November 19, 1999

Mr. Rudolph J. Schuhbauer
Project Director
Cost Accounting Standards Board
Office of Federal Procurement Policy
725 17th Street, N.W., Room 9013
Washington, D.C. 20503

Attn: CASB Docket No. 93-01N(3), Cost Accounting Practice Changes

Dear Mr. Schuhbauer:

The Section of Public Contract Law ("Section") of the American Bar Association ("Association") appreciates the opportunity to submit the following comments on the Second Supplemental Notice of Proposed Rulemaking on Changes in Cost Accounting Practices ("SNPRM II"), 64 Fed. Reg. 45700 (August 20, 1999). The Section consists of attorneys and associated professionals in private practice, industry and Government service. The Section’s governing Council and substantive committees contain 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 American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.

I. Introduction

The Section appreciates the decision of the Cost Accounting Standards Board ("Board" or "CAS Board") to issue a second supplemental notice of proposed rulemaking to elicit further public comment regarding the proposed changes to the definitions of "cost accounting practice" and "change to a cost accounting practice," as well as the related subject of administration of cost accounting practice changes. We thank the Board for granting our request for an extension of time in which to submit comments, and applaud the Board’s decision to hold an open meeting on the subject on December 6, 1999. As evidenced by its lengthy history, the proposal is controversial and would have important consequences for contractors and the federal agencies administering CAS-covered contracts. The Board’s willingness to engage in further public discourse is very much appreciated and will, we hope, lead to an acceptable solution.

II. Basic Concerns with the Proposal

Despite previous comments from the Section and others requesting that the proposal be shortened and simplified, it has grown even longer, now taking up (with explanatory material) 42 pages of the Federal Register. Unfortunately, this new, lengthier version of the proposal fails to answer the basic concerns that the Section and other commentators have previously expressed. Therefore, the Section has decided to
submit an alternative proposal to address the issue that we believe to be at the heart of the proposal in a clear, succinct rule. This alternative proposal is Attachment A to these comments. Below, we reiterate our basic concerns, which the CAS Board still has not addressed, and discuss the rationale behind our alternative proposal.

A. The Expanded Definition of "Cost Accounting Practice" and "Change to a Cost Accounting Practice"

Each of the many CAS Board promulgations on the subject of cost accounting practice changes has included a greatly expanded definition of the terms "cost accounting practice" and "change to a cost accounting practice," the practical effect of which is to endorse the position taken by DCAA in 1988 and to overturn the decisions of the U.S. Court of Appeals for the Federal Circuit and the Armed Services Board of Contract Appeals on the subject. 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). Despite protestations to the contrary in SNPRM II, it is evident from the body of the proposed rule that the expanded definitions encompass organizational changes without any accompanying change to a contractor's accounting practices.

The Section recommends that the Board refrain from making any change to either the definitions of "cost accounting practice" and "change to a cost accounting practice" or to the current illustrations. SNPRM II represents an approach that is fundamentally flawed and cannot — as its numerous promulgations attest — be fixed. That the expanded definitions of "cost accounting practice" and "change to a cost accounting practice" do not constitute a clarification is evident from the sheer length of the proposed rule. Instead, the expanded definitions occasion a rule that is complex and overly detailed. Much of the excessive length and complexity results from the over-inclusiveness of the expanded definitions, which in turn necessitates new exemptions and other adjustments that are not necessary under the rule as it currently exists.

The CAS Board still has not provided a clear accounting-based rationale for its proposed new definitions, which leads us to the conclusion that one does not exist. Worse, the proposed changes conflict with existing CAS rules and concepts. The Board focuses on "flow of costs" and "accumulation of cost" — i.e., on the effect or result of events, not on accounting methods or techniques. The original CAS Board clearly stated that Cost Accounting Standards provide for the measurement of costs, the assignment of costs to cost accounting periods, and the allocation of costs to cost objectives. Restatement of Objectives, Policies and Concepts (May 1977), Cost Accounting Standards Guide (CCH) ¶ 2915. The original Board defined "allocate" to mean assignment of an item of cost to one or more cost objectives, whether direct assignment or reassignment of a share from an indirect cost pool. See, e.g., CAS 402, 403, 406, 410, 411, 418, and 420. "Accumulate," on the other hand, is defined as "the collecting of cost data in an organized manner, such as through a system of accounts." CAS 401-30(a)(1).

In Preamble J to the original promulgation defining change to a cost accounting practice, 4 C.F.R. § 331.50 (March 10, 1978), the original Board observed that business changes by themselves are not changes in cost accounting practices. The Board acknowledged that in a dynamic business environment, it may be desirable to make changes of many types, such as organizational changes and changes in the way work is performed. The Board deliberately chose to focus on whether the accounting method or technique, as opposed to the underlying facts and circumstances, had changed:

The decision as to whether there is a change in cost accounting practice is made through an analysis of the circumstances of each individual situation based on the criteria being promulgated in these regulations.

Preamble J, Cost Accounting Standards Guide (CCH) ¶ 3601. The original Board was faithful to its statutory mission and authority. It addressed only increased costs flowing from accounting practice changes, even where such accounting practice changes occur in conjunction with structural or business changes. The original Board clearly excluded impacts on the flow of costs that result solely from structural (organizational) or business changes unaccompanied by accounting practice changes. A contractor's organizational structure (e.g., choosing to operate a specific number of segments) is not an accounting practice. The original Board recognized that it had no mission or authority to demand indemnity against increased costs flowing from business changes.
In contrast, SNPRM II would define nearly any circumstance causing an alteration in the flow of costs as a cost accounting practice change. The Section submits that the original CAS Board’s approach was sound and that SNPRM II not only conflicts with established CAS rules and concepts but exceeds the CAS Board’s lawful authority.

The Section understands that the driver behind this proposal is a perceived need to protect the Government from increased costs, in the aggregate, that may result from pool combinations, pool split-outs, and/or transfers of a function from one pool to another that take place as a result of either external (e.g., mergers and acquisitions) or internal restructuring. If this is indeed the case, there is a simpler way to address the problem than through attempting to fit the square peg of organizational changes into the round hole of cost accounting practice changes. Our alternative proposal demonstrates one such approach.

A. New Subpart 9903.4, Contractor Cost Accounting Changes and Noncompliances

In the Section’s view, this part of SNPRM II is an unwarranted incursion by the Board into matters of contract administration that are properly within the scope of FAR Part 30, under the jurisdiction of the FAR Council. This part of the proposal takes up over 18 pages in the Federal Register and covers in great detail such subjects as contractor notifications to the Government of changes in cost accounting practices and the type and extent of information to be submitted, determinations of adequacy and compliance by the agency, requirements for contractor cost impact submissions, negotiation and resolution of cost impact, cost and price adjustments, and separate procedures to be followed in the event of a "cost estimating noncompliance" vs. a "cost accumulation noncompliance." There are even five pages of "illustrations" of procedures.

The current CAS Board was created by section 26 of the Office of Federal Procurement Policy Act Amendments of 1988, Pub. L. 100-679. Its authority was expressly limited by Congress to cost accounting matters, and the Board recognized this limitation in its May 1992 Statement of Objectives, Policies and Concepts:

While the Board has exclusive authority for establishing Standards governing the measurement, assignment and allocation of costs, it does not determine the allowability of categories of individual items of cost. Allowability is a procurement concept affecting contract price and in most cases is established in regulatory or contractual provisions. An agency’s policies on allowability of costs may be derived from law and are generally embodied in its procurement regulations. A contracting agency may include in contract terms, or in its procurement regulations, a provision that it will refuse to allow certain costs incurred by contractors that are unreasonable in amount or contrary to public policy. In accounting terms, these same costs may be allocable to the contract in question.


The Board has expressed the opinion that Subpart 9903.4 is necessary because the CAS cost impact process is "generally not being accomplished in a timely or efficient manner." 62 Fed. Reg. 37654, 37664 (July 14, 1997). Regardless of the truth of this observation, the Board’s proposal is an unwarranted intrusion into contract administration. If there are deficits in the process, FAR Part 30 is the place to fix them. The Board does not have jurisdiction to do so.

In short, the Section strongly recommends that new Subpart 9903.4 be deleted because it treats matters of contract administration that are beyond the CAS Board’s statutory authority.

III. Additional Comments

A. Desirable Changes

One of the issues with which the Board has struggled since the first notice of proposed rulemaking is desirable changes. SNPRM II does not resolve the problems with the existing desirable changes provision.
The proposal attempts to repose in the contracting officer unreviewable discretion to decline to determine that a change is desirable. We doubt that the Board can (or should attempt to) remove the issue of the desirability of a change in cost accounting practice from the reach of the Disputes Clause. The proposal also fails to specify a time in which the cognizant Federal agency official must determine whether or not the change is desirable, saying only that notification of the official’s determination "should be made promptly after the change is determined to be adequate and compliant." Finally, the proposal still fails to include accounting practice changes mandated by law or regulation. The Board has previously observed that generally accepted accounting principles ("GAAP") and the Internal Revenue Code are generally not mandatory for purposes of Government contracting. Nevertheless, many of these types of accounting practice changes are mandatory, either through the FAR cost principles or the CAS. For example, FAR 31.201-2 requires compliance with GAAP whenever particular cost accounting practices are not covered by CAS or a specific section of FAR Part 31. FAR 31.205-36 adopts the criteria established by the Financial Accounting Standards Board for determining when a capital lease has been entered into and should be capitalized under CAS 9904.404. Hence, if the FASB changes the criteria for capitalization, the contractor would be required to use the changed criteria for purposes of FAR 31.205-36 and CAS 9904.404.

The Section recommends that 48 C.F.R. 9903.201-7 be revised to read as follows:

I. COST ACCOUNTING STANDARDS

9903.201-7 Desirable changes.

(a) Prior to making any equitable adjustment under the provisions of paragraph (a)(4)(iii) of the contract clauses set forth in 9903.201-4(a), 9903.201-4(c) or 9903.201-4(e), a determination as to whether or not a voluntary change in cost accounting practice is desirable shall be made on a case-by-case basis in accordance with, but not limited to, one or more of the criteria specified in paragraph (b) of this subsection.

(b) A voluntary change in cost accounting practice shall be deemed to be desirable and not detrimental to the interests of the Government if:

(1) For a Cost Accounting Standard with which the contractor has complied, the change is necessary in order for the contractor to remain in compliance with that Standard.

(2) The contractor changes from one compliant practice to another compliant practice as a result of a written recommendation by the cognizant Federal agency official.

(3) The contractor is required by FAR, CAS, or the terms of a contract to change the accounting practices it uses for Government contract costing purposes because of a change in generally accepted accounting principles (GAAP) or the Internal Revenue Code.

(c) A finding under this subsection shall not be made based solely on the cost impact a proposed cost accounting practice change will have on a contractor’s or subcontractor’s existing CAS-covered contracts. A voluntary change in cost accounting practice may be determined to be desirable and not detrimental to the Government’s interest even though existing contract prices and/or cost allowances may increase.

B. Burden on Contracting Personnel and Smaller Contractors

The Section believes that the complexity and ambiguity of the proposed new rules, especially 9903.404 through 9903.406, place an unworkable decision-making burden on the cognizant Federal agency official ("CFAO") and other Government personnel. The proposed cost impact process requires CFAOs (and other
Government representatives involved in the process) to make a number of decisions regarding complicated accounting issues. The Section has counted more than 15 separate possible CFAO determinations within the proposed 9903.4 cost impact process.

The difficulties in decision-making will lead to delays in the contract administration process that will have a disproportionate impact on smaller contractors. Under the proposed rules, a determination of whether a "change" has occurred and its impact on current contracts could take several months or years because there is no time limit placed upon when the determination would have to be made. Given the complexity of the proposed rules, there could be many snags that could delay the final determination. In the meantime, Contracting Officers will likely rely on DCAA's recommendations and take a conservative approach by withholding funds pending the final determination. This withholding could be devastating for smaller contractors.

The additional administrative burdens on the contracting process run counter to the Administration's policy in favor of acquisition streamlining. The clearly foreseeable negative economic impact on smaller contractors could cause many to forego federal contracting opportunities altogether.

C. Proposed Limitation of Offsets.

In SNPRM II, the Board has continued to include the provision that: "The offset process shall only be applied to contracts that are of the same contract type..." The Section's comments provided on SNPRM I, and submitted to the Board on September 12, 1997, remain unchanged. We believe that the Board's language is too limiting, and conflicts with the Board's authorizing statute, 41 U.S.C. § 422(h)(3). Based on the statute, 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." (Emphasis added.) The purpose of the law is to ensure that net increased costs, in the aggregate, are not paid. The Government is not to receive a windfall for contract cost or price adjustments. However, the Board's proposed illustration could result in such a windfall as we have illustrated in our previous response to the Board.

We also believe that the Board's proposed limitation on offsets to contract type is inconsistent with its prior interpretations on this subject. At 48 C.F.R. 9903.306, the Board has interpreted the meaning of "increased costs" and the use of offsets. It is clear from the interpretation that the process for applying offsets is intended to be flexible, as long as the Government does not pay material increased costs in the aggregate. Specifically, the Board states:

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\text{Whether cost impact is recognized by modifying a single contract, several but not all contracts, or all contracts, or any other suitable technique, is a contract administration matter. The Cost Accounting Standards rules do not in any way restrict the capacity of the parties to select the method by which the cost impact attributable to a change in cost accounting practice is recognized.}
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Furthermore, the Department of Defense ("DoD") has previously provided guidance on the use of offset principles (DoD CAS Working Group Item 76-8, December 17, 1976), and has acknowledged flexibility in the process, as well as the responsibility of the contracting officer. The guidance states: "No specific method for applying the offset concept has been established. It remains the responsibility of the Administrative Contracting Officer to address each specific situation in a way that best accomplishes the overall objective."

The Section has recommended above that the entire Subpart 9903.4 be deleted as in excess of the Board’s authority. At the very least, however, the Board’s limitation on offsets must be retracted because it is contrary to the statute and an impermissible limitation on the discretion of contracting officers.

IV. The Section’s Proposed Alternative

The Section proposes a new FAR 31.201-8, Change in Organizational Structure, to address aggregate increased costs as a result of pool combinations, pool split-outs, or function transfers. Because shifts of costs from one contract to another as a result solely of organizational changes have nothing to do with cost
accounting and are therefore outside the statutory authority of the CAS Board, only the FAR Council has the legal authority to make rules in this area. Therefore, we have framed the provision as part of FAR Part 31, Contract Cost Principles and Procedures.

This alternative proposal addresses organizational changes directly, and ensures that the United States will not pay increased costs, in the aggregate, as a result of pool combinations, pool split-outs, or transfers of a function from one pool to another. Coverage is limited to contractors subject to full CAS coverage in order to avoid imposing a burden on smaller contractors. Decreased cost allocations to firm fixed-price contracts would not be considered to be "increased costs" under this proposal. Aggregate increased costs are to be determined by taking into account anticipated future cost decreases and increases (thus, if projected decreases outweigh increases, there will be no aggregate increased cost).

The Section submits that this alternative demonstrates that there is a simple, clear way to address the issue of cost shifts due to organizational changes. This new FAR provision would work as a complement to existing CAS provisions, and Administrative Contracting Officers would be able to administer them together. We recommend that the CAS Board defer to the FAR Council in this area. We further recommend that the Board acknowledge that the issue of increased costs due to organizational changes is an allowability issue over which the Board does not have authority, so as not to invite future legal challenge to any FAR Part 31 promulgation on the subject.

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

Sincerely,

Rand L. Allen
Chair

Enclosures: (1) Attachment A

(2) 3.5" disk in Corel WordPerfect 8 format

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Attachment A

ABA Section of Public Contract Law

Alternative Proposal on Organizational Changes

FAR 31.201-8 Change in organizational structure.

(a) This provision applies only to contractors who, in their preceding cost accounting period, met the
criteria for full CAS coverage.

(b) The aggregate increased costs paid by the United States on contracts and subcontracts subject to the Cost Accounting Standards as a result of a contractor change in organizational structure shall be credited to the Government either as a cost or price reduction, by cash refund, or as otherwise agreed by the parties.

(c) "Change in organizational structure" for purposes of this section shall include:

   (1) **Pool Combinations.** The merging of existing indirect cost pools.

   (2) **Pool Split-outs.** The expansion or breakdown of an existing indirect cost pool into two or more pools.

   (3) **Functional Transfers.** The transfer of an existing ongoing function in its entirety from an existing pool to another cost pool.

(d) "Aggregate increased costs paid" for purposes of this section is the sum of the increased and decreased cost allocations to existing and anticipated future CAS-covered flexibly priced contracts and subcontracts. The determination of "aggregate increased costs paid" shall take into account anticipated increases and decreases in cost allocation over the life of existing contracts and anticipated future contract awards.