliance will have to change its practice twice -- once when it receives the determination of noncompliance and again when it receives the decision vindicating its old practice. Further, if the contractor disputes a noncompliance, there is no reason to require the contractor to submit a cost impact proposal until after the existence of a noncompliance has been finally adjudicated. In fact, the boards of contract appeals routinely hear only the entitlement portion of an appeal and then remand to the parties to negotiate quantum. Consistent with the CASB's avowed interest in diminishing unnecessary paperwork, the proposed regulation should be changed to require a contractor to change its practice and submit a cost impact proposal only after final adjudication of a disputed noncompliance.

V. Conclusion

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may required.

Sincerely,

John T. Kuelbs
Chair, Section of Public Contract Law

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