

FEDERAL ACQUISITION REGULATION

APPENDIX

The official codified Cost Accounting Standards appear at 48 CFR Chapter 99.
This Chapter may be accessed via the website at www.access.gpo.gov/nara/cfr.

APPENDIX—COST ACCOUNTING STANDARDS PREAMBLES AND REGULATIONS*

Cost Accounting Standards and Cost Accounting Standards Board Rules and Regulations Recodified by the Cost Accounting Standards Board at 48 CFR Chapter 99

Preambles to the Cost Accounting Standards, Related Rules and Regulations, and the FAR System

Part I—Preambles to the Cost Accounting Standards Published by the Cost Accounting Standards Board

Part II—Preambles to the Related Rules and Regulations Published by the Cost Accounting Standards Board

Part III—Preambles Published under the FAR system

* This Appendix is provided for the convenience of users of the looseleaf FAR. The official codified Cost Accounting Standards appear at 48 CFR Chapter 99.

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**Cost Accounting Standards and Cost Accounting
Standards Board Rules and Regulations
Recodified by the Cost Accounting Standards
Board at 48 CFR Chapter 99**

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PART 9900—SCOPE OF CHAPTER

AUTHORITY: Pub. L. 100-679, 102 Stat. 4056, 41 U.S.C. 422.

9900.000 Scope of chapter.

This chapter describes policies and procedures for applying the Cost Accounting Standards (CAS) to negotiated contracts and sub-contracts. This chapter does not apply to sealed bid contracts or to any contract with a small business concern (see 9903.201-1(b) for these and other exemptions).

SUBCHAPTER A—ADMINISTRATION

PART 9901—RULES AND PROCEDURES

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AUTHORITY: Pub. L. 100-679, 102 Stat. 4056, 41 U.S.C. 422.

SOURCE: 56 FR 19304, Apr. 26, 1991, unless otherwise noted.

9901.301 Purpose.

This part is published in compliance with Public Law 100-679, section 5(f) (3), 41 U.S.C. 422(f) (3), and constitutes the rules and procedures governing actions and the administration of the Cost Accounting Standards Board.

9901.302 Authority.

(a) The Cost Accounting Standards Board (hereinafter referred to as the "Board") is established by and operates in compliance with Public Law 100-679.

(b) The Board has the exclusive authority to make, promulgate, amend, and rescind cost accounting standards and regulations, including interpretations thereof, designed to achieve uniformity and consistency in the cost accounting practices governing measurement, assignment, and allocation of costs to contracts with the United States Government.

(c) All cost accounting standards, waivers, exemptions, interpretations, modifications, rules, and regulations promulgated under section 719 of the Defense Production Act of 1950 (50 U.S.C. App. 2168) shall remain in effect unless and until amended, superseded, or rescinded by the Board pursuant to Public Law 100-679.

9901.303 Offices.

The Cost Accounting Standards Board's offices are located in the New Executive Office Building, 725 17th Street, NW.,

Washington, DC 20503. The hours of business for the Board are 9 a.m. to 5:30 p.m., local time, Monday through Friday, excluding holidays observed by the Federal Government in Washington, DC.

9901.304 Membership.

The Board consists of five members, including the Administrator of the Office of Federal Procurement Policy (hereinafter referred to as the "Administrator") who shall serve as Chairman, and four other members with experience in Government contract cost accounting who are to be appointed as follows:

(a) A representative of the Department of Defense appointed by the Secretary of Defense.

(b) An officer or employee of the General Services Administration appointed by the Administrator of the General Services Administration his/her designee.

(c) A representative of industry appointed from the private sector by the Administrator.

(d) An individual who is particularly knowledgeable about cost accounting problems and systems appointed from the private sector by the Administrator.

(e) The term of office of each of the members of the Board, other than the Administrator, shall be four years, with the exception of the initial appointment of members. Of the initial appointments to the Board, two members shall hold appointment for a term of two years, one shall hold appointment for a term of three years, and one shall hold appointment for a term of four years.

(f) The members from the Department of Defense and the General Services Administration shall not be permitted to continue to serve on the Board after ceasing to be an officer or employee of their respective appointing agency. A vacancy on the Board shall be filled in the same manner in which the original appointment was made. A member may be reappointed for a subsequent term(s). Any member appointed to fill an interim vacancy on the Board shall serve for the remainder of the term for which his or her predecessor was appointed.

(g) In the event of the absence or incapacity of the Administrator or during a vacancy in the office, the official of the Office of Federal Procurement Policy, acting as Administrator, shall serve as the Chairmen of the Board.

(h) In the event of the absence of any of the other Board members, a representative of that Board member may attend the Board meeting, but shall have no vote, and his or her attendance shall not be counted to establish a quorum.

9901.305 Requirements for standards and interpretive rulings.

Prior to the promulgation of cost accounting standards and interpretations thereof, the Board shall:

(a) Take into account, after consultation and discussion with the Comptroller General, professional accounting organizations, contractors, governments agencies and other interested parties:

(1) The probable costs of implementations, including inflationary effects, if any, compared to the probable benefits;

(2) The advantage, disadvantage, and improvements anticipated in the pricing and administration of, and settlement of disputes concerning, contracts; and

(3) The scope of, and alternatives available to, the action proposed to be taken.

(b) Prepare and publish a report in the **FEDERAL REGISTER** on issues reviewed under paragraph (a) of this section.

(c) Publish an advance notice of proposed rulemaking in the **FEDERAL REGISTER** in order to solicit comments on the report prepared pursuant to paragraph (b) of this section, and days after such publication to submit their views and comments. During this 60-day period, consult with the Comptroller General and consider any recommendation the Comptroller General may make.

(d) Publish a notice of such proposed rulemaking in the **FEDERAL REGISTER** and provide all parties affected a period of not less than 60 days after consult publication to submit their views and comments.

(e) Rules regulations, cost accounting standards, and modification thereof promulgated or amended by the Board, shall have the full force and effect of law and shall become effective within 120 days after publication in the **FEDERAL REGISTER** in final form, unless the Board determine a longer period is necessary. Implementation dates for contractors and subcontractors shall be determined by the Board, but in no event shall such dates be later than the beginning of the second fiscal year of affected contractors or subcontractors after the standard, becomes effective. Rules, regulations, cost accounting standards and modifications thereof promulgated or amended by the Board shall be accompanied by prefatory comments and by illustrations, if necessary.

(f) The above functions exercised by the Board are excluded from the operations of sections 551, 553 through 559, and 701 through 706 of title 5, United States Code.

9901.306 Standards applicability.

Cost Accounting Standards promulgated by the Board shall be mandatory for use by all executive agencies and by contractors and subcontractors in estimating, accumulating, and reporting costs in connection with pricing and administration of, and settlement of disputes concerning, all negotiated prime contract and subcontract procurements with the United States Government in excess of \$500,000, other than contracts or subcontracts that have been exempted by the Board's regulations.

9901.307 Exemptions and waivers.

The Board may exempt classes or categories of contractors and subcontractors from cost accounting standards requirements, and establish procedures for waiver of the requirements and the respect to individual contracts and subcontracts. The official records of the Board shall be documented with supporting justification for class category exemptions and individual waivers.

9901.308 Meetings.

The Board shall meet at the call of the Chairman. Agenda for Board meetings shall be proposed by the Chairman, but any Board member may request any item to be placed on the agenda.

9901.309 Quorum.

Three Board members, at least one of whom is appointed by the Administrator from the private sector, shall constitute a quorum of the Board.

9901.310 Board actions.

Board actions shall be by majority vote of the members present and voting, except that any vote to publish a proposed standard, rule

or regulation in the **FEDERAL REGISTER** for comment or any vote to promulgate, amend or rescind a standard, rule or regulation, or any interpretation thereof, shall require at least three affirmative votes for the five Board members. The Chairman may vote on all matters presented for a vote, not merely to resolve tie votes. The results of final votes shall be reported in the minutes of the meeting, and the vote of a Board member may be recorded at his/her request.

9901.311 Executive sessions.

During the course of a Board meeting, any Board Member may request that for any portion of the meeting, the Board meet in executive session. The Chairman shall thereupon order such a session.

9901.312 Minutes.

The Executive Secretary of the Board shall be responsible for keeping accurate minutes of Board meetings and maintaining Board files.

9901.313 Public hearings.

Public hearings to assist the Board in the development and explanation of cost accounting standards and interpretive rulings may be held to the extent the Board in its sole discretion deems desirable. Notice of such hearings shall be given by publication in the **FEDERAL REGISTER**.

9901.314 Informal actions.

The Chairman may take actions on behalf of the Board on administrative issues, as determined by the Chairman, without holding an official meeting of the members. However, details of the actions so taken shall be provided to all of the members at the next Board meeting following such actions. Board members may be polled by telephone on other issues that must be processed on a timely basis when such matters cannot be deferred until the next formal meetings of the Board.

9901.315 Executive secretary.

The Board's staff of professional, technical and supporting personnel is directed and supervised by the Executive Secretary.

9901.316 Files and records.

The files and records of the Board shall be maintained in accordance with the Federal Records Creation, Maintenance, and Disposition Manual of the Executive Office of The President, Office of Administration. As a minimum, the files and records shall include:

(a) A record of every Board meeting, including the minutes of Board proceedings and public hearings.

(b) Cost accounting standards promulgated, amended, or rescinded and interpretations thereof along with the supporting documentation and applicable research material.

(c) Applicable working papers, memoranda, research material, etc. related to issues under consideration by the Board and/or previously considered by the Board.

(d) Substantive regulations and statutes of general applicability and general policy and interpretations thereof.

(e) Any other file or record deemed important and relevant to the duties and responsibilities of the Board.

9901.317 Amendments.

This Part 9901, Rules and Procedures, may be amended by the Chairman, after consultation with the Board.

PART 9902—[RESERVED]**SUBCHAPTER B—PROCUREMENT PRACTICES AND COST ACCOUNTING STANDARDS****PART 9903—CONTRACT COVERAGE****Subpart 9903.1—General**

- 9903.101 Cost Accounting Standards.
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- 9903.201-3 Solicitation provisions.
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- 9903.202-5 Filing Disclosure Statements.
- 9903.202-6 Adequacy of Disclosure Statement.
- 9903.202-7 [Reserved]
- 9903.202-8 Subcontractor Disclosure Statements.
- 9903.202-9 Illustration of Disclosure Statement Form, CASB DS-1.
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- 9903.301 Definitions.
- 9903.302 Definitions, Explanations, and Illustrations of the Terms, "Cost Accounting Practice" and "Change to a Cost Accounting Practice."
- 9903.302-1 Cost accounting practice.
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- 9903.302-3 Illustrations of changes which Meet the Definition of "Change to a Cost Accounting Practice."
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- 9903.307 Cost Accounting Standards Preambles.

AUTHORITY: Pub. L. 100-679, 102 Stat. 4056, 41 U.S.C. 422.

Subpart 9903.1—General**9903.101 Cost Accounting Standards.**

Public Law 100-679 (41 U.S.C. 422) requires certain contractors and subcontractors to comply with Cost Accounting Standards (CAS) and to disclose in writing and follow consistently their cost accounting practices.

9903.102 OMB approval under the Paperwork Reduction Act.

The Paperwork Reduction Act of 1980 (Pub. L. 96-511) imposes a requirement on Federal agencies to obtain approval from the Office of Management and Budget (OMB) before collecting information from ten or more members of the public. The information collection and recordkeeping requirements contained in this regulation have been approved by OMB. OMB has assigned Control Numbers 0348-0051 and 0348-0055 to the paperwork, recordkeeping and forms associated with this regulation.

Subpart 9903.2—CAS Program Requirements**9903.201 Contract requirements.****9903.201-1 CAS applicability.**

(a) This subsection describes the rules for determining whether a proposed contract or subcontract is exempt from CAS. (See 9904 or 9905, as applicable.) Negotiated contracts not exempt in accordance with 9903.201-1(b) shall be subject to CAS. A CAS-covered contract may be subject to full, modified or other types of CAS coverage. The rules for determining the applicable type of CAS coverage are in 9903.201-2.

(b) The following categories of contracts and subcontracts are exempt from all CAS requirements:

(1) Sealed bid contracts.

(2) Negotiated contracts and subcontracts not in excess of \$500,000. For purposes of this paragraph (b)(2) an order issued by one segment to another segment shall be treated as a subcontract.

(3) Contracts and subcontracts with small businesses.

(4) Contracts and subcontracts with foreign governments or their agents or instrumentalities or, insofar as the requirements of CAS other than 9904.401 and 9904.402 are concerned, any contract or subcontract awarded to a foreign concern.

(5) Contracts and subcontracts in which the price is set by law or regulation.

(6) Firm fixed-priced and fixed-price with economic price adjustment (provided that price adjustment is not based on actual costs incurred) contracts and subcontracts for the acquisition of commercial items.

(7) Contracts or subcontracts of less than \$7.5 million, provided that, at the time of award, the business unit of the contractor or subcontractor is not currently performing any CAS-covered contracts or subcontracts valued at \$7.5 million or greater.

(8) — (11) [Reserved]

(12) Contracts and subcontracts awarded to a United Kingdom contractor for performance substantially in the United Kingdom, provided that the contractor has filed with the United Kingdom Ministry of Defence, for retention by the Ministry, a completed Disclosure Statement (Form No. CASB-DS-1) which shall adequately describe its cost accounting practices. Whenever that contractor is already required to follow U.K. Government Accounting Conventions, the disclosed practices shall be in accord with the requirements of those conventions. (See 9903.201-4(d).)

(13) Subcontracts under the NATO PHM Ship program to be performed outside the United States by a foreign concern.

(14) Contracts and subcontracts to be executed and performed entirely outside the United States, its territories, and possessions.

(15) Firm-fixed-price contracts or subcontracts awarded on the basis of adequate price competition without submission of cost or pricing data.

9903.201-2 Types of CAS coverage.

(a) *Full coverage.* Full coverage requires that the business unit comply with all of the CAS specified in Part 9904 that are in effect on the date of the contract award and with any CAS that become applicable because of later award of a CAS-covered contract. Full coverage applies to contractor business units that—

(1) Receive a single CAS-covered contract award of \$50 million or more; or

(2) Received \$50 million or more in net CAS-covered awards during its preceding cost accounting period.

(b) *Modified coverage.* (1) Modified CAS coverage requires only that the contractor comply with Standard 9904.401, Consistency in Estimating, Accumulating, and Reporting Costs, Standard 9904.402, Consistency in Allocating Costs Incurred for the Same Purpose, Standard 9904.405, Accounting for Unallowable Costs, and Standard 9904.406, Cost Accounting Standard--Cost Accounting Period. Modified, rather than full, CAS coverage may be applied to a covered contract of less than \$50 million awarded to a business unit that received less than \$50 million in net CAS-covered awards in the immediately preceding cost accounting period.

(2) If any one contract is awarded with modified CAS coverage, all CAS-covered contracts awarded to that business unit during that cost accounting period must also have modified coverage with the following exception: if the business unit receives a single CAS-covered contract award of \$50 million or more, that contract must be subject to full CAS coverage. Thereafter, any covered contract awarded in the same cost accounting period must also be subject to full CAS coverage.

(3) A contract awarded with modified CAS coverage shall remain subject to such coverage throughout its life regardless of changes in the business unit's CAS status during subsequent cost accounting periods.

(c) *Coverage for educational institutions* — (1) *Regulatory Requirements.* Parts 9903 and 9905 apply to educational institutions except as otherwise provided in this paragraph (c) and at 9903.202-1(f).

(2) *Definitions.* (i) The following term is prominent in Parts 9903 and 9905. Other terms defined elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (c)(2)(ii) of this subsection below requires otherwise.

Educational institution means a public or nonprofit institution of higher education, e.g., an accredited college or university, as defined in Section 1201(a) of Public Law 89-329, November 8, 1965, Higher Education Act of 1965; (20 U.S.C. § 1141(a)).

(ii) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to educational institutions:

Business unit means any segment of an educational institution, or an entire educational institution which is not divided into segments.

Segment means one of two or more divisions, campus locations, or other subdivisions of an educational institution that operate as independent organizational entities under the auspices of the parent educational institution and report directly to an intermediary group office or the governing central system office of the parent educa-

tional institution. Two schools of instruction operating under one division, campus location or other subdivision would not be separate segments unless they follow different cost accounting practices, for example, the School of Engineering should not be treated as a separate segment from the School of Humanities if they both are part of the same division's cost accounting system and are subject to the same cost accounting practices. The term includes Government-owned contractor-operated (GOCO) facilities, Federally Funded Research and Developments Centers (FFRDCs), and joint ventures and subsidiaries (domestic and foreign) in which the institution has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the institution has less than a majority of ownership, but over which it exercises control.

(3) *Applicable Standards.* Coverage for educational institutions requires that the business unit comply with all of the CAS specified in Part 9905 that are in effect on the date of the contract award and with any CAS that become applicable because of later award of a CAS-covered contract. This coverage applies to business units that receive negotiated contracts in excess of \$500,000, except for CAS-covered contracts awarded to FFRDCs operated by an educational institution.

(4) *FFRDCs.* Negotiated contracts awarded to an FFRDC operated by an educational institution are subject to the full or modified CAS coverage prescribed in paragraphs (a) and (b) of this subsection. CAS-covered FFRDC contracts shall be excluded from the institution's universe of contracts when determining CAS applicability and disclosure requirements for contracts other than those to be performed by the FFRDC.

(5) *Contract Clauses.* The contract clause at 9903.201-4(e) shall be incorporated in each negotiated contract and subcontract awarded to an educational institution when the negotiated contract or subcontract price exceeds \$500,000. For CAS-covered contracts awarded to a FFRDC operated by an educational institution, however, the full or modified CAS contract clause specified at 9903.201-4(a) or (c), as applicable, shall be incorporated.

(6) *Continuity in Fully CAS-Covered Contracts.* Where existing contracts awarded to an educational institution incorporate full CAS coverage, the contracting officer may continue to apply full CAS coverage, as prescribed at 9903.201-2(a), in future awards made to that educational institution.

(d) *Subcontracts.* Subcontract awards subject to CAS require the same type of CAS coverage as would prime contracts awarded to the same business unit. In measuring total net CAS-covered awards for a year, a transfer by one segment to another shall be deemed to be a subcontract award by the transferor.

(e) *Foreign concerns.* Contracts with foreign concerns subject to CAS shall only be subject to Standard 9904.401, Consistency in Estimating, Accumulating, and Reporting Costs, and Standard 9904.402, Consistency in Allocating Costs Incurred for the Same Purpose.

9903.201-3 Solicitation provisions.

(a) *Cost Accounting Standards Notices and Certification.* (1) The contracting officer shall insert the provision set forth below, Cost Accounting Standards Notices and Certification, in solicitations for proposed contracts subject to CAS as specified in 9903.201. The provision allows offerors to—

- (i) Certify their Disclosure Statement status;
 - (ii) [Reserved];
 - (iii) Claim exemption from full CAS coverage and elect modified CAS coverage when appropriate; and
 - (iv) Certify whether award of the contemplated contract would require a change to existing cost accounting practices.
- (2) If an award to an educational institution is contemplated prior to July 1, 1997, the contracting officer shall use the basic provision set forth below with its Alternate I, unless the contract is to be performed by an FFRDC (see 9903.201(c)(5)), or the provision at 9903.201(c)(6) applies.

**COST ACCOUNTING STANDARDS NOTICES AND CERTIFICATION
(APRIL 2000)**

NOTE: This notice does not apply to small businesses or foreign governments.

This notice is in three parts, identified by Roman numerals I through III.

Offerors shall examine each part and provide the requested information in order to determine Cost Accounting Standards (CAS) requirements applicable to any resultant contract.

If the offeror is an educational institution, Part II does not apply unless the contemplated contract will be subject to full or modified CAS-coverage pursuant to 9903.201-2(c)(5) or 9903.201-2(c)(6).

I. Disclosure Statement—Cost Accounting Practices and Certification

(a) Any contract in excess of \$500,000 resulting from this solicitation, except for those contracts which are exempt as specified in 9903.201-1.

(b) Any offeror submitting a proposal which, if accepted, will result in a contract subject to the requirements of 48 CFR, Chapter 99 must, as a condition of contracting, submit a Disclosure Statement as required by 9903.202. When required, the Disclosure Statement must be submitted as a part of the offeror's proposal under this solicitation unless the offeror has already submitted a Disclosure Statement disclosing the practices used in connection with the pricing of this proposal. If an applicable Disclosure Statement has already been submitted, the offeror may satisfy the requirement for submission by providing the information requested in paragraph (c) of Part I of this provision.

Caution: In the absence of specific regulations or agreement, a practice disclosed in a Disclosure Statement shall not, by virtue of such disclosure, be deemed to be a proper, approved, or agreed-to practice for pricing proposals or accumulating and reporting contract performance cost data.

(c) Check the appropriate box below:

(1) Certificate of Concurrent Submission of Disclosure Statement.

The offeror hereby certifies that, as a part of the offer, copies of the Disclosure Statement have been submitted as follows: (i) original and one copy to the cognizant Administrative Contracting Officer (ACO) or cognizant Federal agency official authorized to act in that capacity, as applicable, and (ii) one copy to the cognizant Federal auditor.

(Disclosure must be on Form No. CASB DS-1 or CASB DS-2, as applicable. Forms may be obtained from the cognizant ACO or

cognizant Federal agency official acting in that capacity and/or from the looseleaf version of the Federal Acquisition Regulation.)

Date of Disclosure Statement: _____

Name and Address of Cognizant ACO or Federal Official where filed: _____

The offeror further certifies that the practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the Disclosure Statement.

(2) Certificate of Previously Submitted Disclosure Statement.

The offeror hereby certifies that the required Disclosure Statement was filed as follows:

Date of Disclosure Statement: _____

Name and Address of Cognizant ACO or Federal Official where filed: _____

The offeror further certifies that the practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the applicable Disclosure Statement.

(3) Certificate of Monetary Exemption.

The offeror hereby certifies that the offeror, together with all divisions, subsidiaries, and affiliates under common control, did not receive net awards of negotiated prime contracts and subcontracts subject to CAS totaling \$50 million or more in the cost accounting period immediately preceding the period in which this proposal was submitted. The offeror further certifies that if such status changes before an award resulting from this proposal, the offeror will advise the Contracting Officer immediately.

(4) Certificate of Interim Exemption.

The offeror hereby certifies that (i) the offeror first exceeded the monetary exemption for disclosure, as defined in (3) above, in the cost accounting period immediately preceding the period in which this offer was submitted and (ii) in accordance with 9903.202-1, the offeror is not yet required to submit a Disclosure Statement. The offeror further certifies that if an award resulting from this proposal has not been made within 90 days after the end of that period, the offeror will immediately submit a revised certificate to the Contracting Officer, in the form specified under subparagraphs (c)(1) or (c)(2) of Part I of this provision, as appropriate, to verify submission of a completed Disclosure Statement.

Caution: Offerors currently required to disclose because they were awarded a CAS-covered prime contract or subcontract of \$50 million or more in the current cost accounting period may not claim this exemption (4). Further, the exemption applies only in connection with proposals submitted before expiration of the 90-day period following the cost accounting period in which the monetary exemption was exceeded.

II. Cost Accounting Standards—Eligibility for Modified Contract Coverage

If the offeror is eligible to use the modified provisions of 9903.201-2(b) and elects to do so, the offeror shall indicate by checking the box below. Checking the box below shall mean that the resultant contract is subject to the Disclosure and Consistency of Cost Accounting Practices clause in lieu of the Cost Accounting Standards clause.

The offeror hereby claims an exemption from the Cost Accounting Standards clause under the provisions of 9903.201-2(b) and certifies that the offeror is eligible for use of the Disclosure and Consistency of Cost Accounting Practices clause because during

the cost accounting period immediately preceding the period in which this proposal was submitted, the offeror received less than \$50 million in awards of CAS-covered prime contracts and subcontracts. The offeror further certifies that if such status changes before an award resulting from this proposal, the offeror will advise the Contracting Officer immediately.

Caution: An offeror may not claim the above eligibility for modified contract coverage if this proposal is expected to result in the award of a CAS-covered contract of \$50 million or more or if, during its current cost accounting period, the offeror has been awarded a single CAS-covered prime contract or subcontract of \$50 million or more.

III. Additional Cost Accounting Standards Applicable to Existing Contracts

The offeror shall indicate below whether award of the contemplated contract would, in accordance with subparagraph (a)(3) of the Cost Accounting Standards clause, require a change in established cost accounting practices affecting existing contracts and subcontracts.

YES NO

(End of basic provision)

Alternate I (OCT 1994) Insert the following subparagraph (5) at the end of Part I of the basic clause:

(5) Certificate of Disclosure Statement Due Date by Educational Institution. If the offeror is an educational institution that, under the transition provisions of 9903.202-1(f), is or will be required to submit a Disclosure Statement after receipt of this award, the offeror hereby certifies that (check one and complete):

(a) A Disclosure Statement filing Due Date of _____ has been established with the cognizant Federal agency.

(b) The Disclosure Statement will be submitted within the six month period ending _____ months after receipt of this award.

Name and Address of Cognizant ACO or Federal Official where Disclosure Statement is to be filed:

(End of Alternate I)

9903.201-4 Contract clauses.

(a) *Cost Accounting Standards.* (1) The contracting officer shall insert the clause set forth below, Cost Accounting Standards, in negotiated contracts, unless the contract is exempted (see 9903.201-1), the contract is subject to modified coverage (see 9903.201-2), or the clause prescribed in paragraphs (d) or (e) of this subsection is used.

(2) The clause below requires the contractor to comply with all CAS specified in Part 9904, to disclose actual cost accounting practices (applicable to CAS-covered contracts only), and to follow disclosed and established cost accounting practices consistently.

COST ACCOUNTING STANDARDS (MAY 1997)

(a) Unless the contract is exempt under 9903.201-1 and 9903.201-2, the provisions of 9903 are incorporated herein by reference and the Contractor in connection with this contract, shall—

(1) (CAS-covered Contracts Only) By submission of a Disclosure Statement, disclose in writing the Contractor's cost accounting

practices as required by 9903.202-1 through 9903.202-5 including methods of distinguishing direct costs from indirect costs and the basis used for allocating indirect costs. The practices disclosed for this contract shall be the same as the practices currently disclosed and applied on all other contracts and subcontracts being performed by the Contractor and which contain a Cost Accounting Standards (CAS) clause. If the Contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets, and commercial or financial information which is privileged and confidential, the Disclosure Statement shall be protected and shall not be released outside of the Government.

(2) Follow consistently the Contractor's cost accounting practices in accumulating and reporting contract performance cost data concerning this contract. If any change in cost accounting practices is made for the purposes of any contract or subcontract subject to CAS requirements, the change must be applied prospectively to this contract and the Disclosure Statement must be amended accordingly. If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) of this clause, as appropriate.

(3) Comply with all CAS, including any modifications and interpretations indicated thereto contained in Part 9904, in effect on the date of award of this contract or, if the Contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the Contractor's signed certificate of current cost or pricing data. The Contractor shall also comply with any CAS (or modifications to CAS) which hereafter become applicable to a contract or subcontract of the Contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract.

(4)(i) Agree to an equitable adjustment as provided in the Changes clause of this contract if the contract cost is affected by a change which, pursuant to subparagraph (a)(3) of this clause, the Contractor is required to make to the Contractor's established cost accounting practices.

(ii) Negotiate with the Contracting Officer to determine the terms and conditions under which a change may be made to a cost accounting practice, other than a change made under other provisions of subparagraph (a)(4) of this clause; provided that no agreement may be made under this provision that will increase costs paid by the United States.

(iii) When the parties agree to a change to a cost accounting practice, other than a change under subdivision (a)(4)(i) of this clause, negotiate an equitable adjustment as provided in the Changes clause of this contract.

(5) Agree to an adjustment of the contract price or cost allowance, as appropriate, if the Contractor or a subcontractor fails to comply with an applicable Cost Accounting Standard, or to follow any cost accounting practice consistently and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States, together with interest thereon computed at the annual rate established under section 6621(a)(2) of the Internal Revenue Code of 1986 (26 U.S.C. 6621(a)(2)) for such period, from the time the payment by the United States was made to the time the adjustment is effected. In no case shall the Government recover costs greater than the increased cost to the Government, in the aggregate, on the relevant contracts subject to the price adjustment, unless the Contractor

made a change in its cost accounting practices of which it was aware or should have been aware at the time of price negotiations and which it failed to disclose to the Government.

(b) If the parties fail to agree whether the Contractor or a subcontractor has complied with an applicable CAS in Part 9904 or a CAS rule or regulation in Part 9903 and as to any cost adjustment demanded by the United States, such failure to agree will constitute a dispute under the Contract Disputes Act (41 U.S.C. 601).

(c) The Contractor shall permit any authorized representatives of the Government to examine and make copies of any documents, papers, or records relating to compliance with the requirements of this clause.

(d) The contractor shall include in all negotiated subcontracts which the Contractor enters into, the substance of this clause, except paragraph (b), and shall require such inclusion in all other subcontracts, of any tier, including the obligation to comply with all CAS in effect on the subcontractor's award date or if the subcontractor has submitted cost or pricing data, on the date of final agreement on price as shown on the subcontractor's signed Certificate of Current Cost or Pricing Data. If the subcontract is awarded to a business unit which pursuant to 9903.201-2 is subject to other types of CAS coverage, the substance of the applicable clause set forth in 9903.201-4 shall be inserted. This requirement shall apply only to negotiated subcontracts in excess of \$500,000, except that the requirement shall not apply to negotiated subcontracts otherwise exempt from the requirement to include a CAS clause as specified in 9903.201-1.

(End of clause)

(b) [Reserved]

(c) *Disclosure and Consistency of Cost Accounting Practices.*

(1) The contracting officer shall insert the clause set forth below, Disclosure and Consistency of Cost Accounting Practices, in negotiated contracts when the contract amount is over \$500,000 but less than \$50 million, and the offeror certifies it is eligible for and elects to use modified CAS coverage (see 9903.201-2, unless the clause prescribed in paragraph (d) of this subsection is used).

(2) The clause below requires the contractor to comply with CAS 9904.401 9904.402, 9904.405, and 9904.406 to disclose (if it meets certain requirements) actual cost accounting practices, and to follow consistently disclosed and established cost accounting practices.

DISCLOSURE AND CONSISTENCY OF COST ACCOUNTING PRACTICES (MAY 1997)

(a) The Contractor, in connection with this contract, shall—

(1) Comply with the requirements of 9904.401, Consistency in Estimating, Accumulating, and Reporting Costs; 9904.402, Consistency in Allocating Costs Incurred for the Same Purpose; 9904.405, Accounting for Unallowable Costs; and 9904.406, Cost Accounting Standard — Cost Accounting Period, in effect on the date of award of this contract, as indicated in Part 9904.

(2) (CAS-covered Contracts Only) If it is a business unit of a company required to submit a Disclosure Statement, disclose in writing its cost accounting practices as required by 9903.202-1 through 9903.202-5. If the Contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets and commercial or financial information which is privileged and confi-

dential, the Disclosure Statement shall be protected and shall not be released outside of the Government.

(3)(i) Follow consistently the Contractor's cost accounting practices. A change to such practices may be proposed, however, by either the Government or the Contractor, and the Contractor agrees to negotiate with the Contracting Officer the terms and conditions under which a change may be made. After the terms and conditions under which the change is to be made have been agreed to, the change must be applied prospectively to this contract, and the Disclosure Statement, if affected, must be amended accordingly.

(ii) The Contractor shall, when the parties agree to a change to a cost accounting practice and the Contracting Officer has made the finding required in 9903.201-6(c) that the change is desirable and not detrimental to the interests of the Government, negotiate an equitable adjustment as provided in the Changes clause of this contract. In the absence of the required finding, no agreement may be made under this contract clause that will increase costs paid by the United States.

(4) Agree to an adjustment of the contract price or cost allowance, as appropriate, if the Contractor or a subcontractor fails to comply with the applicable CAS or to follow any cost accounting practice, and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States, together with interest thereon computed at the annual rate established under section 6621(a)(2) of the Internal Revenue Code of 1986 (26 U.S.C. 6621(a)(2)) for such period, from the time the payment by the United States was made to the time the adjustment is effected.

(b) If the parties fail to agree whether the Contractor has complied with an applicable CAS rule, or regulation as specified in Parts 9903 and 9904 and as to any cost adjustment demanded by the United States, such failure to agree will constitute a dispute under the Contract Disputes Act (41 U.S.C. 601).

(c) The Contractor shall permit any authorized representatives of the Government to examine and make copies of any documents, papers, and records relating to compliance with the requirements of this clause.

(d) The Contractor shall include in all negotiated subcontracts, which the Contractor enters into, the substance of this clause, except paragraph (b), and shall require such inclusion in all other subcontracts of any tier, except that—

(1) If the subcontract is awarded to a business unit which pursuant to 9903.201-2 is subject to other types of CAS coverage, the substance of the applicable clause set forth in 9903.201-4 shall be inserted.; or

(2) This requirement shall apply only to negotiated subcontracts in excess of \$500,000.

(3) The requirement shall not apply to negotiated subcontracts otherwise exempt from the requirement to include a CAS clause as specified in 9903.201-1.

(End of clause)

(d) *Consistency in Cost Accounting Practices.* The contracting officer shall insert the clause set forth below, Consistency in Cost Accounting Practices, in negotiated defense contracts that are exempt from CAS requirements solely on the basis of the fact that the contract is to be awarded to a United Kingdom contractor and is

to be performed substantially in the United Kingdom (see 9903.201-1(b)(12)).

CONSISTENCY IN COST ACCOUNTING PRACTICES (APR 1992)

The Contractor agrees that it will consistently follow the cost accounting practices disclosed on Form CASB DS-1 in estimating, accumulating and reporting costs under this contract. In the event the Contractor fails to follow such practices, it agrees that the contract price shall be adjusted, together with interest, if such failure results in increased cost paid by the U.S. Government. Interest shall be computed at the annual rate of interest established under section 6621 of the Internal Revenue Code of 1986 (26 U.S.C. 6621) from the time payment by the Government was made to the time adjustment is effected. The Contractor agrees that the Disclosure Statement filed with the U.K. Ministry of Defence shall be available for inspection and use by authorized representatives of the United States Government.

(End of clause)

(e) *Cost Accounting Standards—Educational Institutions.* (1) The contracting officer shall insert the clause set forth below, Cost Accounting Standards—Educational Institution, in negotiated contracts awarded to educational institutions, unless the contract is exempted (see 9903.201-1), the contract is to be performed by an FFRDC (see 9903.201-2(c)(5)), or the provision at 9903.201-2(c)(6) applies.

(2) The clause below requires the educational institution to comply with all CAS specified in Part 9905, to disclose actual cost accounting practices as required by 9903.202-1(f), and to follow disclosed and established cost accounting practices consistently.

COST ACCOUNTING STANDARDS—EDUCATIONAL INSTITUTIONS (JULY 1996)

(a) Unless the contract is exempt under 9903.201-1 and 9903.201-2, the provisions of 9903 are incorporated herein by reference and the Contractor in connection with this contract, shall—

(1) (CAS-covered Contracts Only) If a business unit of an educational institution required to submit a Disclosure Statement, disclose in writing the Contractor's cost accounting practices as required by 9903.202-1 through 9903.202-5 including methods of distinguishing direct costs from indirect costs and the basis used for accumulating and allocating indirect costs. The practices disclosed for this contract shall be the same as the practices currently disclosed and applied on all other contracts and subcontracts being performed by the Contractor and which contain a Cost Accounting Standards (CAS) clause. If the Contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets, and commercial or financial information which is privileged and confidential, the Disclosure Statement shall be protected and shall not be released outside of the Government.

(2) Follow consistently the Contractor's cost accounting practices in accumulating and reporting contract performance cost data concerning this contract. If any change in cost accounting practices is made for the purposes of any contract or subcontract subject to CAS requirements, the change must be applied prospectively to this contract and the Disclosure Statement, if required, must be amended accordingly. If an accounting principle change mandated under Office of Management and Budget (OMB) Circular A-21,

Cost Principles for Educational Institutions, requires that a change in the Contractor's cost accounting practices be made after the date of this contract award, the change must be applied prospectively to this contract and the Disclosure Statement, if required, must be amended accordingly. If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) of this clause, as appropriate.

(3) Comply with all CAS, including any modifications and interpretations indicated thereto contained in 48 CFR 9905, in effect on the date of award of this contract or, if the Contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the Contractor's signed certificate of current cost or pricing data. The Contractor shall also comply with any CAS (or modifications to CAS) which hereafter become applicable to a contract or subcontract of the Contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract.

(4)(i) Agree to an equitable adjustment as provided in the Changes clause of this contract if the contract cost is affected by a change which, pursuant to subparagraph (a)(3) of this clause, the Contractor is required to make to the Contractor's established cost accounting practices.

(ii) Negotiate with the Contracting Officer to determine the terms and conditions under which a change may be made to a cost accounting practice, other than a change made under other provisions of subparagraph (a)(4) of this clause; provided that no agreement may be made under this provision that will increase costs paid by the United States.

(iii) When the parties agree to a change to a cost accounting practice, other than a change under subdivision (a)(4)(i) or (a)(4)(iv) of this clause, negotiate an equitable adjustment as provided in the Changes clause of this contract.

(iv) Agree to an equitable adjustment as provided in the Changes clause of this contract, if the contract cost is materially affected by an OMB Circular A-21 accounting principle amendment which, on becoming effective after the date of contract award, requires the Contractor to make a change to the Contractor's established cost accounting practices.

(5) Agree to an adjustment of the contract price or cost allowance, as appropriate, if the Contractor or a subcontractor fails to comply with an applicable Cost Accounting Standard, or to follow any cost accounting practice consistently and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States, together with interest thereon computed at the annual rate established under section 6621(a)(2) of the Internal Revenue Code of 1986 (26 U.S.C. 6621(a)(2)) for such period, from the time the payment by the United States was made to the time the adjustment is effected. In no case shall the Government recover costs greater than the increased cost to the Government, in the aggregate, on the relevant contracts subject to the price adjustment, unless the Contractor made a change in its cost accounting practices of which it was aware or should have been aware at the time of price negotiations and which it failed to disclose to the Government.

(b) If the parties fail to agree whether the Contractor or a subcontractor has complied with an applicable CAS or a CAS rule or regulation in 9903 and as to any cost adjustment demanded by the

United States, such failure to agree will constitute a dispute under the Contract Disputes Act (41 U.S.C. 601).

(c) The Contractor shall permit any authorized representatives of the Government to examine and make copies of any documents, papers, or records relating to compliance with the requirements of this clause.

(d) The Contractor shall include in all negotiated subcontracts which the Contractor enters into, the substance of this clause, except paragraph (b), and shall require such inclusion in all other subcontracts, of any tier, including the obligation to comply with all applicable CAS in effect on the subcontractor's award date or if the subcontractor has submitted cost or pricing data, on the date of final agreement on price as shown on the subcontractor's signed Certificate of Current Cost or Pricing Data, except that—

(1) If the subcontract is awarded to a business unit which pursuant to 9903.201-2 is subject to other types of CAS coverage, the substance of the applicable clause set forth in 9903.201-4 shall be inserted; and

(2) This requirement shall apply only to negotiated subcontracts in excess of \$500,000.

(3) The requirement shall not apply to negotiated subcontracts otherwise exempt from the requirement to include a CAS clause as specified in 9903.201-1c

(End of Clause)

9903.201-5 Waiver.

(a) The head of an executive agency may waive the applicability of the Cost Accounting Standards for a contract or subcontract with a value of less than \$15 million, if that official determines, in writing, that the business unit of the contractor or subcontractor that will perform the work—

(1) Is primarily engaged in the sale of commercial items; and

(2) Would not otherwise be subject to the Cost Accounting Standards under this Chapter.

(b) The head of an executive agency may waive the applicability of the Cost Accounting Standards for a contract or subcontract under exceptional circumstances when necessary to meet the needs of the agency. A determination to waive the applicability of the Cost Accounting Standards by the agency head shall be set forth in writing, and shall include a statement of the circumstances justifying the waiver.

(c) The head of an executive agency may not delegate the authority under paragraphs (a) and (b) of this section, to any official below the senior policymaking level in the agency.

(d) The head of each executive agency shall report the waivers granted under paragraphs (a) and (b) of this section, for that agency, to the Cost Accounting Standards Board, on an annual basis, not later than 90 days after the close of the Government's fiscal year.

(e) Upon request of an agency head or his designee, the Cost Accounting Standards Board may waive all or any part of the requirements of 9903.201-4(a), Cost Accounting Standards, or 9903.201-4(c), Disclosure and Consistency of Cost Accounting Practices, with respect to a contract subject to the Cost Accounting Standards. Any request for a waiver shall describe the proposed contract or subcontract for which the waiver is sought and shall contain—

(1) An unequivocal statement that the proposed contractor or subcontractor refuses to accept a contract containing all or a specified part of a CAS clause and the specific reason for that refusal;

(2) A statement as to whether the proposed contractor or subcontractor has accepted any prime contract or subcontract containing a CAS clause;

(3) The amount of the proposed award and the sum of all awards by the agency requesting the waiver to the proposed contractor or subcontractor in each of the preceding 3 years;

(4) A statement that no other source is available to satisfy the agency's needs on a timely basis;

(5) A statement of alternative methods considered for fulfilling the need and the agency's reasons for rejecting them;

(6) A statement of steps being taken by the agency to establish other sources of supply for future contracts for the products or services for which a waiver is being requested; and

(7) Any other information that may be useful in evaluating the request.

(f) Except as provided by the Cost Accounting Standards Board, the authority in paragraph (e) of this section shall not be delegated.

9903.201-6 Findings.

(a) *Required change.* (1) *Finding.* Prior to making any equitable adjustment under the provisions of paragraph (a)(4)(i) of the contract clause set forth in 99.03.201-4(a) or 9903.201-4(e), or paragraph (a)(3)(i) of the contract clause set forth in 9903.201-4(c), the Contracting Officer shall make a finding that the practice change was required to comply with a CAS, modification or interpretation thereof, that subsequently became applicable to the contract; or, for planned changes being made in order to remain CAS compliant, that the former practice was in compliance with applicable CAS and the planned change is necessary for the contractor to remain in compliance.

(2) Required change means a change in cost accounting practice that a contractor is required to make in order to comply with applicable Standards, modifications, or interpretations thereto, that subsequently become applicable to an existing CAS-covered contract due to the receipt of another CAS-covered contract or subcontract. It also includes a prospective change to a disclosed or established cost accounting practice when the cognizant Federal agency official determines that the former practice was in compliance with applicable CAS and the change is necessary for the contractor to remain in compliance.

(b) *Unilateral change.* (1) *Finding.* Prior to making any contract price or cost adjustment(s) under the change provisions of paragraph (a)(4)(ii) of the contract clause set forth in 9903.201-4(a) or 9903.201-4(e), or paragraph (a)(3)(ii) of the contract clause set forth in 9903.201-4(c), the Contracting Officer shall make a finding that the contemplated contract price and cost adjustments will protect the United States from payment of increased costs, in the aggregate; and that the net effect of the adjustments being made does not result in the recovery of more than the estimated amount of such increased costs.

(2) Unilateral change by a contractor means a change in cost accounting practice from one compliant practice to another compliant practice that a contractor with a CAS-covered contract(s) elects to make that has not been deemed desirable by the cognizant Fed-

eral agency official and for which the Government will pay no aggregate increased costs.

(3) Action to preclude the payment of aggregate increased costs by the Government. In the absence of a finding pursuant to paragraph (c) of this subsection that a compliant change is desirable, no agreement may be made with regard to a change to a cost accounting practice that will result in the payment of aggregate increased costs by the United States. For these changes, the cognizant Federal agency official shall limit upward contract price adjustments to affected contracts to the amount of downward contract price adjustments of other affected contracts, *i.e.*, no net upward contract price adjustment shall be permitted.

(c) *Desirable change.* (1) *Finding.* Prior to making any equitable adjustment under the provisions of paragraph (a)(4)(iii) of the contract clause set forth in 9903.201-4(a) or 9903.201-4(e), or paragraph (a)(3)(ii) of the contract clause set forth in 9903.201-4(c), the cognizant Federal agency official shall make a finding that the change to a cost accounting practice is desirable and not detrimental to the interests of the Government.

(2) Desirable change means a compliant change to a contractor's established or disclosed cost accounting practices that the cognizant Federal agency official finds is desirable and not detrimental to the Government and is therefore not subject to the no increased cost prohibition provisions of CAS-covered contracts affected by the change. The cognizant Federal agency official's finding need not be based solely on the cost impact that a proposed practice change will have on a contractor's or subcontractor's current CAS-covered contracts. The change to a cost accounting practice may be determined to be desirable even though existing contract prices and/or cost allowances may increase. The determination that the change to a cost accounting practice is desirable, should be made on a case-by-case basis.

(3) Once a determination has been made that a compliant change to a cost accounting practice is a desirable change, associated management actions that also have an impact on contract costs should be considered when negotiating contract price or cost adjustments that may be needed to equitably resolve the overall cost impact of the aggregated actions.

(4) Until the cognizant Federal agency official has determined that a change to a cost accounting practice is deemed to be a desirable change, the change shall be considered to be a change for which the Government will not pay increased costs, in the aggregate.

(d) *Noncompliant cost accounting practices.* (1) *Findings.* Prior to making any contract price or cost adjustment(s) under the provisions of paragraph (a)(5) of the contract clause set forth in 9903.201-4(a) or 9903.201-4(e), or paragraph (a)(4) of the contract clause set forth in 9903.201-4(c), the Contracting Officer shall make a finding that the contemplated contract price and cost adjustments will protect the United States from payment of increased costs, in the aggregate; and that the net effect of the adjustments being made does not result in the recovery of more than the estimated amount of such increased costs. While individual contract prices, including cost ceilings or target costs, as applicable, may be increased as well as decreased to resolve an estimating noncompliance, the aggregate value of all contracts affected by the estimating noncompliance shall not be increased.

9903.201-7 Cognizant Federal agency responsibilities.

(a) The requirements of Part 9903 shall, to the maximum extent practicable, be administered by the cognizant Federal agency responsible for a particular contractor organization or location, usually the Federal agency responsible for negotiating indirect cost rates on behalf of the Government. The cognizant Federal agency should take the lead role in administering the requirements of Part 9903 and coordinating CAS administrative actions with all affected Federal agencies. When multiple CAS-covered contracts or more than one Federal agency are involved, agencies should discourage Contracting Officers from individually administering CAS on a contract-by-contract basis. Coordinated administrative actions will provide greater assurances that individual contractors follow their cost accounting practices consistently under all their CAS-covered contracts and that changes in cost accounting practices or CAS non-compliance issues are resolved, equitably, in a uniform overall manner.

(b) Federal agencies shall prescribe regulations and establish internal policies and procedures governing how agencies will administer the requirements of CAS-covered contracts, with particular emphasis on interagency coordination activities. Procedures to be followed when an agency is and is not the cognizant Federal agency should be clearly delineated. Internal agency policies and procedures shall provide for the designation of the agency office(s) or officials responsible for administering CAS under the agency's CAS-covered contracts at each contractor business unit and the delegation of necessary contracting authority to agency individuals authorized to administer the terms and conditions of CAS-covered contracts, *e.g.*, Administrative Contracting Officers (ACOs) or other agency officials authorized to perform in that capacity. Agencies are urged to coordinate on the development of such regulations.

9903.201-8 Compliant accounting changes due to external restructuring activities.

The contract price and cost adjustment requirements of this part 9903 are not applicable to compliant cost accounting practice changes directly associated with external restructuring activities that are subject to and meet the requirements of 10 U.S.C. 2325.

9903.202 Disclosure requirements.

The contract price and cost adjustment requirements of this part 9903 are not applicable to compliant cost accounting practice changes directly associated with external restructuring activities that are subject to and meet the requirements of 10 U.S.C. 2325.

9903.202-1 General requirements.

(a) A Disclosure Statement is a written description of a contractor's cost accounting practices and procedures. The submission of a new or revised Disclosure Statement is not required for any non-CAS-covered contract or from any small business concern.

(b) Completed Disclosure Statements are required in the following circumstances:

(1) Any business unit that is selected to receive a CAS-covered contract or subcontract of \$50 million or more shall submit a Disclosure Statement before award.

(2) Any company which, together with its segments, received net awards of negotiated prime contracts and subcontracts subject to CAS totaling \$50 million or more in its most recent cost accounting period, must submit a Disclosure Statement before award of its first CAS-covered contract in the immediately following cost

accounting period. However, if the first CAS-covered contract is received within 90 days of the start of the cost accounting period, the contractor is not required to file until the end of 90 days.

(c) When a Disclosure Statement is required, a separate Disclosure Statement must be submitted for each segment whose costs included in the total price of any CAS-covered contract or subcontract exceed \$500,000, unless (i) The contract or subcontract is of the type or value exempted by 9903.201-1 or (ii) In the most recently completed cost accounting period the segment's CAS-covered awards are less than 30 percent of total segment sales for the period and less than \$10 million.

(d) Each corporate or other home office that allocates costs to one or more disclosing segments performing CAS-covered contracts must submit a Part VIII of the Disclosure Statement.

(e) Foreign contractors and subcontractors who are required to submit a Disclosure Statement may, in lieu of filing a Form No. CASB DS-1, make disclosure by using a disclosure form prescribed by an agency of its Government, provided that the Cost Accounting Standards Board determines that the information disclosed by that means will satisfy the objectives of Public Law 100-679. The use of alternative forms has been approved for the contractors of the following countries:

- (1) Canada.
- (2) Federal Republic of Germany.

(f) *Educational institutions-disclosure requirements.* (1) Educational institutions receiving contracts subject to the CAS specified in Part 9905 are subject to the requirements of 9903.202, except that completed Disclosure Statements are required in the following circumstances.

(2) *Basic requirement.* For CAS-covered contracts placed on or after January 1, 1996, completed Disclosure Statements are required as follows:

(i) Any business unit of an educational institution that is selected to receive a CAS-covered contract or subcontract in excess of \$500,000 and is part of a college or university location listed in Exhibit A of Office of Management and Budget (OMB) Circular A-21 shall submit a Disclosure Statement before award. A Disclosure Statement is not required, however, if the listed entity can demonstrate that the net amount of Federal contract and financial assistance awards received during its immediately preceding cost accounting period was less than \$25 million.

(ii) Any business unit that is selected to receive a CAS-covered contract or subcontract of \$25 million or more shall submit a Disclosure Statement before award.

(iii) Any educational institution which, together with its segments, received net awards of negotiated prime contracts and subcontracts subject to CAS totaling \$25 million or more in its most recent cost accounting period, of which, at least one award exceeded \$1 million, must submit a Disclosure Statement before award of its first CAS-covered contract in the immediately following cost accounting period. However, if the first CAS-covered contract is received within 90 days of the start of the cost accounting period, the institution is not required to file until the end of 90 days.

(3) *Transition period requirement.* For CAS-covered contracts placed on or before December 31, 1995, completed Disclosure Statements are required as follows:

(i) For business units that are selected to receive a CAS-covered contract or subcontract in excess of \$500,000 and are part of the

first 20 college or university locations (i.e., numbers 1 through 20) listed in Exhibit A of OMB Circular A-21, Disclosure Statements shall be submitted within six months after the date of contract award.

(ii) For business units that are selected to receive a CAS-covered contract or subcontract in excess of \$500,000 and are part of a college or university location that is listed as one of the institutions numbered 21 through 50, in Exhibit A of OMB Circular A-21, Disclosure Statements shall be submitted during the six month period ending twelve months after the date of contract award.

(iii) For business units that are selected to receive a CAS-covered contract or subcontract in excess of \$500,000 and are part of a college or university location that is listed as one of the institutions numbered 51 through 99, in Exhibit A of OMB Circular A-21, Disclosure Statements shall be submitted during the six month period ending eighteen months after the date of contract award.

(iv) For any other business unit that is selected to receive a CAS-covered contract or subcontract of \$25 million or more, a Disclosure Statement shall be submitted within six months after the date of contract award.

(4) *Transition period due dates.* The educational institution and cognizant Federal agency should establish a specific due date within the periods prescribed in 9903.202-1(f)(3) when a Disclosure Statement is required under a CAS-covered contract placed on or before December 31, 1995.

(5) *Transition period waiver authority.* For a CAS-covered contract to be awarded during the period January 1, 1996 through June 30, 1997, the awarding agency may waive the preaward Disclosure Statement submission requirement specified in 9903.202-1(f)(2) when a due date for the submission of a Disclosure Statement has previously been established by the cognizant Federal agency and the educational institution under the provisions of 9903.202-1(f)(3) and (4).

Caution: This waiver authority is not available unless the cognizant Federal agency and the educational institution have established a disclosure statement due date pursuant to a written agreement executed prior to January 1, 1996, and award is made prior to the established disclosure statement due date.

9903.202-2 Impracticality of submission.

The agency head may determine that it is impractical to secure the Disclosure Statement, although submission is required, and authorize contract award without obtaining the Statement. He shall, within 30 days of having done so, submit a report to the Cost Accounting Standards Board setting forth all material facts. This authority may not be delegated.

9903.202-3 Amendments and revisions.

Contractors and subcontractors are responsible for maintaining accurate Disclosure Statements and complying with disclosed practices. Amendments and revisions to Disclosure Statements may be submitted at any time and may be proposed by either the contractor or the Government. Resubmission of complete, updated, Disclosure Statements is discouraged except when extensive changes require it to assist the review process.

9903.202-4 Privileged and confidential information.

If the offeror or contractor notifies the contracting officer that the Disclosure Statement contains trade secrets and commercial or financial information, which is privileged and confidential, the Dis-

closure Statement shall be protected and shall not be released outside the Government.

9903.202-5 Filing Disclosure Statements.

(a) Disclosure must be on Form Number CASB DS-1 or CASB DS-2, as applicable. Forms may be obtained from the cognizant Federal agency (cognizant ACO or cognizant Federal agency official authorized to act in that capacity) or from the looseleaf version of the Federal Acquisition Regulation. When requested in advance by a contractor, the cognizant Federal agency may authorize contractor disclosure based on computer generated reproductions of the applicable Disclosure Statement Form.

(b) Offerors are required to file Disclosure Statements as follows:

(1) Original and one copy with the cognizant ACO or cognizant Federal agency official acting in that capacity, as applicable; and

(2) One copy with the cognizant Federal auditor.

(c) Amendments and revisions shall be submitted to the ACO or agency official acting in that capacity, as applicable, and the Federal auditor of the currently cognizant Federal agency.

9903.202-6 Adequacy of Disclosure Statement.

Federal agencies shall prescribe regulations and establish internal procedures by which each will promptly determine on behalf of the Government, when serving as the cognizant Federal agency for a particular contractor location, that a Disclosure Statement has adequately disclosed the practices required to be disclosed by the Cost Accounting Standards Board's rules, regulations and Standards. The determination of adequacy shall be distributed to all affected agencies. Agencies are urged to coordinate on the development of such regulations.

9903.202-7 [Reserved]

9903.202-8 Subcontractor Disclosure Statements.

(a) The contractor or higher tier subcontractor is responsible for administering the CAS requirements contained in subcontracts.

(b) If the subcontractor has previously furnished a Disclosure Statement to an ACO, the subcontractor may satisfy the submission requirement by identifying to the contractor or higher tier subcontractor the ACO to whom it was submitted.

(c)(1) If the subcontractor considers the Disclosure Statement (or other similar information) privileged or confidential, the subcontractor may submit it directly to the ACO and auditor cognizant of the subcontractor, notifying the contractor or higher tier subcontractor. A preaward determination of adequacy is not required in such cases. Instead, the ACO cognizant of the subcontractor shall—

(i) Notify the auditor that the adequacy review will be performed during the postaward compliance review and, upon completion,

(ii) Notify the subcontractor, the contractor or higher tier subcontractor, and the cognizant ACOs of the findings.

(2) Even though a Disclosure Statement is not required, a subcontractor may

(i) Claim that CAS-related reviews by contractors or higher tier subcontractors would reveal proprietary data or jeopardize the subcontractor's competitive position and

(ii) Request that the Government perform the required reviews.

(d) When the Government requires determinations of adequacy or inadequacy, the ACO cognizant of the subcontractor shall make such recommendation to the ACO cognizant of the prime contractor or next higher tier subcontractor. ACOs cognizant of higher tier subcontractors or prime contractors shall not reverse the determination of the ACO cognizant of the subcontractor.

9903.202-9 Illustration of Disclosure Statement Form, CASB DS-1.

The data which are required to be disclosed are set forth in detail in the Disclosure Statement Form, CASB DS-1, which is illustrated below:

FORM APPROVED OMB NUMBER
0348-0051

<p>COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679</p>	<p>INDEX</p>
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	GENERAL INSTRUCTIONS
<p>1. This Disclosure Statement has been designed to meet the requirements of Public Law 100-679, and persons completing it are to describe the contractor and its contract cost accounting practices. For complete regulations, instructions and timing requirements concerning submission of the Disclosure Statement, refer to Section 9903.202 of Chapter 99 Of Title 48 CFR (48 CFR 9903.202).</p> <p>2. Part I of the Statement provides general information concerning each reporting unit (e.g., segment, Corporate or other intermediate level home office, or a business unit). Parts II through VII pertain to the types of costs generally incurred by the segment or business unit directly performing Federal contracts or similar cost objectives. Part VIII pertains to the types of costs that are generally incurred by a Home office and are allocated to one or more segments performing Federal contracts. For a definition of the term "home office", see 48 CFR 9904.403.</p> <p>3. Each segment or business unit required to disclose its cost accounting practices should complete the Cover Sheet, the Certification, and Parts I through VII.</p> <p>4. Each home office required to disclose its cost accounting practices for measuring, assigning and allocating its costs to segments performing Federal contracts or similar cost objectives shall complete the Cover Sheet, the Certification, Part I and Part VIII of the Disclosure Statement. Where a home office either establishes practices or procedures for the types of costs covered by Parts V, VI and VII, or incurs and then allocates these types of cost to its segments, the home office may complete Parts V, VI and VII to be included in the Disclosure Statement submitted by its segments. While a home office may have more than one segment submitting Disclosure Statements, only one Statement needs to be submitted to cover the home office operations.</p> <p>5. The Statement must be signed by an authorized signatory of the reporting unit.</p> <p>6. The Disclosure Statement should be answered by marking the appropriate line or inserting the applicable letter code which describes the segment's (reporting unit's) cost accounting practices.</p> <p>7. A number of questions in this Statement may need narrative answers requiring more space than is provided. In such instances, the reporting unit should use the attached continuation sheet provided. The continuation sheet may be reproduced locally as needed. The number of the question involved should be indicated and the same coding required to answer the questions in the Statement should be used in presenting the answer on the continuation sheet. Continuation sheets should be inserted at the end of the pertinent Part of the Statement. On each continuation sheet, the reporting unit should enter the next sequential page number for that Part and, on the last continuation sheet used, the words "End of Part" should be inserted after the last entry.</p> <p>8. Where the cost accounting practice being disclosed is clearly set forth in the contractor's existing written accounting policies and procedures, such documents may be cited on a continuation sheet and incorporated by reference at the option of the contractor. In such cases, the contractor should provide the date of issuance and effective date for each accounting policy and/or procedures document cited. Alternatively, copies of the relevant parts of such documents may be attached as appendices to the pertinent Disclosure Statement Part. Such continuation sheets and appendices should be labeled and cross-referenced with the applicable Disclosure Statement number and follow the page number specified in paragraph 7. Any supplementary comments needed to adequately describe the cost accounting practice being disclosed should also be provided.</p> <p>9. Disclosure Statements must be amended when cost accounting practices are changed to comply with a new CAS or when practices are changed with or without knowledge of the Government (Also see 48 CFR 9903.202-3).</p>	

**COST ACCOUNTING STANDARDS BOARD
DISCLOSURE STATEMENT
REQUIRED BY PUBLIC LAW 100-679**

GENERAL INSTRUCTIONS

10. Amendments shall be submitted to the same offices to which submission would have been made were an original Disclosure Statement filed.

11. Each amendment, or set of amendments should be accompanied by an amended cover sheet (indicating revision number and effective date of the change) and a signed certification. For all resubmissions, on each page, insert "Revision Number ____" and "Effective Date ____" in the Item Description block; and, insert a revision mark (e.g., "R") in the right hand margin of any line that is revised. Completely resubmitted Disclosure Statements must be accompanied by similar notations identifying the items which have been changed.

12. Use of this Disclosure Statement, amended February 1996, shall be phased in as follows:

A. **New Contractors.** This form shall be used by new contractors when they are initially required to disclose their cost accounting practices pursuant to 9903.202-1.

B. **Existing Contractors.** If a contractor has disclosed its cost accounting practices on a prior edition of the Disclosure Statement (CASB DS-1), such disclosure shall remain in effect until the contractor amends or revises a significant portion of the Disclosure Statement in accordance with CAS 9903.202-3. Minor amendments to an existing DS-1 may continue to be made using the prior form. However, when a substantive change is made, a complete Disclosure Statement must be filed using this form. In any event, all contractors and subcontractors must submit a new Disclosure Statement (this version of the CASB DS-1) not later than the beginning of the contractor's next full fiscal year after December 31, 1998.

ATTACHMENT - Blank Continuation Sheet

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		CONTINUATION SHEET NAME OF REPORTING UNIT
Item No.	Item description	

FORM CASB DS-1 (REV 2/96)

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	COVER SHEET AND CERTIFICATION
<p>0.1 <u>Company or Reporting Unit.</u></p> <p style="padding-left: 40px;">Name</p> <p style="padding-left: 40px;">Street Address</p> <p style="padding-left: 40px;">City, State, & Zip Code</p> <p style="padding-left: 40px;">Division or Subsidiary of (if applicable)</p> <p>0.2 <u>Reporting Unit:</u> (Mark one.)</p> <p style="padding-left: 40px;">A. <input type="checkbox"/> Business Unit comprising an entire business organization which is not divided into segments.</p> <p style="padding-left: 40px;">B.1. <input type="checkbox"/> Corporate Home Office</p> <p style="padding-left: 80px;">2. <input type="checkbox"/> Intermediate Level Home Office</p> <p style="padding-left: 80px;">3. <input type="checkbox"/> Segment or business unit reporting directly to a home office.</p> <p>0.3 <u>Official to Contact Concerning this Statement.</u></p> <p style="padding-left: 40px;">Name and Title</p> <p style="padding-left: 40px;">Phone number (including area code and extension)</p> <p>0.4 <u>Statement Type and Effective Date:</u></p> <p style="padding-left: 40px;">A. (Mark type of submission. If a revision, enter number)</p> <p style="padding-left: 80px;">(a) <input type="checkbox"/> Original Statement</p> <p style="padding-left: 80px;">(b) <input type="checkbox"/> Revised Statement; Revision No. _____</p> <p style="padding-left: 40px;">B. Effective Date of this Statement/Revision: _____</p> <p>0.5 <u>Statement Submitted To</u> (Provide office name, location and telephone number, include area code and extension):</p> <p style="padding-left: 40px;">(a) Cognizant Federal Agency: _____</p> <p style="padding-left: 40px;">(b) Cognizant Federal Auditor: _____</p>	<p style="text-align: center;">CERTIFICATION</p> <p>I certify that to the best of my knowledge and belief this Statement, as amended in the case of a revision, is the complete and accurate disclosure as of the above date by the above-named organization of its cost accounting practices, as required by the Disclosure Regulation (48 CFR 9903.202) of the Cost Accounting Standards Board under P.L. 100-679.</p> <p style="text-align: center;">_____</p> <p style="text-align: center;">(Name)</p> <p style="text-align: center;">_____</p> <p style="text-align: center;">(Title)</p> <p style="text-align: center;">THE PENALTY FOR MAKING A FALSE STATEMENT IN THIS DISCLOSURE IS PRESCRIBED IN 18 U.S.C. 1001</p>

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	PART I - GENERAL INFORMATION NAME OF REPORTING UNIT
Item No.	Item description
	<p><u>Part I Instructions</u></p> <p>Sales data for this part should cover the most recently completed fiscal year of the reporting unit. "Government CAS Covered Sales" includes sales under both prime contracts and subcontracts. "Annual CAS Covered Sales" includes intracorporate transactions.</p>
<p>1.1.0</p>	<p><u>Type of Business Entity of Which the Reporting Unit is a Part.</u> (Mark one.)</p> <p>A. <input type="checkbox"/> Corporation B. <input type="checkbox"/> Partnership C. <input type="checkbox"/> Proprietorship D. <input type="checkbox"/> Not-for-profit organization E. <input type="checkbox"/> Joint Venture F. <input type="checkbox"/> Federally Funded Research and Development Center (FFRDC) Y. <input type="checkbox"/> Other (Specify) _____</p>
<p>1.2.0</p>	<p><u>Predominant Type of Government Sales.</u> (Mark one.) <u>1/</u></p> <p>A. <input type="checkbox"/> Manufacturing B. <input type="checkbox"/> Research and Development C. <input type="checkbox"/> Construction D. <input type="checkbox"/> Services Y. <input type="checkbox"/> Other (Specify) _____</p>
<p>1.3.0</p>	<p><u>Annual CAS Covered Government Sales as Percentage of Total Sales (Government and Commercial).</u> (Mark one. An estimate is permitted for this section.) <u>1/</u></p> <p>A. <input type="checkbox"/> Less than 10% B. <input type="checkbox"/> 10%-50% C. <input type="checkbox"/> 51%-80% D. <input type="checkbox"/> 81% - 95% E. <input type="checkbox"/> Over 95%</p>
<p>1.4.0</p>	<p><u>Description of Your Cost Accounting System for Government Contracts and Subcontracts.</u> (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.) <u>1/</u></p> <p>A. <input type="checkbox"/> Standard costs - Job order B. <input type="checkbox"/> Standard costs - Process C. <input type="checkbox"/> Actual costs - Job order D. <input type="checkbox"/> Actual costs - Process Y. <input type="checkbox"/> Other(s) <u>2/</u></p>
	<p><u>1/</u> Do not complete when Part I is filed in conjunction with Part VIII. <u>2/</u> Describe on a Continuation Sheet.</p>

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	PART I - GENERAL INFORMATION
NAME OF REPORTING UNIT	
Item No.	Item description
<p>1.5.0</p> <p>1.6.0</p> <p>1.6.1</p> <p>1.6.2</p> <p>1.7.0</p> <p>1.7.1</p>	<p><u>Identification of Differences Between Contract Cost Accounting and Financial Accounting Records.</u> List on a continuation sheet, the types of costs charged to Federal contracts that are supported by memorandum records and identify the method used to reconcile with the entity's financial accounting records.</p> <p><u>Unallowable Costs.</u> Costs that are not reimbursable as allowable costs under the terms and conditions of Federal awards are identified as follows: (Mark all that apply and if more than one is marked, describe on a continuation sheet the major cost groupings, organizations, or other criteria for using each marked technique.)</p> <p>Incurred costs.</p> <p style="padding-left: 40px;">A. ____ Specifically identified and recorded separately in the formal financial accounting records.</p> <p style="padding-left: 40px;">B. ____ Identified in separately maintained accounting records or workpapers.</p> <p style="padding-left: 40px;">C. ____ Identifiable through use of less formal accounting techniques that permit audit verification.</p> <p style="padding-left: 40px;">D. ____ Determinable by other means. <u>1/</u></p> <p>Estimated costs.</p> <p style="padding-left: 40px;">A. ____ By designation and description (in backup data, workpapers, etc) which have specifically been identified and recognized in making estimates.</p> <p style="padding-left: 40px;">B. ____ By description of any other estimating technique employed to provide appropriate recognition of any unallowable amounts pertinent to the estimates.</p> <p style="padding-left: 40px;">C. ____ Other. <u>1/</u></p> <p><u>Fiscal Year:</u> _____ (Specify twelve month period used for financial accounting and reporting purposes, e.g., 1/1 to 12/31.)</p> <p><u>Cost Accounting Period:</u> _____ (Specify period. If the cost accounting period used for the accumulation and reporting of costs under Federal contracts is other than the fiscal year identified in Item 1.7.0, explain circumstances on a continuation sheet.)</p> <p><u>1/</u> Describe on a Continuation Sheet.</p>

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	PART II - DIRECT COSTS
NAME OF REPORTING UNIT	
Item No.	Item description
	<p><u>Part II Instructions</u></p> <p>This part covers the three major categories of direct costs, i.e., Direct Material, Direct Labor, and Other Direct Costs.</p> <p>It is not the intent here to spell out or define the three elements of direct costs. Rather, each contractor should disclose practices based on its own definitions of what costs are, or will be, charged directly to Federal contracts or similar cost objectives as Direct Material, Direct Labor, or Other Direct Costs. For example, a contractor may charge or classify purchased labor of a direct nature as "Direct Material" for purposes of pricing proposals, requests for progress payments, claims for cost reimbursement, etc.; some other contractor may classify the same cost as "Direct Labor," and still another as "Other Direct Costs." In these circumstances, it is expected that each contractor will disclose practices consistent with its own classifications of Direct Material, Direct Labor, and Other Direct Costs.</p> <p>2.1.0 <u>Description of Direct Material.</u> Direct material as used here is <u>not</u> limited to those items of material actually incorporated into the end product; they also include material, consumable supplies, and other costs when charged to Federal contracts or similar cost objectives as Direct Material. (Describe on a continuation sheet the principal classes or types of material and services which are charged as direct material; group the material and service costs by those which are incorporated in an end product and those which are not.)</p> <p>2.2.0 <u>Method of Charging Direct Material.</u></p> <p>2.2.1 <u>Direct Charge Not Through an Inventory Account at:</u> (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.)</p> <p style="margin-left: 40px;">A. <input type="checkbox"/> Standard costs (Describe the type of standards used.) <u>1/</u> B. <input type="checkbox"/> Actual Costs Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not applicable</p> <p>2.2.2 <u>Charged Direct from a Contractor-owned Inventory Account at:</u> (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.)</p> <p style="margin-left: 40px;">A. <input type="checkbox"/> Standard costs <u>1/</u> B. <input type="checkbox"/> Average Costs <u>1/</u> C. <input type="checkbox"/> First in, first out D. <input type="checkbox"/> Last in, first out Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not applicable</p> <p><u>1/</u> Describe on a Continuation Sheet.</p>

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	PART II - DIRECT COSTS
NAME OF REPORTING UNIT	
Item No.	Item description
<p>2.3.0</p>	<p><u>Timing of Charging Direct Material.</u> (Mark the appropriate line(s) to indicate the point in time at which direct material are charged to Federal contracts or similar cost objectives, and if more than one line is marked, explain on a continuation sheet.)</p> <p style="margin-left: 40px;"> A. <input type="checkbox"/> When orders are placed B. <input type="checkbox"/> When both the material and invoice are received C. <input type="checkbox"/> When material is issued or released to a process, batch, or similar intermediate cost objective D. <input type="checkbox"/> When material is issued or released to a final cost objective E. <input type="checkbox"/> When invoices are paid Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not applicable </p>
<p>2.4.0</p>	<p><u>Variances from Standard Costs for Direct Material.</u> (Do not complete this item unless you use a standard cost method, i.e., you have marked Line A of Item 2.2.1, or 2.2.2. Mark the appropriate line(s) in Items 2.4.1, 2.4.2, and 2.4.4, and if more than one line is marked, explain on a continuation sheet.)</p>
<p>2.4.1</p>	<p><u>Type of Variance.</u></p> <p style="margin-left: 40px;"> A. <input type="checkbox"/> Price B. <input type="checkbox"/> Usage C. <input type="checkbox"/> Combined (A and B) Y. <input type="checkbox"/> Other(s) <u>1/</u> </p>
<p>2.4.2</p>	<p><u>Level of Production Unit used to Accumulate Variance.</u> Indicate which level of production unit is used as a basis for accumulating material variances.</p> <p style="margin-left: 40px;"> A. <input type="checkbox"/> Plant-wide Basis B. <input type="checkbox"/> By Department C. <input type="checkbox"/> By Product or Product Line Y. <input type="checkbox"/> Other(s) <u>1/</u> </p>
<p>2.4.3</p>	<p><u>Method of Disposing of Variance.</u> Describe on a continuation sheet the basis for, and the frequency of, the disposition of the variance.</p>
<p>2.4.4</p>	<p><u>Revisions.</u> Standard costs for direct materials are revised:</p> <p style="margin-left: 40px;"> A. <input type="checkbox"/> Semiannually B. <input type="checkbox"/> Annually C. <input type="checkbox"/> Revised as needed, but at least once annually Y. <input type="checkbox"/> Other(s) <u>1/</u> </p>
<p><u>1/</u> Describe on a Continuation Sheet.</p>	

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2.5.0	<p><u>Method of Charging Direct Labor:</u> (Mark the appropriate line(s) for each Direct Labor Category to show how such labor is charged to Federal contracts or similar cost objectives, and if more than one line is marked, explain on a continuation sheet. Also describe on a continuation sheet the principal classes of labor rates that are, or will be applied to Manufacturing Labor, Engineering Labor, and Other Direct Labor, in order to develop direct labor costs.</p> <table style="width: 100%; margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th> <th colspan="3" style="text-align: center; border-bottom: 1px solid black;">Direct Labor Category</th> </tr> <tr> <th></th> <th style="text-align: center; border-bottom: 1px solid black;">Manufacturing</th> <th style="text-align: center; border-bottom: 1px solid black;">Engineering</th> <th style="text-align: center; border-bottom: 1px solid black;">Other Direct</th> </tr> </thead> <tbody> <tr> <td style="padding-left: 20px;">A. Individual/actual rates</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">B. Average rates -- uncompensated overtime hours included in computation <u>1/</u></td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">C. Average rates -- uncompensated overtime hours excluded from computation</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">D. Standard costs/rates <u>1/</u></td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">Y. Other(s) <u>1/</u></td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">Z. Labor category is not applicable</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> </tbody> </table>					Direct Labor Category				Manufacturing	Engineering	Other Direct	A. Individual/actual rates	_____	_____	_____	B. Average rates -- uncompensated overtime hours included in computation <u>1/</u>	_____	_____	_____	C. Average rates -- uncompensated overtime hours excluded from computation	_____	_____	_____	D. Standard costs/rates <u>1/</u>	_____	_____	_____	Y. Other(s) <u>1/</u>	_____	_____	_____	Z. Labor category is not applicable	_____	_____	_____
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2.6.0	<p><u>Variances from Standard Costs for Direct Labor.</u> (Do not complete this item unless you use a standard costs/rate method, i.e., you have marked Line D of Item 2.5.0 for any direct labor category. Mark the appropriate line(s) in each column of Items 2.6.1, 2.6.2, and 2.6.4. If more than one is marked, explain on a continuation sheet.)</p>																																			
2.6.1	<p><u>Type of Variance.</u></p> <table style="width: 100%; margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th> <th colspan="3" style="text-align: center; border-bottom: 1px solid black;">Direct Labor Category</th> </tr> <tr> <th></th> <th style="text-align: center; border-bottom: 1px solid black;">Manufacturing</th> <th style="text-align: center; border-bottom: 1px solid black;">Engineering</th> <th style="text-align: center; border-bottom: 1px solid black;">Other Direct</th> </tr> </thead> <tbody> <tr> <td style="padding-left: 20px;">A. Rate</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">B. Efficiency</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">C. Combined (A and B)</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">Y. Other(s) <u>1/</u></td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">Z. Labor category is not applicable</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> </tbody> </table>					Direct Labor Category				Manufacturing	Engineering	Other Direct	A. Rate	_____	_____	_____	B. Efficiency	_____	_____	_____	C. Combined (A and B)	_____	_____	_____	Y. Other(s) <u>1/</u>	_____	_____	_____	Z. Labor category is not applicable	_____	_____	_____				
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2.6.3	<p><u>Method of Disposing of Variance.</u> Describe on a continuation sheet the basis for, and the frequency of, the disposition of the variance.</p>																															
2.6.4	<p><u>Revisions.</u> Standard costs for direct labor are revised:</p> <p style="padding-left: 20px;">A. _____ Semiannually B. _____ Annually C. _____ Revised as needed, but at least once annually Y. _____ Other(s) <u>1/</u></p>																															
2.7.0	<p><u>Description of Other Direct Costs.</u> Other significant items of cost directly identified with Federal contracts or other final cost objectives. Describe on a continuation sheet the principal classes of other costs that are always charged directly, that is, identified specifically with final cost objectives, e.g., fringe benefits, travel costs, services, subcontracts, etc.</p>																															
2.7.1	<p>When Employee Travel Expenses for lodging and subsistence are charged direct to Federal contracts or similar cost objectives the charge is based on:</p> <p style="padding-left: 20px;">A. _____ Actual Costs B. _____ Per Diem Rates C. _____ Lodging at actual costs and subsistence at per diem Y. _____ Other Method <u>1/</u> Z. _____ Not Applicable</p>																															
2.8.0	<p><u>Credits to Contract Costs.</u> When Federal contracts or similar cost objectives are credited for the following circumstances, are the rates of direct labor, direct materials, other direct costs and applicable indirect costs always the same as those for the original charges? (Mark one line for each circumstance, and for each "No" answer, explain on a continuation sheet how the credit differs from the original charge.)</p> <table style="margin-left: auto; margin-right: auto; border-collapse: collapse;"> <thead> <tr> <th style="border-bottom: 1px solid black; text-align: left;">Circumstance</th> <th style="border-bottom: 1px solid black; text-align: center;">A. Yes</th> <th style="border-bottom: 1px solid black; text-align: center;">B. No</th> <th style="border-bottom: 1px solid black; text-align: center;">Z. Not Applicable</th> </tr> </thead> <tbody> <tr> <td style="padding-left: 20px;">(a) Transfers to other jobs/contracts</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">(b) Unused or excess materials remaining upon completion of contract</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> </tbody> </table> <p><u>1/</u> Describe on a Continuation Sheet.</p>				Circumstance	A. Yes	B. No	Z. Not Applicable	(a) Transfers to other jobs/contracts	_____	_____	_____	(b) Unused or excess materials remaining upon completion of contract	_____	_____	_____																
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART III - DIRECT VS. INDIRECT COSTS	
		NAME OF REPORTING UNIT	
Item No.	Item description		
3.1.0	<u>Criteria for Determining How Costs are Charged to Federal Contracts Or Similar Cost Objectives.</u> Describe on a continuation sheet your criteria for determining when costs incurred for the same purpose, in like circumstances, are treated either as direct costs only or as indirect costs only with respect to final cost objectives.		
3.2.0	<u>Treatment of Costs of Specified Functions, Elements of Cost, or Transactions.</u> (For each of the functions, elements of cost or transactions listed in Items 3.2.1, 3.2.2, and 3.2.3, enter one of the Codes A through F, or Y, to indicate how the item is treated. Enter Code Z in those lines that are not applicable to you. Also, specify the name(s) of the indirect pool(s) (as listed in 4.1.0, 4.2.0 and 4.3.0) for each function, element of cost, or transaction coded E or F. If Code E, Sometimes direct/Sometimes indirect, is used, explain on a continuation sheet the circumstances under which both direct and indirect allocations are made.)		
	<u>Treatment Code</u>		
	A. Direct material B. Direct labor C. Direct material and labor D. Other direct costs	E. Sometimes direct/Sometimes indirect F. Indirect only Y. Other(s) <u>1/</u> Z. Not applicable	
3.2.1	<u>Functions, Elements of Cost, or Transactions Related to Direct Material</u>		
		<u>Treatment Code</u>	<u>Name of Pool(s)</u>
	(a) Cash Discounts on Purchases	_____	_____
	(b) Freight in	_____	_____
	(c) Income from Sale of Scrap	_____	_____
	(d) Income from Sale of Salvage	_____	_____
	(e) Incoming Material Inspection (receiving)	_____	_____
	(f) Inventory adjustment	_____	_____
	(g) Purchasing	_____	_____
	(h) Trade Discounts, Refunds, Rebates, and Allowances on Purchases	_____	_____
	<u>1/</u> Describe on a Continuation Sheet.		

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679</p>		<p align="center">PART III - DIRECT VS. INDIRECT COSTS</p>																																								
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<p>3.2.2</p>	<table border="0"> <tr> <td data-bbox="251 573 885 640"> <p>Functions, Elements of Cost, <u>or Transactions Related to</u> <u>Direct Labor</u></p> </td> <td data-bbox="885 573 1079 640"> <p align="center">Treatment Code</p> </td> <td data-bbox="1079 573 1469 640"> <p align="center"><u>Name of Pool(s)</u></p> </td> </tr> <tr> <td data-bbox="251 703 885 745"> <p>(a) Incentive Compensation</p> </td> <td data-bbox="885 703 1079 745"> <p align="center">_____</p> </td> <td data-bbox="1079 703 1469 745"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 766 885 808"> <p>(b) Holiday Differential (Premium Pay)</p> </td> <td data-bbox="885 766 1079 808"> <p align="center">_____</p> </td> <td data-bbox="1079 766 1469 808"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 829 885 871"> <p>(c) Vacation Pay</p> </td> <td data-bbox="885 829 1079 871"> <p align="center">_____</p> </td> <td data-bbox="1079 829 1469 871"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 892 885 934"> <p>(d) Overtime Premium Pay</p> </td> <td data-bbox="885 892 1079 934"> <p align="center">_____</p> </td> <td data-bbox="1079 892 1469 934"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 955 885 997"> <p>(e) Shift Premium Pay</p> </td> <td data-bbox="885 955 1079 997"> <p align="center">_____</p> </td> <td data-bbox="1079 955 1469 997"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 1018 885 1060"> <p>(f) Pension Costs</p> </td> <td data-bbox="885 1018 1079 1060"> <p align="center">_____</p> </td> <td data-bbox="1079 1018 1469 1060"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 1081 885 1144"> <p>(g) Post Retirement Benefits Other Than Pensions</p> </td> <td data-bbox="885 1081 1079 1144"> <p align="center">_____</p> </td> <td data-bbox="1079 1081 1469 1144"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 1165 885 1207"> <p>(h) Health Insurance</p> </td> <td data-bbox="885 1165 1079 1207"> <p align="center">_____</p> </td> <td data-bbox="1079 1165 1469 1207"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 1228 885 1270"> <p>(i) Life Insurance</p> </td> <td data-bbox="885 1228 1079 1270"> <p align="center">_____</p> </td> <td data-bbox="1079 1228 1469 1270"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 1291 885 1333"> <p>(j) Other Deferred Compensation <u>1/</u></p> </td> <td data-bbox="885 1291 1079 1333"> <p align="center">_____</p> </td> <td data-bbox="1079 1291 1469 1333"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 1354 885 1396"> <p>(k) Training</p> </td> <td data-bbox="885 1354 1079 1396"> <p align="center">_____</p> </td> <td data-bbox="1079 1354 1469 1396"> <p align="center">_____</p> </td> </tr> <tr> <td data-bbox="251 1417 885 1459"> <p>(l) Sick Leave</p> </td> <td data-bbox="885 1417 1079 1459"> <p align="center">_____</p> </td> <td data-bbox="1079 1417 1469 1459"> <p align="center">_____</p> </td> </tr> </table>			<p>Functions, Elements of Cost, <u>or Transactions Related to</u> <u>Direct Labor</u></p>	<p align="center">Treatment Code</p>	<p align="center"><u>Name of Pool(s)</u></p>	<p>(a) Incentive Compensation</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(b) Holiday Differential (Premium Pay)</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(c) Vacation Pay</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(d) Overtime Premium Pay</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(e) Shift Premium Pay</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(f) Pension Costs</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(g) Post Retirement Benefits Other Than Pensions</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(h) Health Insurance</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(i) Life Insurance</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(j) Other Deferred Compensation <u>1/</u></p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(k) Training</p>	<p align="center">_____</p>	<p align="center">_____</p>	<p>(l) Sick Leave</p>	<p align="center">_____</p>	<p align="center">_____</p>
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART III - DIRECT VS. INDIRECT COSTS	
		NAME OF REPORTING UNIT	
Item No.	Item description		
3.2.3	<u>Functions, Elements of Cost, or Transactions - Miscellaneous</u>	<u>Treatment Code</u>	<u>Name of Pool(s)</u>
	(a) Design Engineering (in-house)	_____	_____
	(b) Drafting (in-house)	_____	_____
	(c) Computer Operations (in-house)	_____	_____
	(d) Contract Administration	_____	_____
	(e) Subcontract Administration Costs	_____	_____
	(f) Freight Out (finished product)	_____	_____
	(g) Line (or production) Inspection	_____	_____
	(h) Packaging and Preservation	_____	_____
	(i) Preproduction Costs and Startup Costs	_____	_____
	(j) Departmental Supervision	_____	_____
	(k) Professional Services (consultant fees)	_____	_____
	(l) Purchased Labor of Direct Nature (on premises)	_____	_____
	(m) Purchased Labor of Direct Nature (off premises)	_____	_____
	(n) Rearrangement Costs	_____	_____
	(o) Rework Costs	_____	_____
	(p) Royalties	_____	_____
	(q) Scrap Work	_____	_____
	(r) Special Test Equipment	_____	_____
	(s) Special Tooling	_____	_____
	(t) Warranty Costs	_____	_____
	(u) Rental Costs	_____	_____
	(v) Travel and Subsistence	_____	_____
	(w) Employee Severance Pay	_____	_____
	(x) Security Guards	_____	_____

<p>COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679</p>	<p>PART IV - INDIRECT COSTS</p>		
<p>NAME OF REPORTING UNIT</p>			
<p>Item No.</p>	<p>Item description</p>		
<p><u>Part IV Instructions</u></p> <p>For the purpose of this part, indirect costs have been divided into three categories: (i) manufacturing, engineering, and comparable indirect costs, (ii) general and administrative (G&A) expenses, and (iii) service center and expense pool costs, as defined in Item 4.3.0. The term "overhead," as used in this part, refers only to the first category of indirect costs.</p> <p>The following Allocation Base Codes are provided for use in connection with Items 4.1.0, 4.2.0 and 4.3.0.</p> <table style="width: 100%; border: none;"> <tr> <td style="width: 50%; vertical-align: top;"> <p>A. Sales</p> <p>B. Cost of sales</p> <p>C. Total Cost input (direct material, direct labor, other direct costs and applicable overhead)</p> <p>D. Value-added cost input (total cost input less direct material and subcontract costs)</p> <p>E. Total cost incurred (total cost input plus G&A expenses)</p> <p>F. Prime cost (direct material, direct labor and other direct cost)</p> <p>G. Processing or conversion cost (direct labor and applicable overhead)</p> </td> <td style="width: 50%; vertical-align: top;"> <p>H. Direct labor dollars</p> <p>I. Direct labor hours</p> <p>J. Machine hours</p> <p>K. Usage</p> <p>L. Unit of production</p> <p>M. Direct material cost</p> <p>N. Total payroll dollars (direct and indirect employees)</p> <p>O. Headcount or number of employees (direct and indirect employees)</p> <p>P. Square feet</p> <p>Y. Other(s), or more than one basis (Describe on a continuation sheet.)</p> <p>Z. Pool not applicable</p> </td> </tr> </table>		<p>A. Sales</p> <p>B. Cost of sales</p> <p>C. Total Cost input (direct material, direct labor, other direct costs and applicable overhead)</p> <p>D. Value-added cost input (total cost input less direct material and subcontract costs)</p> <p>E. Total cost incurred (total cost input plus G&A expenses)</p> <p>F. Prime cost (direct material, direct labor and other direct cost)</p> <p>G. Processing or conversion cost (direct labor and applicable overhead)</p>	<p>H. Direct labor dollars</p> <p>I. Direct labor hours</p> <p>J. Machine hours</p> <p>K. Usage</p> <p>L. Unit of production</p> <p>M. Direct material cost</p> <p>N. Total payroll dollars (direct and indirect employees)</p> <p>O. Headcount or number of employees (direct and indirect employees)</p> <p>P. Square feet</p> <p>Y. Other(s), or more than one basis (Describe on a continuation sheet.)</p> <p>Z. Pool not applicable</p>
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<p>4.1.0</p>	<p><u>Overhead Pools.</u> List all the overhead pools, i.e., pools of indirect costs, other than general and administrative (G&A) expenses, that are allocated to final cost objectives without any intermediate allocations. A segment or business unit may have only a single pool encompassing all of its overhead costs or alternatively it may have several pools such as manufacturing overhead, engineering overhead, material handling overhead, etc. For each pool listed indicate the base used for allocating such pooled expenses to Federal contracts or similar cost objectives. Also, for each of the pools indicate (a) the major functions, activities, and elements of cost included, and (b) the make up of the allocation base. Use a continuation sheet if additional space is required.</p> <p style="text-align: right; margin-right: 100px;"><u>Allocation Base Code</u></p> <p>1. _____</p> <p style="margin-left: 40px;">(a) Major functions, activities, and elements of cost included:</p> <p style="margin-left: 80px;">_____</p> <p style="margin-left: 80px;">_____</p> <p style="margin-left: 40px;">(b) Description/Make up of the allocation base:</p> <p style="margin-left: 80px;">_____</p> <p style="margin-left: 80px;">_____</p>		

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART IV - INDIRECT COSTS
		NAME OF REPORTING UNIT
Item No.	Item description	
4.1.0	Continued.	
	<u>Allocation Base Code</u>	<hr style="width: 50px; margin: 0 auto;"/>
	2. _____	
	(a) Major functions, activities, and elements of cost included:	
	_____ _____	
	(b) Description/Make up of the allocation base:	
	_____ _____	
4.2.0	<u>General and Administrative (G&A) Expense Pool(s).</u> Select among the three categories of pools below that describe(s) the manner in which G&A expenses are allocated. For each category of pool(s) selected indicate the base(s) used for allocating such pooled expenses to Federal contracts or similar cost objectives. Also, for each category of pool(s) selected, indicate (a) the major functions, activities, and elements of cost included, and (b) the make up of the allocation base(s). For example, if direct labor dollars are used, are fringe benefits included? If a total cost input base is used, is the imputed cost of capital included? Use a continuation sheet if additional space is required.	
	<u>Allocation Base Code</u>	<hr style="width: 50px; margin: 0 auto;"/>
	<u>Single Pool Containing G&A Expenses Only</u>	

	(a) Major functions, activities, and elements of cost included:	
	_____ _____	
	(b) Description/Make up of the allocation base:	
	_____ _____	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART IV - INDIRECT COSTS
		NAME OF REPORTING UNIT
Item No.	Item description	
4.2.0	Continued.	
	<u>Single Pool Containing Both G&A and Non-G&A Expenses</u>	<u>Allocation Base Code</u>
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>
	(a) Major functions, activities, and elements of cost included:	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	(b) Description/Make up of the allocation base:	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	<u>Special Allocations</u>	<u>Allocation Base Code</u>
	1. <hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>
	(a) Major functions, activities, and elements of cost included:	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	(b) Description/Make up of the allocation base:	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	2. <hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>
	(a) Major functions, activities, and elements of cost included:	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
	(b) Description/Make up of the allocation base:	
	<hr style="border: 0; border-top: 1px solid black; margin: 5px 0;"/>	
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART IV - INDIRECT COSTS																																																																
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4.3.0	<p><u>Service Center and Expense Pool Allocation Bases.</u></p> <p>Service centers are departments or other functional units which perform specific technical and/or administrative services primarily for the benefit of other units within a reporting unit. Expense pools are pools of indirect costs that are allocated primarily to other units within a reporting unit. Examples of service centers are data processing centers, reproduction services and communications services. Examples of expense pools are use and occupancy pools and fringe benefit pools.</p> <p style="text-align: center;"><u>Category Code</u></p> <p>Generally, costs incurred by such centers or pools are, or can be, charged or allocated (i) partially to specific final cost objectives as direct costs and partially to other indirect cost pools (such as a manufacturing overhead pool) for subsequent reallocation to several final cost objectives, referred to herein as Category "A", and (ii) only to several other indirect cost pools (such as a manufacturing overhead pool, engineering overhead pool and G&A expense pool) for subsequent reallocation to several final cost objectives, referred to herein as Category "B".</p> <p style="text-align: center;"><u>Rate Code</u></p> <p>Some service centers or expense pools may use predetermined billing or costing rates to charge or allocate the costs (Rate Code A) while others may charge or allocate on an actual basis (Rate Code B).</p> <p>List all the service centers and expense pools and enter in column (1) Code A or B to indicate the category of pool. Enter in Column (2) one of the Allocation Base Codes A through P, or Y, listed on Page ____, to indicate the base used for charging or allocating service center or expense pool costs. Enter in Column (3) Rate Code A or B to describe the costing method used. Also, for each of the centers and pools indicate (a) the major functions, activities, and elements of cost included, and (b) the make up of the allocation base. Use a continuation sheet if additional space is required.</p> <table style="width: 100%; margin-top: 20px;"> <thead> <tr> <th style="width: 70%;"></th> <th style="width: 10%; text-align: center;">Alloca- tion</th> <th style="width: 10%;"></th> <th style="width: 10%;"></th> </tr> <tr> <th style="text-align: center;">Service Center or Expense Pool</th> <th style="text-align: center;">Category Code</th> <th style="text-align: center;">Base Code</th> <th style="text-align: center;">Rate Code</th> </tr> <tr> <th style="text-align: center;">(1)</th> <th style="text-align: center;">(2)</th> <th style="text-align: center;">(3)</th> <th style="text-align: center;">(3)</th> </tr> </thead> <tbody> <tr> <td style="padding: 5px;">1. _____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding: 5px;">(a) Major functions, activities, and elements of cost included:</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">_____</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">(b) Description/Make up of the allocation base:</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">_____</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">_____</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">2. _____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding: 5px;">(a) Major functions, activities, and elements of cost included:</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">_____</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">_____</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">(b) Description/Make up of the allocation base:</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">_____</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;">_____</td> <td></td> <td></td> <td></td> </tr> </tbody> </table>			Alloca- tion			Service Center or Expense Pool	Category Code	Base Code	Rate Code	(1)	(2)	(3)	(3)	1. _____	_____	_____	_____	(a) Major functions, activities, and elements of cost included:				_____				(b) Description/Make up of the allocation base:				_____				_____				2. _____	_____	_____	_____	(a) Major functions, activities, and elements of cost included:				_____				_____				(b) Description/Make up of the allocation base:				_____				_____			
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	PART IV - INDIRECT COSTS																				
	NAME OF REPORTING UNIT																				
Item No.	Item description																				
4.4.0	<p><u>Treatment of Variances from Actual Cost (Underabsorption or Overabsorption).</u> Where predetermined billing or costing rates are used to charge costs of service centers and expense pools to Federal contracts or other indirect cost pools (Rate Code A in Column (3) of Item 4.3.0), variances from actual costs are: (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.)</p> <p>A. <input type="checkbox"/> Prorated to users on the basis of charges made, at least once annually B. <input type="checkbox"/> All charged or credited to indirect cost pool(s) at least once annually Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Service center is not applicable to reporting unit</p>																				
4.5.0	<p><u>Application of Overhead and G&A Rates to Specified Transactions or Costs.</u></p> <p>This item is directed to ascertaining your practice in special situations where, in lieu of establishing a separate indirect cost pool, allocation is made from an established overhead or G&A pool at a rate other than the normal full rate for that pool. In the case of such a special allocation, the terms "less than full rate" or "more than full rate" should be used to describe the practice. The terms do <u>not</u> apply to situations where, as in some cases of off-site activities, etc., a separate indirect cost pool and base are used and the rate for such activities is lower than the "in-house" rate.</p> <p>For each of the transactions or costs listed below, enter one of the following codes to indicate your indirect cost allocation practice with respect to that transaction or cost. If Code A, full rate, is entered, identify on a continuation sheet the pool(s) reported under items 4.1.0, 4.2.0, and 4.3.0, which are applicable. If Codes B or C, less than or more than the full rate, is entered, describe on a continuation sheet the major types of expenses that are covered by such a rate.</p> <p style="text-align: center;"><u>Rate Code</u></p> <p>A. Full rate B. Special allocation at less than full rate C. Special allocation at more than full rate D. No overhead or G&A is applied Z. Transaction or cost is not applicable to reporting unit</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left; border-bottom: 1px solid black;"><u>Transaction or Cost to Which Indirect Costs May be Allocated</u></th> <th style="text-align: center; border-bottom: 1px solid black;"><u>Rate Code</u></th> </tr> </thead> <tbody> <tr> <td>(a) Subcontract costs</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(b) Purchased Labor</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(c) Government-furnished materials</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(d) Self-constructed depreciable assets</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(e) Labor on installation of assets</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(f) Off-site work</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(g) Interorganizational transfers out</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(h) Interorganizational transfers in (Also indicate on a continuation sheet the basis used by you as transferee to charge the cost or price of interorganizational transfers to Federal contracts or similar cost objectives. If the charge is based on cost, indicate whether the transferor's G&A expenses are included.)</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(i) Other transactions or costs (Enter Code B or C on this line if there are other transactions or costs to which either less than full rate or more than full rate is applied. List such transactions or costs on a continuation sheet, and for each describe the major types of expenses covered by such a rate. If there are no other such transactions or costs, enter code Z.)</td> <td style="text-align: center;">_____</td> </tr> </tbody> </table> <p><u>1/</u> Describe on a Continuation Sheet.</p>	<u>Transaction or Cost to Which Indirect Costs May be Allocated</u>	<u>Rate Code</u>	(a) Subcontract costs	_____	(b) Purchased Labor	_____	(c) Government-furnished materials	_____	(d) Self-constructed depreciable assets	_____	(e) Labor on installation of assets	_____	(f) Off-site work	_____	(g) Interorganizational transfers out	_____	(h) Interorganizational transfers in (Also indicate on a continuation sheet the basis used by you as transferee to charge the cost or price of interorganizational transfers to Federal contracts or similar cost objectives. If the charge is based on cost, indicate whether the transferor's G&A expenses are included.)	_____	(i) Other transactions or costs (Enter Code B or C on this line if there are other transactions or costs to which either less than full rate or more than full rate is applied. List such transactions or costs on a continuation sheet, and for each describe the major types of expenses covered by such a rate. If there are no other such transactions or costs, enter code Z.)	_____
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART IV - INDIRECT COSTS
		NAME OF REPORTING UNIT
Item No.	Item description	
4.6.0	<p><u>Independent Research and Development (IR&D) and Bid and Proposal (B&P) Costs.</u> Definitions of and requirements for the allocation of IR&D and B&P costs are contained in 48 CFR 9904.420. The full rate of all allocable manufacturing, engineering, and/or other overhead is applied to IR&D and B&P costs as if IR&D and B&P projects were under contract, and the "burdened" IR&D and B&P costs are: (Mark appropriate line(s))</p> <p style="margin-left: 40px;">A. <input type="checkbox"/> Allocated to Federal contracts or similar cost objectives by means of a composite pool with G&A expenses.</p> <p style="margin-left: 40px;">B. <input type="checkbox"/> Allocated to Federal contracts or similar cost objectives by means of a separate pool.</p> <p style="margin-left: 40px;">C. <input type="checkbox"/> Transferred to the corporate or home office level for reallocation to the benefiting segments.</p> <p style="margin-left: 40px;">Y. <input type="checkbox"/> Other <u>1/</u></p> <p style="margin-left: 40px;">Z. <input type="checkbox"/> Not applicable</p>	
4.7.0	<p><u>Cost of Capital Committed to Facilities.</u> In accordance with instructions for Form CASB-CMF, undistributed facilities capital items are allocated to overhead and G&A expense pools: (Mark one.)</p> <p style="margin-left: 40px;">A. <input type="checkbox"/> On a basis identical to that used to absorb the actual depreciation or amortization from these facilities; <u>land is assigned in the same manner as the facilities to which it relates.</u></p> <p style="margin-left: 40px;">B. <input type="checkbox"/> On a basis not identical to that used to absorb the actual depreciation or amortization from these facilities. (Describe on a continuation sheet the difference for each step of the allocation process.)</p> <p style="margin-left: 40px;">C. <input type="checkbox"/> By the "alternative allocation process" described in instructions for Form CASB-CMF.</p> <p style="margin-left: 40px;">Z. <input type="checkbox"/> Not applicable.</p>	
<p><u>1/</u> Describe on a Continuation Sheet.</p>		

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART V - DEPRECIATION AND CAPITALIZATION PRACTICES				
		NAME OF REPORTING UNIT				
Item No.	Item description					
5.1.0	<p style="text-align: center;"><u>Part V Instructions</u></p> <p>Where a home office either establishes practices or procedures for the types of costs covered in this Part or incurs and then allocates these costs to its segments, the home office may complete this Part to be included in the submission by the segment as indicated on page (i) 4., <u>General Instructions</u>.</p> <p><u>Depreciating Tangible Assets for Government Contract Costing.</u> (For each of the asset categories listed on Page ____, enter a code from A through H in Column (1) describing the method of depreciation (Code F for assets that are expensed); a code from A through C in Column (2) describing the basis for determining useful life; a code from A through C in Column (3) describing how depreciation methods or use charges are applied to property units; and a Code A, B or C in Column (4) indicating whether or not residual value is deducted from the total cost of depreciable assets. Enter Code Y in each column of an asset category where another or more than one method applies. Enter Code Z in Column (1) only, if an asset category is not applicable.)</p> <table style="width: 100%; border: none;"> <tr> <td style="width: 50%; vertical-align: top;"> <p style="text-align: center;"><u>Column (1)--Depreciation Method Code</u></p> <ul style="list-style-type: none"> A. Straight Line B. Declining balance C. Sum-of-the years digits D. Machine hours E. Unit of production F. Expensed at acquisition G. Use charge H. Method of depreciation used under the applicable Internal Revenue Procedures Y. Other or more than one method <u>1/</u> Z. Asset category is not applicable </td> <td style="width: 50%; vertical-align: top;"> <p style="text-align: center;"><u>Column (2)--Useful Life Code</u></p> <ul style="list-style-type: none"> A. Replacement experience adjusted by expected changes in periods of usefulness B. Term of Lease C. Estimated on the basis of Asset Guidelines under Internal Revenue Procedures Y. Other, or more than one method <u>1/</u> </td> </tr> <tr> <td style="vertical-align: top;"> <p style="text-align: center;"><u>Column (3)--Property Units Code</u></p> <ul style="list-style-type: none"> A. Individual units are accounted for separately B. Applied to groups of assets with similar service lives C. Applied to groups of assets with varying service lives Y. Other or more than one method <u>1/</u> </td> <td style="vertical-align: top;"> <p style="text-align: center;"><u>Column (4)--Residual Value Code</u></p> <ul style="list-style-type: none"> A. Residual value is estimated and deducted B. Residual value is covered by the depreciation method (e.g., declining balance) C. Residual value is estimated but not deducted in accordance with the provisions of 48 CFR 9904.409 <u>1/</u> Y. Other or more than one method <u>1/</u> </td> </tr> </table> <p><u>1/</u> Describe on a Continuation Sheet.</p>		<p style="text-align: center;"><u>Column (1)--Depreciation Method Code</u></p> <ul style="list-style-type: none"> A. Straight Line B. Declining balance C. Sum-of-the years digits D. Machine hours E. Unit of production F. Expensed at acquisition G. Use charge H. Method of depreciation used under the applicable Internal Revenue Procedures Y. Other or more than one method <u>1/</u> Z. Asset category is not applicable 	<p style="text-align: center;"><u>Column (2)--Useful Life Code</u></p> <ul style="list-style-type: none"> A. Replacement experience adjusted by expected changes in periods of usefulness B. Term of Lease C. Estimated on the basis of Asset Guidelines under Internal Revenue Procedures Y. Other, or more than one method <u>1/</u> 	<p style="text-align: center;"><u>Column (3)--Property Units Code</u></p> <ul style="list-style-type: none"> A. Individual units are accounted for separately B. Applied to groups of assets with similar service lives C. Applied to groups of assets with varying service lives Y. Other or more than one method <u>1/</u> 	<p style="text-align: center;"><u>Column (4)--Residual Value Code</u></p> <ul style="list-style-type: none"> A. Residual value is estimated and deducted B. Residual value is covered by the depreciation method (e.g., declining balance) C. Residual value is estimated but not deducted in accordance with the provisions of 48 CFR 9904.409 <u>1/</u> Y. Other or more than one method <u>1/</u>
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART V - DEPRECIATION AND CAPITALIZATION PRACTICES				
Item No.		Item description				
5.1.0	Continued.		Depreciation Method Code (1)	Useful Life Code (2)	Property Units Code (3)	Residual Value Code (4)
	<u>Asset Category</u>					
	(a) Land improvements	_____	_____	_____	_____	_____
	(b) Building	_____	_____	_____	_____	_____
	(c) Building improvements	_____	_____	_____	_____	_____
	(d) Leasehold improvements	_____	_____	_____	_____	_____
	(e) Machinery and equipment	_____	_____	_____	_____	_____
	(f) Furniture and fixtures	_____	_____	_____	_____	_____
	(g) Automobiles and trucks	_____	_____	_____	_____	_____
	(h) Data processing equipment	_____	_____	_____	_____	_____
	(i) Programming/reprogramming costs	_____	_____	_____	_____	_____
	(j) Patterns and dies	_____	_____	_____	_____	_____
	(k) Tools	_____	_____	_____	_____	_____
	(l) Other depreciable asset categories (Enter Code Y on this line if other asset categories are used and enumerate on a continuation sheet each such asset category and the applicable codes. Otherwise enter Code Z.)	_____	_____	_____	_____	_____
5.2.0	<u>Depreciation Practices for Costing, Financial Accounting, and Income Tax.</u> Are depreciation practices the same for costing Federal contracts as for financial accounting and income tax? (Mark either (A) or (B) on each line under Financial Accounting and Income Tax. Not-for-profit organizations need not complete this item.)					
	<u>Financial Accounting</u>	A. <u>Yes</u>	B. <u>No</u>			
	(a) Methods	_____	_____			
	(b) Useful lives	_____	_____			
	(c) Property units	_____	_____			
	(d) Residual values	_____	_____			
	<u>Income Tax</u>	A. <u>Yes</u>	B. <u>No</u>			
	(e) Methods	_____	_____			
	(f) Useful lives	_____	_____			
	(g) Property units	_____	_____			
	(h) Residual values	_____	_____			

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART V - DEPRECIATION AND CAPITALIZATION PRACTICES																		
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Item No.	Item description																			
5.3.0	<p><u>Fully Depreciated Assets.</u> Is a usage charge for fully depreciated assets charged to Federal contracts? (Mark one.)</p> <p style="margin-left: 40px;">A. <input type="checkbox"/> Yes <u>1/</u></p> <p style="margin-left: 40px;">B. <input type="checkbox"/> No</p> <p style="margin-left: 40px;">Z. <input type="checkbox"/> Not applicable</p>																			
5.4.0	<p><u>Treatment of Gains and Losses on Disposition of Depreciable Property.</u> Gains and losses are: (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.)</p> <p style="margin-left: 40px;">A. <input type="checkbox"/> Credited or charged currently to the same overhead or G&A pools to which the depreciation of the assets was charged</p> <p style="margin-left: 40px;">B. <input type="checkbox"/> Taken into consideration in the depreciation cost basis of the new items, where trade-in is involved</p> <p style="margin-left: 40px;">C. <input type="checkbox"/> Not accounted for separately, but reflected in the depreciation reserve account</p> <p style="margin-left: 40px;">Y. <input type="checkbox"/> Other(s) <u>1/</u></p> <p style="margin-left: 40px;">Z. <input type="checkbox"/> Not applicable</p>																			
5.5.0	<p><u>Capitalization or Expensing of Specified Costs.</u> (Mark one line on each item to indicate your practices regarding capitalization or expensing of specified costs incurred in connection with capital assets. If the same specified cost is sometimes expensed and sometimes capitalized, mark both lines and describe on a continuation sheet the circumstances when each method is used.)</p> <table style="width: 100%; margin-left: 40px;"> <thead> <tr> <th style="text-align: left;"><u>Cost</u></th> <th style="text-align: center;">A. <u>Expensed</u></th> <th style="text-align: center;">B. <u>Capitalized</u></th> </tr> </thead> <tbody> <tr> <td>(a) Freight-in</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(b) Sales taxes</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(c) Excise taxes</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(d) Architect-engineer fees</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>(e) Overhauls (extraordinary repairs)</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> </tbody> </table>		<u>Cost</u>	A. <u>Expensed</u>	B. <u>Capitalized</u>	(a) Freight-in	_____	_____	(b) Sales taxes	_____	_____	(c) Excise taxes	_____	_____	(d) Architect-engineer fees	_____	_____	(e) Overhauls (extraordinary repairs)	_____	_____
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART V - DEPRECIATION AND CAPITALIZATION PRACTICES
		NAME OF REPORTING UNIT
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5.6.0	<p><u>Criteria for Capitalization.</u> Enter (a) the minimum dollar amount of acquisition cost or expenditures for addition, alteration and improvement of depreciable assets capitalized, and (b) the minimum number of expected life years of capitalized assets.</p> <p style="margin-left: 40px;">If more than one dollar amount or number applies, show the information for the majority of your depreciable assets, and enumerate on a continuation sheet the dollar amounts and/or number of years for each category or subcategory of assets involved which differ from those for the majority of assets.</p> <p style="margin-left: 80px;">(a) Minimum dollar amount capitalized _____</p> <p style="margin-left: 80px;">(b) Minimum service life years _____</p>	
5.7.0	<p><u>Group or Mass Purchase.</u> Are group or mass purchases (original complement) of low cost equipment, which individually are less than the capitalization amount indicated above, capitalized? (Mark one. If <u>Yes</u> is marked, provide the minimum aggregate dollar amount capitalized.)</p> <p style="margin-left: 40px;">A. ___ Yes</p> <p style="margin-left: 80px;">_____ Minimum aggregate dollar amount capitalized</p> <p style="margin-left: 40px;">B. ___ No</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VI - OTHER COSTS AND CREDITS																				
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<u>Part VI Instructions</u>																						
Where a home office either establishes practices or procedures for the types of costs covered in this Part or incurs and then allocates these costs to its segments, the home office may complete this Part to be included in the submission by the segment as indicated on page (ii) 4., <u>General Instructions</u> .																						
6.1.0	<u>Method of Charging and Crediting Vacation, Holiday, and Sick Pay.</u> (Mark the appropriate line(s) in each column of Items 6.1.1, 6.1.2, 6.1.3 and 6.1.4 to indicate the method used to charge, or credit any unused or unpaid vacation, holiday, or sick pay. If more than one method is marked, explain on a continuation sheet.)																					
6.1.1	Charges for Vacation Pay	<table style="margin-left: auto; margin-right: auto;"> <tr> <td></td> <td colspan="2" style="text-align: center; border-bottom: 1px solid black;">Salaried</td> </tr> <tr> <td></td> <td style="text-align: center;">Non-</td> <td></td> </tr> <tr> <td></td> <td style="text-align: center;">Hourly</td> <td style="text-align: center;">Exempt 1/</td> </tr> <tr> <td></td> <td style="text-align: center;">(1)</td> <td style="text-align: center;">(2)</td> </tr> <tr> <td></td> <td></td> <td style="text-align: center;">Exempt 1/</td> </tr> <tr> <td></td> <td></td> <td style="text-align: center;">(3)</td> </tr> </table>		Salaried			Non-			Hourly	Exempt 1/		(1)	(2)			Exempt 1/			(3)	A. When Accrued (earned)	_____
	Salaried																					
	Non-																					
	Hourly	Exempt 1/																				
	(1)	(2)																				
		Exempt 1/																				
		(3)																				
	B. When Taken	_____	Y. Other(s) <u>2/</u>	_____																		
6.1.2	Charges for Holiday Pay	A. When Accrued (earned)	_____	B. When Taken	_____																	
		Y. Other(s) <u>2/</u>	_____	_____	_____																	
6.1.3	Charges for Sick Pay	A. When Accrued (earned)	_____	B. When Taken	_____																	
		Y. Other(s) <u>2/</u>	_____	_____	_____																	
6.1.4	Credits for Unused or Unpaid Vacation, Holiday, or Sick Pay	A. Credited to Accounts Originally charged at Least Once Annually	_____	B. Credited to Indirect Cost Pools at Least Once Annually	_____																	
		C. Carried Over to Future Cost Accounting Periods <u>2/</u>	_____	Y. Other(s) <u>2/</u>	_____																	
		Z. Not Applicable	_____	_____	_____																	
<u>1/</u> For the definition of Non-exempt and Exempt salaries, see the Fair Labor Standards Act, 29 U.S.C. 206. <u>2/</u> Describe on a Continuation Sheet.																						

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VI - OTHER COSTS AND CREDITS
		NAME OF REPORTING UNIT
Item No.	Item description	
6.2.0	<p><u>Supplemental Unemployment (Extended Layoff) Benefit Plans.</u> Costs of such plans are charged to Federal contracts: (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.)</p> <p style="margin-left: 40px;"> A. <input type="checkbox"/> When actual payments are made directly to employees B. <input type="checkbox"/> When accrued (book accrual or funds set aside but no trust fund involved) C. <input type="checkbox"/> When contributions are made to a nonforfeitable trust fund D. <input type="checkbox"/> Not charged Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not applicable </p>	
6.3.0	<p><u>Severance Pay and Early Retirement.</u> Costs of normal turnover severance pay and early retirement incentive plans, as defined in FAR 31.2 or other pertinent procurement regulations, which are charged directly or indirectly to Federal contracts, are based on: (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.)</p> <p style="margin-left: 40px;"> A. <input type="checkbox"/> Actual payments made B. <input type="checkbox"/> Accrued amounts on the basis of past experience C. <input type="checkbox"/> Not charged Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not applicable </p>	
6.4.0	<p><u>Incidental Receipts.</u> (Mark the appropriate line(s) to indicate the method used to account for incidental or miscellaneous receipts, such as revenues from renting real and personal property or selling services, when related costs have been allocated to Federal contracts. If more than one is marked, explain on a continuation sheet.)</p> <p style="margin-left: 40px;"> A. <input type="checkbox"/> The entire amount of the receipt is credited to the same indirect cost pools to which related costs have been charged B. <input type="checkbox"/> Where the amount of the receipt includes an allowance for profit, the cost-related part of the receipt is credited to the same indirect cost pools to which related costs have been charged; the profits are credited to Other (Miscellaneous) Income C. <input type="checkbox"/> The entire amount of the receipt is credited directly to Other (Miscellaneous) Income Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not applicable </p>	
<p><u>1/</u> Describe on a Continuation Sheet.</p>		

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VI - OTHER COSTS AND CREDITS
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6.5.0	<p><u>Proceeds from Employee Welfare Activities.</u> Employee welfare activities include all of those activities set forth in FAR 31.2 . (Mark the appropriate line(s) to indicate the practice followed in accounting for the proceeds from such activities. If more than one is marked, explain on a continuation sheet.)</p> <p>A. <input type="checkbox"/> Proceeds are turned over to an employee-welfare organization or fund; such proceeds are reduced by all applicable costs such as depreciation, heat, light and power</p> <p>B. <input type="checkbox"/> Same as above, except the proceeds are not reduced by all applicable costs</p> <p>C. <input type="checkbox"/> Proceeds are credited at least once annually to the appropriate cost pools to which costs have been charged</p> <p>D. <input type="checkbox"/> Proceeds are credited to Other (Miscellaneous) Income</p> <p>Y. <input type="checkbox"/> Other(s) <u>1/</u></p> <p>Z. <input type="checkbox"/> Not applicable</p>	
	<p><u>1/</u> Describe on a Continuation Sheet.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	PART VII - DEFERRED COMPENSATION AND INSURANCE COST																												
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7.1.0	<p style="text-align: center;"><u>Part VII Instructions</u></p> <p>This part covers the measurement and assignment of costs for employee pensions, post retirement benefits other than pensions (including post retirement health benefits), certain other types of deferred compensation, and insurance. Some organizations may incur all of these costs at the corporate or home office level, while others may incur them at subordinate organizational levels. Still others may incur a portion of these costs at the corporate level and the balance at subordinate organizational levels.</p> <p>Where the segment (reporting unit) does not directly incur such costs, the segment should, on a continuation sheet, identify the organizational entity that incurs and records such costs, and should require that entity to complete the applicable portions of this Part VII. Each such entity is to fully disclose the methods and techniques used to measure, assign, and allocate such costs to the segment(s) performing Federal contracts or similar cost objectives. Necessary explanations required to achieve that objective should be provided by the entity on a continuation sheet.</p> <p>Where a home office either establishes practices or procedures for the types of costs covered in this Part VII or incurs and then allocates those costs to its segments, the home office may complete this Part to be included in the submission by the segment as indicated on page (i) 4., <u>General Instructions.</u></p> <p><u>Pension Plans with Costs Charged to Federal Contracts.</u> Identify the types and number of pension plans whose costs are charged to Federal contracts or similar cost objectives: (Mark applicable line(s) and enter number of plans.)</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: center; width: 80%;"><u>Type of Pension Plan</u></th> <th style="text-align: center; width: 20%;"><u>Number of Plans</u></th> </tr> </thead> <tbody> <tr> <td colspan="2">A. Defined-Contribution Plan (Other than ESOPs (see 7.5.0))</td> </tr> <tr> <td style="padding-left: 20px;">1. Non-Qualified</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">2. Qualified</td> <td style="text-align: center;">_____</td> </tr> <tr> <td colspan="2">B. Defined-Benefit Plan</td> </tr> <tr> <td colspan="2">1. Non-Qualified</td> </tr> <tr> <td style="padding-left: 20px;">a. Costs are measured and assigned on accrual basis</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">b. Costs are measured and assigned on cash (pay-as-you-go) basis</td> <td style="text-align: center;">_____</td> </tr> <tr> <td colspan="2">2. Qualified</td> </tr> <tr> <td style="padding-left: 20px;">a. Trusteed (Subject to ERISA's minimum funding requirements)</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">b. Fully-insured plan (Exempt from ERISA's minimum funding requirements) treated as a defined-contribution plan</td> <td style="text-align: center;">_____</td> </tr> <tr> <td style="padding-left: 20px;">c. Collectively bargained plan treated as a defined-contribution plan</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>Y. _____ Other <u>1/</u> _____</td> <td></td> </tr> <tr> <td>Z. _____ Not Applicable (Proceed to Item 7.2.0)</td> <td></td> </tr> </tbody> </table> <p><u>1/</u> Describe on a Continuation Sheet.</p>	<u>Type of Pension Plan</u>	<u>Number of Plans</u>	A. Defined-Contribution Plan (Other than ESOPs (see 7.5.0))		1. Non-Qualified	_____	2. Qualified	_____	B. Defined-Benefit Plan		1. Non-Qualified		a. Costs are measured and assigned on accrual basis	_____	b. Costs are measured and assigned on cash (pay-as-you-go) basis	_____	2. Qualified		a. Trusteed (Subject to ERISA's minimum funding requirements)	_____	b. Fully-insured plan (Exempt from ERISA's minimum funding requirements) treated as a defined-contribution plan	_____	c. Collectively bargained plan treated as a defined-contribution plan	_____	Y. _____ Other <u>1/</u> _____		Z. _____ Not Applicable (Proceed to Item 7.2.0)	
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COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VII - DEFERRED COMPENSATION AND INSURANCE COST
		NAME OF REPORTING UNIT
Item No.	Item description	
7.1.1	<p>General Plan Information. On a continuation sheet for each plan identified in item 7.1.0, provide the following information:</p> <ul style="list-style-type: none"> A. The plan name B. The Employer Identification Number (EIN) of the plan sponsor as reported on IRS Form 5500, if any C. The plan number as reported on IRS Form 5500, if any D. Is there a funding agency established for the plan? E. Indicate where costs are accumulated: <ul style="list-style-type: none"> (1) Home Office (2) Segment F. If the plan provides supplemental benefits to any other plan, identify the other plan(s). 	
7.1.2	<p>Defined-Contribution Plan(s) and Certain Defined-Benefit Plans treated as Defined-Contribution Plans. Where numerous plans are listed under 7.1.0.A., 7.1.0.B.2.b., or 7.1.0.B.2.c., for those plans which represent the largest dollar amounts of costs charged to Federal contracts, or similar cost objectives, describe on a continuation sheet the basis for the contribution (including treatment of dividends, credits, and forfeitures) required for each fiscal year. (If there are not more than three plans, provide information for all the plans. If there are more than three plans, information should be provided for those plans that in the aggregate account for at least 80 percent of those defined-contribution plan costs allocable to this segment or business unit.)</p> <p>Z. <input type="checkbox"/> Not applicable. (Proceed to Item 7.1.3)</p>	
7.1.3	<p>Defined-Benefit Plan(s). Where numerous plans are listed under 7.1.0.B. (excluding certain defined-benefit plans treated as defined-contribution plans reported under 7.1.0.B.2.b. and 7.1.0.B.2.c.), for those plans which represent the largest dollar amounts of costs charged to Federal contracts, provide the information requested below on a continuation sheet. (If there are not more than three plans, provide information for all the plans. If there are more than three plans, information should be provided for those plans that in the aggregate account for at least 80 percent of those defined-benefit plan costs allocable to this segment or business unit.):</p> <p>A. Actuarial Cost Method. Identify the actuarial cost method used, including the cost method(s) used to value ancillary benefits, for each plan. Include the method used to determine the actuarial value of assets. Also, if applicable, include whether normal cost is developed as a level dollar amount or as a level percent of salary. For plans listed under 7.1.0.B.1.b., enter "pay-as-you-go".</p> <p>B. Actuarial Assumptions. Describe the events or conditions for which significant actuarial assumptions are made for each plan. Do not include the current numeric values of the assumptions, but provide a description of the basis used for determining these numeric values. Also, describe the criteria used to evaluate the validity of an actuarial assumption. For plans listed under 7.1.0.B.1.b., enter "not applicable".</p> <p>C. Market Value of Funding Agency Assets. Indicate if all assets of the funding agency are valued on the basis of a readily determinable market price. If yes, indicate the basis for the market value. If no, describe how the market values are determined for those assets that do not have a readily determinable market price. For plans listed under 7.1.0.B.1.b., enter "not applicable".</p> <p>D. Basis for Cost Computation. Indicate whether the cost for the segment is determined as:</p> <ul style="list-style-type: none"> 1. An allocated portion of the total pension plan cost. 2. A separately computed pension cost for one or more segments. If so, identify those segments. <p>Z. <input type="checkbox"/> Not applicable, proceed to Item 7.2.0.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	PART VII - DEFERRED COMPENSATION AND INSURANCE COST																		
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7.2.0	<p><u>Post-retirement Benefits (PRBs) Other than Pensions (including post-retirement health care benefits) Charged to Federal Contracts.</u> Identify the accounting method used to determine the costs and the number of PRB plans whose costs are charged to Federal contracts or similar cost objectives. Where retiree benefits are provided as an integral part of an employee group insurance plan that covers active employees, report that plan under 7.3.0. (Mark applicable line(s) and enter number of plans.)</p> <table style="width: 100%; margin-left: 40px;"> <thead> <tr> <th style="text-align: left;"><u>Method Used to Determine Costs</u></th> <th style="text-align: right;"><u>Number of Plans</u></th> </tr> </thead> <tbody> <tr> <td>A. Accrual Accounting</td> <td style="text-align: right;">_____</td> </tr> <tr> <td>B. Cash (pay-as-you-go) Accounting</td> <td style="text-align: right;">_____</td> </tr> <tr> <td>C. Purchased Insurance from unrelated Insurer</td> <td style="text-align: right;">_____</td> </tr> <tr> <td>D. Purchased Insurance from Captive Insurer</td> <td style="text-align: right;">_____</td> </tr> <tr> <td>E. Self-Insurance (including insurance obtained through Captive Insurer)</td> <td style="text-align: right;">_____</td> </tr> <tr> <td>F. Terminal Funding</td> <td style="text-align: right;">_____</td> </tr> <tr> <td>Y. Other <u>1/</u></td> <td style="text-align: right;">_____</td> </tr> <tr> <td>Z. _____ Not Applicable (Proceed to Item 7.3.0)</td> <td style="text-align: right;">_____</td> </tr> </tbody> </table>	<u>Method Used to Determine Costs</u>	<u>Number of Plans</u>	A. Accrual Accounting	_____	B. Cash (pay-as-you-go) Accounting	_____	C. Purchased Insurance from unrelated Insurer	_____	D. Purchased Insurance from Captive Insurer	_____	E. Self-Insurance (including insurance obtained through Captive Insurer)	_____	F. Terminal Funding	_____	Y. Other <u>1/</u>	_____	Z. _____ Not Applicable (Proceed to Item 7.3.0)	_____
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Y. Other <u>1/</u>	_____																		
Z. _____ Not Applicable (Proceed to Item 7.3.0)	_____																		
7.2.1	<p>General PRB Plan Information. On a continuation sheet for each plan identified in item 7.2.0, provide the following information grouped by method used to determine costs:</p> <p>A. The plan name</p> <p>B. The Employer Identification Number (EIN) of the plan sponsor as reported on IRS Form 5500, if any</p> <p>C. The plan number as reported on IRS Form 5500, if any</p> <p>D. Is there a funding agency or funded reserve established for the plan?</p> <p>E. Indicate where costs are accumulated: (1) Home Office (2) Segment</p> <p>F. Are benefits provided pursuant to a written plan or an established practice? If established practice, briefly describe.</p> <p>G. If this PRB plan is listed under 7.2.0.C., 7.2.0.D., or 7.2.0.E., indicate whether the plan is operated as an employee group insurance program. If this PRB plan is listed under 7.2.0.Y., indicate whether the plan is operated as a group insurance program. If the plan is operated as an employee group insurance program, report this plan under 7.3.0. and 7.3.1., as appropriate. If no, report the plan under 7.2.2.</p> <p><u>1/</u> Describe on a Continuation Sheet.</p>																		

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679</p>		<p align="center">PART VII - DEFERRED COMPENSATION AND INSURANCE COST</p>
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<p>7.2.2</p>	<p>PRB Plan(s). Where numerous plans are listed under 7.2.0, for those plans which represent the largest dollar amounts of costs charged to Federal contracts, or other similar cost objectives, provide the information below on a continuation sheet. (If there are not more than three plans, provide information for all the plans. If there are more than three plans, information should be provided for those plans that in the aggregate account for at least 80 percent of those PRB costs allocable to this segment or business unit.)</p> <p>A. <u>Actuarial Cost Method.</u> Identify the actuarial cost method used for each plan or each benefit, as appropriate. Include the method used to determine the actuarial value of assets. Identify the amortization methods and periods used, if any. For plans listed under 7.2.0.B., enter "cash accounting". For plans listed under 7.2.0.F., enter "terminal funding" and identify the amortization methods and periods used, if any.</p> <p>B. <u>Actuarial Assumptions.</u> Describe the events or conditions for which significant actuarial assumptions are made for each plan. Do not include the current numeric values of the assumptions, but provide a description of the basis used for determining these numeric values. Also, describe the criteria used to evaluate the validity of an actuarial assumption. For plans under 7.2.0.B. or 7.2.0.F., enter "not applicable".</p> <p>C. <u>Funding.</u> Provide the following information on the funding practice for the costs of the plan: (For plans under 7.2.0.B. or 7.2.0.F., enter "not applicable".)</p> <ol style="list-style-type: none"> 1. Describe the criteria for or practice of funding the measured and assigned cost; e.g., full funding of the accrual, funding is made pursuant to VEBA or 401(h) rules. 2. Briefly describe the funding arrangement. 3. Are all assets valued on the basis of a readily determinable market price? If yes, indicate the basis used for the market value. If no, describe how the market value is determined for those assets that are not valued on the basis of a readily determinable market price. <p>D. <u>Basis for Cost Computation.</u> Indicate whether the cost for the segment is determined as:</p> <ol style="list-style-type: none"> 1. An allocated portion of the total PRB plan cost 2. A separately computed PRB cost for one or more segments. If so, identify those segments. <p>E. <u>Forfeitability.</u> Does each participant have a non-forfeitable contractual right to their benefit or account balance? If no, explain.</p> <p>Z. _____ Not applicable, proceed to item 7.3.0.</p>	

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7.3.0	<p><u>Employee Group Insurance Charged to Federal Contracts or Similar Cost Objectives.</u> Does your organization provide group insurance coverage to its employees? (Includes coverage for life, hospital, surgical, medical, disability, accident, and similar plans for both active and retired employees, even if the coverage was previously described in 7.2.0.)</p> <p>A. <input type="checkbox"/> Yes (Complete Item 7.3.1)</p> <p>B. <input type="checkbox"/> No (Proceed to Item 7.4.0)</p>																																																																	
7.3.1	<p>Employee Group Insurance Programs. For each program that covers a category of insured risk (e.g., life, hospital, surgical, medical, disability, accident, and similar programs for both active and retired employees), provide the information below on a continuation sheet, using the codes described below: (If there are not more than three policies or self-insurance plans that comprise the program, provide information for all the policies and self-insurance plans. If there are more than three policies or self-insurance plans, information should be provided for those policies and self-insurance plans that in the aggregate account for at least 80 percent of the costs allocable to this segment or business unit for the program that covers each category of insured risk identified.)</p> <p style="text-align: center;">Description of Employee Group Insurance Program: _____</p> <table style="width: 100%; border-collapse: collapse; margin: 10px 0;"> <thead> <tr> <th style="text-align: left; border-bottom: 1px solid black;">Policy or Self-Insurance Plan</th> <th style="text-align: center; border-bottom: 1px solid black;">Cost Accumulation</th> <th style="text-align: center; border-bottom: 1px solid black;">Cost Basis</th> <th style="text-align: center; border-bottom: 1px solid black;">Includes Retirees</th> <th style="text-align: center; border-bottom: 1px solid black;">Purchased Insurance Rating Basis</th> <th style="text-align: center; border-bottom: 1px solid black;">Self-Insurance Projected Average Loss</th> <th style="text-align: center; border-bottom: 1px solid black;">Insurance Administrative Expenses</th> </tr> <tr> <th></th> <th style="text-align: center;">(1)</th> <th style="text-align: center;">(2)</th> <th style="text-align: center;">(3)</th> <th style="text-align: center;">(4)</th> <th style="text-align: center;">(5)</th> <th style="text-align: center;">(6)</th> </tr> </thead> <tbody> <tr> <td colspan="7" style="text-align: center; padding: 10px 0;"> Column (1) -- <u>Cost Accumulation</u> </td> </tr> <tr> <td colspan="7" style="padding: 5px 0;"> Enter Code A, B, or Y, as appropriate. </td> </tr> <tr> <td colspan="7" style="padding: 5px 0;"> A. Costs are accumulated at the Home Office. B. Costs are accumulated at Segment Y. Other <u> 1 </u>/ </td> </tr> <tr> <td colspan="7" style="text-align: center; padding: 10px 0;"> Column (2) -- <u>Cost Basis</u> </td> </tr> <tr> <td colspan="7" style="padding: 5px 0;"> Enter code A, B, C, or Y, as appropriate. </td> </tr> <tr> <td colspan="7" style="padding: 5px 0;"> A. Purchased Insurance from unrelated third party B. Self-insurance C. Purchased Insurance from a captive insurer Y. Other <u> 1 </u>/ </td> </tr> <tr> <td colspan="7" style="padding: 10px 0;"> <u>1/ Describe on a Continuation Sheet.</u> </td> </tr> </tbody></table>			Policy or Self-Insurance Plan	Cost Accumulation	Cost Basis	Includes Retirees	Purchased Insurance Rating Basis	Self-Insurance Projected Average Loss	Insurance Administrative Expenses		(1)	(2)	(3)	(4)	(5)	(6)	Column (1) -- <u>Cost Accumulation</u>							Enter Code A, B, or Y, as appropriate.							A. Costs are accumulated at the Home Office. B. Costs are accumulated at Segment Y. Other <u> 1 </u> /							Column (2) -- <u>Cost Basis</u>							Enter code A, B, C, or Y, as appropriate.							A. Purchased Insurance from unrelated third party B. Self-insurance C. Purchased Insurance from a captive insurer Y. Other <u> 1 </u> /							<u>1/ Describe on a Continuation Sheet.</u>						
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<p>Item No.</p>	<p align="center">NAME OF REPORTING UNIT</p>	
<p>Item No.</p>	<p align="center">Item description</p>	
<p>7.3.1</p>	<p>Continued.</p> <p align="center">Column (3) -- <u>Includes Retirees</u></p> <p>Enter code A, B, C, or Y, as appropriate.</p> <p>A. No, does not include benefits for retirees. B. Yes, PRB benefits for retirees that are a part of a policy or coverage for both active employees and retirees are reported here instead of 7.2.0. C. Yes, PRB benefits for retirees are a part of a PRB plan previously reported under 7.2.0. Y. Other <u>1/</u></p> <p align="center">Column (4) -- <u>Purchased Insurance Rating Basis</u></p> <p>For each plan listed enter code A, B, C, Y, or Z, as appropriate.</p> <p>A. Retrospective Rating (also called experience rating plan or retention plan). B. Manually Rated C. Community Rated Y. Other, or more than one type <u>1/</u> Z. Not applicable</p> <p align="center">Column (5) -- <u>Projected Average Loss</u></p> <p>For each self-insured group plan, or the self-insured portion of purchased insurance, enter code A, B, C, Y, or Z, as appropriate.</p> <p>A. Self-insurance costs represent the projected average loss for the period estimated on the basis of the cost of comparable purchased insurance. B. Self-insurance costs are based on the contractor's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles. C. Actual payments are considered to represent the projected average loss for the period. Y. Other, or more than one method <u>1/</u> Z. Not applicable</p> <p align="center">Column (6) -- <u>Insurance Administration Expenses</u></p> <p>For each self-insured group plan, or the self-insured portion of purchased insurance, enter code A, B, C, D, Y, or Z, as appropriate, to indicate how administrative costs are treated.</p> <p>A. Separately identified and accumulated in indirect cost pool(s). B. Separately identified, accumulated, and allocated to cost objectives either at the segment and/or home office level (Describe allocation method on a Continuation Sheet). C. Not separately identified, but included in indirect cost pool(s). (Describe pool(s) on a Continuation Sheet) D. Incurred by an insurance carrier or third party (Describe accumulation and allocation process on a Continuation Sheet). Y. Other <u>1/</u> Z. Not applicable</p> <p><u>1/</u> Describe on a Continuation Sheet.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VII - DEFERRED COMPENSATION AND INSURANCE COST
		NAME OF REPORTING UNIT
Item No.	Item description	
7.4.0	<p><u>Deferred Compensation, as defined in CAS 9904.415.</u> Does your organization award deferred compensation, other than ESOPs, which is charged to Federal contracts or similar cost objectives? (Mark one.)</p> <p style="margin-left: 40px;">A. <input type="checkbox"/> Yes (Complete Item 7.4.1.)</p> <p style="margin-left: 40px;">B. <input type="checkbox"/> No (Proceed to Item 7.5.0.)</p>	
7.4.1	<p>General Plan Information. On a continuation sheet for all deferred compensation plans, as defined by CAS 9904.415, provide the following information:</p> <p style="margin-left: 40px;">A. The plan name</p> <p style="margin-left: 40px;">B. The Employer Identification Number (EIN) of the plan sponsor as reported on IRS Form 5500, if any</p> <p style="margin-left: 40px;">C. The plan number as reported on IRS Form 5500, if any</p> <p style="margin-left: 40px;">D. Indicate where costs are accumulated: (1) Home office (2) Segment</p> <p style="margin-left: 40px;">E. Are benefits provided pursuant to a written plan or an established practice? If established practice, briefly describe .</p>	
7.4.2	<p>Deferred Compensation Plans. Where numerous plans are listed under 7.4.1, for those plans which represent the largest dollar amounts of costs charged to Federal contracts, or other similar cost objectives, provide the information below on a continuation sheet. (If there are not more than three plans, provide information for all the plans. If there are more than three plans, information should be provided for those plans that in the aggregate account for at least 80% of these deferred compensation costs allocable to this segment or business unit):</p> <p style="margin-left: 40px;">A. Description of Plan. 1. Stock Options 2. Stock Appreciation Rights 3. Cash Incentive 4. Other (explain)</p> <p style="margin-left: 40px;">B. Method of Charging Costs to Federal Contracts or Similar Cost Objectives. 1. Costs charged when accrued and the accrual is fully funded 2. Costs charged when accrued and the accrual is partially funded or not funded 3. Costs charged when paid to employee (pay-as-you-go) 4. Other (explain)</p>	

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679</p>		<p align="center">PART VII - DEFERRED COMPENSATION AND INSURANCE COST</p>
		<p align="center">NAME OF REPORTING UNIT</p>
<p>Item No.</p>	<p align="center">Item description</p>	
<p>7.5.0</p>	<p><u>Employee Stock Ownership Plans (ESOPs).</u> Does your organization make contributions to fund ESOPs that are charged directly or indirectly to Federal contracts or similar cost objectives? (Mark one)</p> <p>A. ____ Yes (Proceed to Item 7.5.1)</p> <p>B. ____ No (Proceed to Item 7.6.0)</p>	
<p>7.5.1</p>	<p>General Plan Information. On a continuation sheet, for all ESOPs provide the following information:</p> <p>A. The plan name</p> <p>B. The Employer Identification Number (EIN) of the plan sponsor as reported on IRS Form 5500, if any</p> <p>C. The plan number as reported on IRS Form 5500, if any</p> <p>D. Indicate where costs are accumulated: (1) Home office (2) Segment</p> <p>E. Are benefits provided pursuant to a written plan or an established practice? If established practice, briefly describe.</p> <p>F. Indicate whether the ESOP plan is a defined-contribution plan subject to CAS 9904.412. (Answer Yes or No).</p> <p>G. Indicate whether the ESOP is leveraged or nonleveraged.</p> <p>H. <u>Valuation of Stock or Non-Cash Assets.</u> Are the plan assets valued on the basis of a readily determinable market price? If yes, indicate the basis for the market value. If no, indicate how the market value is determined for those assets that do not have a readily determinable market price.</p> <p>I. <u>Forfeitures and Dividends.</u> Describe the accounting treatment for forfeitures and dividends, on both allocated and unallocated shares, in the measurement of ESOP costs charged directly or indirectly to Federal contracts or similar cost objectives for each plan identified.</p> <p>J. <u>Administrative Costs.</u> Describe how the costs of administration of each plan listed are identified, grouped, and accumulated.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VII - DEFERRED COMPENSATION AND INSURANCE COST												
		NAME OF REPORTING UNIT												
Item No.	Item description													
7.6.0	<p><u>Worker's Compensation, Liability, and Property Insurance.</u> Does your organization have insurance coverage regarding worker's compensation, liability and property insurance?</p> <p>A. <input type="checkbox"/> Yes (Complete Item 7.6.1.)</p> <p>B. <input type="checkbox"/> No (Proceed to Part VIII)</p>													
7.6.1	<p>Worker's Compensation, Liability and Property Insurance Coverage.</p> <p>For each line of insurance that covers a category of insured risk (e.g., worker's compensation, fire and similar perils, automobile liability and property damage, general liability), provide the information below on a continuation sheet using the codes described below: (If there are not more than three policies or self-insurance plans that are applicable to the line of insurance, provide information for all the policies and self-insurance plans. If there are more than three policies or insurance plans, information should be provided for those policies and self-insurance plans that in the aggregate account for at least 80 percent of the costs allocable to this segment or business unit for each line of insurance identified.)</p> <p style="text-align: center;">Description of Line of Insurance Coverage: _____</p> <table style="margin-left: auto; margin-right: auto; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left; border-bottom: 1px solid black;">Policy or Self- Insurance Plan</th> <th style="text-align: center; border-bottom: 1px solid black;">Cost Accumulation</th> <th style="text-align: center; border-bottom: 1px solid black;">Cost Basis</th> <th style="text-align: center; border-bottom: 1px solid black;">Crediting of Dividends and Earned Refunds</th> <th style="text-align: center; border-bottom: 1px solid black;">Projected Average Loss</th> <th style="text-align: center; border-bottom: 1px solid black;">Self-Insurance Insurance Administrative Expenses</th> </tr> <tr> <th></th> <th style="text-align: center;">(1)</th> <th style="text-align: center;">(2)</th> <th style="text-align: center;">(3)</th> <th style="text-align: center;">(4)</th> <th style="text-align: center;">(5)</th> </tr> </thead> </table> <p style="text-align: center;">Column (1) -- <u>Cost Accumulation</u></p> <p>Enter code A, B, or Y, as appropriate.</p> <p>A. Costs are accumulated at the Home Office. B. Costs are accumulated at Segment Y. Other <u>1/</u></p> <p style="text-align: center;">Column (2) -- <u>Cost Basis</u></p> <p>Enter code A, B, C, or Y, as appropriate.</p> <p>A. Purchased Insurance from unrelated third party B. Self-insurance C. Purchased Insurance from a captive insurer Y. Other <u>1/</u></p> <p><u>1/</u> Describe on a Continuation Sheet.</p>		Policy or Self- Insurance Plan	Cost Accumulation	Cost Basis	Crediting of Dividends and Earned Refunds	Projected Average Loss	Self-Insurance Insurance Administrative Expenses		(1)	(2)	(3)	(4)	(5)
Policy or Self- Insurance Plan	Cost Accumulation	Cost Basis	Crediting of Dividends and Earned Refunds	Projected Average Loss	Self-Insurance Insurance Administrative Expenses									
	(1)	(2)	(3)	(4)	(5)									

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679</p>		<p align="center">PART VII - DEFERRED COMPENSATION AND INSURANCE COST</p>
<p>Item No.</p>	<p align="center">NAME OF REPORTING UNIT</p>	
<p>Item No.</p>	<p align="center">Item description</p>	
<p>7.6.1</p>	<p>Continued.</p> <p align="center">Column (3) -- <u>Crediting of Dividends and Earned Refunds</u></p> <p>For each line of coverage listed, enter code A, B, C, D, E, Y, or Z, as appropriate.</p> <ul style="list-style-type: none"> A. Credited directly or indirectly to Federal contracts or similar cost objectives in the year earned B. Credited directly or indirectly to Federal contracts or similar cost objectives in the year received, not necessarily in the year earned C. Accrued each year, as applicable, to currently reflect the net annual cost of the insurance D. Not credited or refunded to the contractor but retained by the carriers as reserves in accordance with 48 CFR 9904.416-50(a)(1)(iv) E. Manually Rated - not applicable Y. Other, or more than one <u>1/</u> Z. Not applicable <p align="center">Column (4) -- <u>Projected Average Loss</u></p> <p>For each self-insured group plan, or the self-insured portion of purchased insurance, enter code A, B, C, Y, or Z, as appropriate.</p> <ul style="list-style-type: none"> A. Costs that represent the projected average loss for the period estimated on the basis of the cost of comparable purchased insurance. B. Costs that are based on the contractor's experience, relevant industry experience, and anticipated conditions in accordance with generally accepted actuarial principles and practices. C. The actual amount of losses are considered to represent the projected average loss for the period. Y. Other, or more than one method. <u>1/</u> Z. Not applicable <p align="center">Column (5) -- <u>Insurance Administration Expenses</u></p> <p>For each self-insured group plan, or the self-insured portion of purchased insurance, enter code A, B, C, D, Y, or Z, as appropriate, to indicate how administrative costs are treated.</p> <ul style="list-style-type: none"> A. Separately identified and accumulated in indirect cost pool(s). B. Separately identified, accumulated, and allocated to cost objectives either at the segment and/or home office level (Describe allocation method on a Continuation Sheet). C. Not separately identified, but included in indirect cost pool(s). (Describe pool(s) on a Continuation Sheet). D. Incurred by an insurance carrier or third party. (Describe accumulation and allocation process on a Continuation Sheet). Y. Other <u>1/</u> Z. Not applicable <p><u>1/</u> Describe on a Continuation Sheet.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679	PART VIII - HOME OFFICE EXPENSES									
	NAME OF REPORTING UNIT									
Item No.	Item description									
	<p>Part VIII Instructions</p> <p><u>FOR HOME OFFICE, AS APPLICABLE (Includes home office type operations of subsidiaries, joint ventures, partnerships, etc.). 1/</u></p> <p>This part should be completed <u>only</u> by the office of a corporation or other business entity where such an office is responsible for administering two or more segments, where it allocates its costs to such segments and where at least one of the segments is required to file Parts I through VII of the Disclosure Statement.</p> <p>Data for this part should cover the reporting unit's (corporate or other intermediate level home office's) most recently completed fiscal year. For a corporate (home) office, such data should cover the entire corporation. For an intermediate level home office, they should cover the subordinate organizations administered by that group office.</p> <p>8.1.0 <u>Organizational Structure.</u></p> <p>On a continuation sheet, provide the following information:</p> <ol style="list-style-type: none"> 1. In column (1) list segments and other intermediate level home offices reporting to this home office, 2. In column (2) insert "yes" or "no" to indicate if reporting units have recorded any CAS-covered Government Sales, and 3. In column (3) provide the percentage of annual CAS-covered Government Sales as a Percentage of Total Sales (Government and Commercial), if applicable, as follows: <ul style="list-style-type: none"> A. Less than 10% B. 10%-50% C. 51%-80% D. 81%-95% E. Over 95% <table style="margin-left: auto; margin-right: auto; border: none;"> <thead> <tr> <th style="text-align: center; padding: 5px;">Segment or <u>Other Intermediary Home Office</u></th> <th style="text-align: center; padding: 5px;">CAS Covered <u>Government Sales</u></th> <th style="text-align: center; padding: 5px;">Government Sales as a <u>Percentage of Total Sales</u></th> </tr> <tr> <th style="text-align: center; padding: 5px;">(1)</th> <th style="text-align: center; padding: 5px;">(2)</th> <th style="text-align: center; padding: 5px;">(3)</th> </tr> </thead> <tbody> <tr> <td style="height: 20px;"></td> <td></td> <td></td> </tr> </tbody> </table> <p>8.2.0 <u>Other Applicable Disclosure Statement Parts.</u> (Refer to page (i) 4., <u>General Instructions</u>, and Parts V, VI and VII of the Disclosure Statement. Indicate below the parts that the reporting unit has completed concurrently with Parts I and VIII.)</p> <ul style="list-style-type: none"> A. <input type="checkbox"/> Part V - Depreciation and Capitalization Practices B. <input type="checkbox"/> Part VI - Other Costs and Credits C. <input type="checkbox"/> Part VII - Deferred Compensation and Insurance Costs Z. <input type="checkbox"/> Not Applicable <p>1/ For definition of home office see 48 CFR 9904.403.</p>	Segment or <u>Other Intermediary Home Office</u>	CAS Covered <u>Government Sales</u>	Government Sales as a <u>Percentage of Total Sales</u>	(1)	(2)	(3)			
Segment or <u>Other Intermediary Home Office</u>	CAS Covered <u>Government Sales</u>	Government Sales as a <u>Percentage of Total Sales</u>								
(1)	(2)	(3)								

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VIII - HOME OFFICE EXPENSES
Item No.	NAME OF REPORTING UNIT	
Item No.	Item description	
8.3.0	<p><u>Expenses or Pools of Expenses and Methods of Allocation.</u></p> <p>For classification purposes, three methods of allocation, defined as follows, are to be used:</p> <ul style="list-style-type: none"> (i) Directly Allocated--those expenses that are charged to specific corporate segments or other intermediate level home offices based on a specific identification of costs incurred, as described in 9904.403; (ii) Homogeneous Expense Pools--those individual or groups of expenses which are allocated using a base which reflects beneficial or causal relationships, as described in 9904.403; and (iii) Residual Expense--the remaining expenses which are allocated to all segments by means of a base representative of the total activity of such segments. <p style="text-align: center;"><u>Allocation Base Codes</u></p> <ul style="list-style-type: none"> A. Sales B. Cost of Sales C. Total Cost Input (Direct Material, Direct Labor, Other Direct Costs, and Applicable Overhead) D. Total Cost Incurred (Total Cost Input Plus G&A Expenses) E. Prime Cost (Direct Material, Direct Labor, and Other Direct Costs) F. Three factor formula (CAS 9904.403-50(c)) G. Processing or Conversion Cost (Direct Labor and Applicable Overhead) H. Direct Labor Dollars I. Direct Labor Hours J. Machine Hours K. Usage L. Unit of Production M. Direct Material Cost N. Total Payroll Dollars (Direct and Indirect Employees) O. Headcount or Number of employees (Direct and Indirect Employees) P. Square Feet Q. Value Added Y. Other, or More than One Basis <u>1/</u> <p>(On a continuation sheet, under each of the headings 8.3.1, 8.3.2, and 8.3.3 enter the type of expenses or the name of the expense pool(s). For each of the types of expense or expense pools listed, also indicate as item (a) the major functions, activities, and elements of cost included. In addition, for items listed under 8.3.2 and 8.3.3 enter one of the Allocation Base Codes A through Q, or Y, to indicate the basis of allocation and describe as item (b) the make up of the base(s). For example, if direct labor dollars are used, are overtime premiums, fringe benefits, etc. included? For items listed under 8.3.2 and 8.3.3, if a pool is not allocated to all reporting units listed under 8.1.0, then list those reporting units either receiving or not receiving an allocation. Also identify special allocations of residual expenses and/or fixed management charges (see 9904.403-40(c)(3)).</p> <p><u>1/</u> Describe on a Continuation Sheet.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VIII - HOME OFFICE EXPENSES
		NAME OF REPORTING UNIT
Item No.	Item description	
<u>Type of Expenses or Name of Pool of Expenses</u>		
8.3.1	<u>Directly Allocated</u> 1. _____ (a) Major functions, activities, and elements of cost include: _____ _____ 2. _____ (a) Major functions, activities, and elements of cost include: _____ _____	
8.3.2	<u>Homogeneous Expense Pools</u> 1. _____ (a) Major functions, activities, and elements of cost include: _____ _____ (b) Description/Make up of the allocation base: _____ _____ 2. _____ (a) Major functions, activities, and elements of cost include: _____ _____ (b) Description/Make up of the allocation base: _____ _____	<u>Allocation Base Code</u> _____ _____

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679		PART VIII - HOME OFFICE EXPENSES
		NAME OF REPORTING UNIT
Item No.	Item description	
8.3.3	<u>Residual Expenses</u>	<u>Allocation Base Code</u>
	<hr style="width: 50%; margin: 0 auto;"/>	<hr style="width: 10%; margin: 0 auto;"/>
	(a) Major functions, activities, and elements of cost include:	
	<hr style="width: 50%; margin: 0 auto;"/> <hr style="width: 50%; margin: 0 auto;"/>	
	(b) Description/Make up of the allocation base:	
	<hr style="width: 50%; margin: 0 auto;"/> <hr style="width: 50%; margin: 0 auto;"/>	
8.4.0	<u>Transfer of Expenses.</u> If there are normally transfers of expenses from reporting units to this home office, identify on a continuation sheet the classification of the expense and the name of the reporting unit incurring the expense.	

9903.202-10 Illustration of Disclosure Statement Form, CASB DS-2. The data which are required to be disclosed by educational institutions are set forth in detail in the Disclosure Statement Form, CASB DS-2, which is illustrated below:

FORM APPROVED OMB NUMBER
0348-0055

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS	INDEX
<p>GENERAL INSTRUCTIONS</p>	<p>(i)</p>
<p>COVER SHEET AND CERTIFICATION</p>	<p>C-1</p>
<p>PART I General Information</p>	<p>I-1</p>
<p>PART II Direct Costs</p>	<p>II-1</p>
<p>PART III Indirect Costs</p>	<p>III-1</p>
<p>PART IV Depreciation and Use Allowances</p>	<p>IV-1</p>
<p>PART V Other Costs and Credits</p>	<p>V-1</p>
<p>PART VI Deferred Compensation and Insurance Costs</p>	<p>VI-1</p>
<p>PART VII Central System or Group Expenses</p>	<p>VII-1</p>

FORM CASB DS-2 (REV 10/94)

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS</p>	<p align="center">GENERAL INSTRUCTIONS</p>
<p>1. This Disclosure Statement has been designed to meet the requirements of Public Law 100-679, and persons completing it are to describe the educational institution and its cost accounting practices. For complete regulations, instructions and timing requirements concerning submission of the Disclosure Statement, refer to Section 9903.202 of Chapter 99 of Title 48 CFR (48 CFR 9903).</p> <p>2. Part I of the Statement provides general information concerning each reporting unit (e.g., segments, business units, and central system or group (intermediate administration) offices). Parts II through VI pertain to the types of costs generally incurred by the segment or business unit directly performing under Federally sponsored agreements (e.g., contracts, grants and cooperative agreements). Part VII pertains to the types of costs that are generally incurred by a central or group office and are allocated to one or more segments performing under Federally sponsored agreements.</p> <p>3. Each segment or business unit required to disclose its cost accounting practices should complete the Cover Sheet, the Certification, and Parts I through VI.</p> <p>4. Each central or group office required to disclose its cost accounting practices for measuring, assigning and allocating its costs to segments performing under Federally sponsored agreements should complete the Cover Sheet, the Certification, Part I and Part VII of the Disclosure Statement. Where a central or group office incurs the types of cost covered by Parts IV, V and VI, and the cost amounts allocated to segments performing under Federally sponsored agreements are material, such office(s) should complete Parts IV, V, or VI for such material elements of cost. While a central or group office may have more than one reporting unit submitting Disclosure Statements, only one Statement needs to be submitted to cover the central or group office operations.</p> <p>5. The Statement must be signed by an authorized signatory of the reporting unit.</p> <p>6. The Disclosure Statement should be answered by marking the appropriate line or inserting the applicable letter code which describes the segment's (reporting unit's) cost accounting practices.</p> <p>7. A number of questions in this Statement may need narrative answers requiring more space than is provided. In such instances, the reporting unit should use the attached continuation sheet provided. The continuation sheet may be reproduced locally as needed. The number of the question involved should be indicated and the same coding required to answer the questions in the Statement should be used in presenting the answer on the continuation sheet. Continuation sheets should be inserted at the end of the pertinent Part of the Statement. On each continuation sheet, the reporting unit should enter the next sequential page number for that Part and, on the last continuation sheet used, the words "End of Part" should be inserted after the last entry.</p>	

<p>COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS</p>	<p>GENERAL INSTRUCTIONS</p>
<p>8. Where the cost accounting practice being disclosed is clearly set forth in the institution's existing written accounting policies and procedures, such documents may be cited on a continuation sheet and incorporated by reference. In such cases, the reporting unit should provide the date of issuance and effective date for each accounting policy and/or procedures document cited. Alternatively, copies of the relevant parts of such documents may be attached as appendices to the pertinent Disclosure Statement Part. Such continuation sheets and appendices should be labeled and cross-referenced with the applicable Disclosure Statement item number. Any supplementary comments needed to fully describe the cost accounting practice being disclosed should also be provided.</p> <p>9. Disclosure Statements must be amended when disclosed practices are changed to comply with a new CAS or when practices are changed with or without agreement of the Government (Also see 48 CFR 9903.202-3).</p> <p>10. Amendments shall be submitted to the same offices to which submission would have to be made were an original Disclosure Statement being filed.</p> <p>11. Each amendment should be accompanied by an amended cover sheet (indicating revision number and effective date of the change) and a signed certification. For all resubmissions, on each page, insert "Revision Number ____" and "Effective Date ____" in the Item Description block; and, insert "Revised" under each Item Number amended. Resubmitted Disclosure Statements must be accompanied by similar notations identifying the items which have been changed.</p> <p>ATTACHMENT - Blank Continuation Sheet</p>	

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS</p>		<p>CONTINUATION SHEET</p>
		<p>NAME OF REPORTING UNIT</p>
<p>Item No.</p>	<p>Item description</p>	

<p>COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS</p>	<p>COVER SHEET AND CERTIFICATION</p>
<p>CERTIFICATION</p> <p>I certify that to the best of my knowledge and belief this Statement, as amended in the case of a Revision, is the complete and accurate disclosure as of the date of certification shown below by the above-named organization of its cost accounting practices, as required by the Disclosure Regulations (48 CFR 9903.202) of the Cost Accounting Standards Board under 41 U.S.C. § 422.</p> <p>Date of Certification: _____</p> <p style="text-align: right;">_____ (Signature)</p> <p style="text-align: right;">_____ (Print or Type Name)</p> <p style="text-align: right;">_____ (Title)</p> <p style="text-align: center;">THE PENALTY FOR MAKING A FALSE STATEMENT IN THIS DISCLOSURE IS PRESCRIBED IN 18 U.S.C. § 1001</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART I - GENERAL INFORMATION
		NAME OF REPORTING UNIT
Item No.	Item description	
	Part I	
1.1.0	Description of Your Cost Accounting System for recording expenses charged to Federally sponsored agreements (e.g., contracts, grants and cooperative agreements). (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.) A. <input type="checkbox"/> Accrual B. <input checked="" type="checkbox"/> Modified Accrual Basis <u>1/</u> C. <input type="checkbox"/> Cash Basis Y. <input type="checkbox"/> Other <u>1/</u>	
1.2.0	Integration of Cost Accounting with Financial Accounting. The cost accounting system is: (Mark one. If B or C is marked, describe on a continuation sheet the costs which are accumulated on memorandum records.) A. <input type="checkbox"/> Integrated with financial accounting records (Subsidiary cost accounts are all controlled by general ledger control accounts.) B. <input type="checkbox"/> Not integrated with financial accounting records (Cost data are accumulated on memorandum records.) C. <input type="checkbox"/> Combination of A and B	
1.3.0	Unallowable Costs. Costs that are not reimbursable as allowable costs under the terms and conditions of Federally sponsored agreements are: (Mark one) A. <input type="checkbox"/> Specifically identified and recorded separately in the formal financial accounting records. <u>1/</u> B. <input type="checkbox"/> Identified in separately maintained accounting records or workpapers. <u>1/</u> C. <input type="checkbox"/> Identifiable through use of less formal accounting techniques that permit audit verification. <u>1/</u> D. <input type="checkbox"/> Combination of A, B or C <u>1/</u> E. <input type="checkbox"/> Determinable by other means. <u>1/</u>	
	<u>1/</u> Describe on a Continuation Sheet.	

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS</p>		<p align="center">PART I - GENERAL INFORMATION</p>
		<p align="center">NAME OF REPORTING UNIT</p>
<p>Item No.</p>	<p align="center">Item description</p>	
<p>1.3.1</p>	<p>Treatment of Unallowable Costs. (Explain on a continuation sheet how unallowable costs and directly associated costs are treated in each allocation base and indirect expense pool, e.g., when allocating costs to a major function or activity; when determining indirect cost rates; or, when a central office or group office allocates costs to a segment.)</p>	
<p>1.4.0</p>	<p>Cost Accounting Period: _____ (Specify the twelve month period used for the accumulation and reporting of costs under Federally sponsored agreements, e.g., 7/1 to 6/30. If the cost accounting period is other than the institution's fiscal year used for financial accounting and reporting purposes, explain circumstances on a continuation sheet.)</p>	
<p>1.5.0</p>	<p>State Laws or Regulations. Identify on a continuation sheet any State laws or regulations which influence the institution's cost accounting practices, e.g., State administered pension plans, and any applicable statutory limitations or special agreements on allowance of costs.</p>	
<p><u>1/</u> Describe on a Continuation Sheet.</p>		

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART II - DIRECT COSTS
		NAME OF REPORTING UNIT
Item No.	Item description	
	Instructions for Part II	
	<p>Institutions should disclose what costs are, or will be, charged directly to Federally sponsored agreements or similar cost objectives as Direct Costs. It is expected that the disclosed cost accounting practices (as defined at 48 CFR 9903.302-1) for classifying costs either as direct costs or indirect costs will be consistently applied to all costs incurred by the reporting unit.</p>	
2.1.0	<p><u>Criteria for Determining How Costs are Charged to Federally Sponsored Agreements or Similar Cost Objectives.</u> (For all major categories of cost under each major function or activity such, as instruction, organized research, other sponsored activities and other institutional activities, describe on a continuation sheet, your criteria for determining when costs incurred for the same purpose, in like circumstances, are treated either as direct costs only or as indirect costs only with respect to final cost objectives. Particular emphasis should be placed on items of cost that may be treated as either direct or indirect costs (e.g., Supplies, Materials, Salaries and Wages, Fringe Benefits, etc.) depending upon the purpose of the activity involved. Separate explanations on the criteria governing each direct cost category identified in this Part II are required. Also, list and explain if there are any deviations from the specified criteria.)</p>	
2.2.0	<p><u>Description of Direct Materials.</u> All materials and supplies directly identified with Federally sponsored agreements or similar cost objectives. (Describe on a continuation sheet the principal classes of materials which are charged as direct materials and supplies.)</p>	
2.3.0	<p><u>Method of Charging Direct Materials and Supplies.</u> (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.)</p>	
2.3.1	<p>Direct Purchases for Projects are Charged to Projects at:</p> <p>A. <input type="checkbox"/> Actual Invoiced Costs B. <input type="checkbox"/> Actual Invoiced Costs Net of Discounts Taken Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not Applicable</p>	
2.3.2	<p>Inventory Requisitions from Central or Common, Institution-owned Inventory. (Identify the inventory valuation method used to charge projects):</p> <p>A. <input type="checkbox"/> First In, First Out B. <input type="checkbox"/> Last In, First Out C. <input type="checkbox"/> Average Costs <u>1/</u> D. <input type="checkbox"/> Predetermined Costs <u>1/</u> Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not Applicable</p>	
	<p><u>1/</u> Describe on a Continuation Sheet.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART II - DIRECT COSTS			
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Item No.	Item description				
2.4.0	Description of Direct Personal Services. All personal services directly identified with Federally sponsored agreements or similar cost objectives. (Describe on a continuation sheet the personal services compensation costs, including applicable fringe benefits costs, if any, within each major institutional function or activity that are charged as direct personal services.)				
2.5.0	Method of Charging Direct Salaries and Wages. (Mark the appropriate line(s) for each Direct Personal Services Category to identify the method(s) used to charge direct salary and wage costs to Federally sponsored agreements or similar cost objectives. If more than one line is marked in a column, fully describe on a continuation sheet, the applicable methods used.)				
	<u>Direct Personal Services Category</u>				
	<u>Faculty</u> (1)	<u>Staff</u> (2)	<u>Students</u> (3)	<u>Other ^{1/}</u> (4)	
	A. Payroll Distribution Method (Individual time card/actual hours and rates)	_____	_____	_____	_____
	B. Plan - Confirmation (Budgeted, planned or assigned work activity, updated to reflect significant changes)	_____	_____	_____	_____
	C. After-the-fact Activity Records (Percentage Distribution of employee activity)	_____	_____	_____	_____
	D. Multiple Confirmation Records (Employee Reports prepared each academic term, to account for employee's activities, direct and indirect charges are certified separately.)	_____	_____	_____	_____
	Y. Other(s) ^{1/}	_____	_____	_____	_____
	^{1/} Describe on a Continuation Sheet.				

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS</p>		<p align="center">PART II - DIRECT COSTS</p>
		<p align="center">NAME OF REPORTING UNIT</p>
<p>Item No.</p>	<p align="center">Item description</p>	
<p>2.5.1</p>	<p>Salary and Wage Cost Distribution Systems.</p> <p>Within each major function or activity, are the methods marked in Item 2.5.0 used by all employees compensated by the reporting unit? (If "NO", describe on a continuation sheet, the types of employees not included and describe the methods used to identify and distribute their salary and wage costs to direct and indirect cost objectives.)</p> <p>_____ Yes _____ No</p>	
<p>2.5.2</p>	<p>Salary and Wage Cost Accumulation System.</p> <p>(Within each major function or activity, describe, on a continuation sheet, the specific accounting records or memorandum records used to accumulate and record the share of the total salary and wage costs attributable to each employee's direct (Federally sponsored projects, non-sponsored projects or similar cost objectives) and indirect activities. Indicate how the salary and wage cost distributions are reconciled with the payroll data recorded in the institution's financial accounting records.)</p>	
<p>2.6.0</p>	<p><u>Description of Direct Fringe Benefits Costs.</u> All fringe benefits that are attributable to direct salaries and wages and are charged directly to Federally sponsored agreements or similar cost objectives. (Describe on a continuation sheet <u>all</u> of the different types of fringe benefits which are classified and charged as direct costs, e.g., actual or accrued costs of vacation, holidays, sick leave, sabbatical leave, premium pay, social security, pension plans, post-retirement benefits other than pensions, health insurance, training, tuition, tuition remission, etc.)</p>	
<p>2.6.1</p>	<p>Method of Charging Direct Fringe Benefits. (Describe on a continuation sheet, how each type of fringe benefit cost identified in item 2.6.0. is measured, assigned and allocated (for definitions, See 9903.302-1); first, to the major functions (e.g., instruction, research); and, then to individual projects or direct cost objectives within each function.)</p>	
<p>2.7.0</p>	<p><u>Description of Other Direct Costs.</u> All other items of cost directly identified with Federally sponsored agreements or similar cost objectives. (List on a continuation sheet the principal classes of other costs which are charged directly, e.g., travel, consultants, services, subgrants, subcontracts, malpractice insurance, etc.)</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART II - DIRECT COSTS																														
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2.8.0	<p><u>Cost Transfers.</u> When Federally sponsored agreements or similar cost objectives are credited for cost transfers to other projects, grants or contracts, is the credit amount for direct personal services, materials, other direct charges and applicable indirect costs always based on the same amount(s) or rate(s) (e.g., direct labor rate, indirect costs) originally used to charge or allocate costs to the project (Consider transactions where the original charge and the credit occur in different cost accounting periods). (Mark one, if "No", explain on a continuation sheet how the credit differs from original charge.)</p> <p> <input type="checkbox"/> Yes <input type="checkbox"/> No </p>																															
2.9.0	<p><u>Interorganizational Transfers.</u> This item is directed only to those materials, supplies, and services which are, or will be transferred to you from other segments of the educational institution. (Mark the appropriate line(s) in each column to indicate the basis used by you as transferee to charge the cost or price of interorganizational transfers or materials, supplies, and services to Federally sponsored agreements or similar cost objectives. If more than one line is marked in a column, explain on a continuation sheet.)</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 80%;"></th> <th style="text-align: center; border-bottom: 1px solid black;"><u>Materials</u></th> <th style="text-align: center; border-bottom: 1px solid black;"><u>Supplies</u></th> <th style="text-align: center; border-bottom: 1px solid black;"><u>Services</u></th> </tr> <tr> <th></th> <th style="text-align: center;">(1)</th> <th style="text-align: center;">(2)</th> <th style="text-align: center;">(3)</th> </tr> </thead> <tbody> <tr> <td>A. At full cost <u>excluding</u> indirect costs attributable to group or central office expenses.</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>B. At full cost <u>including</u> indirect costs attributable to group or central office expenses.</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>C. At established catalog or market price or prices based on adequate competition.</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>Y. Other(s) <u>1/</u></td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> <tr> <td>Z. Interorganizational transfers are not applicable</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> <td style="text-align: center;">_____</td> </tr> </tbody> </table> <p><u>1/</u> Describe on a Continuation Sheet.</p>					<u>Materials</u>	<u>Supplies</u>	<u>Services</u>		(1)	(2)	(3)	A. At full cost <u>excluding</u> indirect costs attributable to group or central office expenses.	_____	_____	_____	B. At full cost <u>including</u> indirect costs attributable to group or central office expenses.	_____	_____	_____	C. At established catalog or market price or prices based on adequate competition.	_____	_____	_____	Y. Other(s) <u>1/</u>	_____	_____	_____	Z. Interorganizational transfers are not applicable	_____	_____	_____
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	<p>Institutions should disclose how the segment's total indirect costs are identified and accumulated in specific indirect cost categories and allocated to applicable indirect cost pools and service centers within each major function or activity, how service center costs are accumulated and "billed" to users, and the specific indirect cost pools and allocation bases used to calculate the indirect cost rates that are used to allocate accumulated indirect costs to Federally sponsored agreements or similar final cost objectives. A continuation sheet should be used wherever additional space is required or when a response requires further explanation to ensure clarity and understanding.</p> <p>The following Allocation Base Codes are provided for use in connection with Items 3.1.0 and 3.3.0.</p> <ul style="list-style-type: none"> A. Direct Charge or Allocation B. Total Expenditures C. Modified Total Cost Basis D. Modified Total Direct Cost Basis E. Salaries and Wages F. Salaries, Wages and Fringe Benefits G. Number of Employees (head count) H. Number of Employees (full-time equivalent basis) I. Number of Students (head count) J. Number of Students (full-time equivalent basis) K. Student Hours -- classroom and work performed L. Square Footage M. Usage N. Unit of Product O. Total Production P. More than one base (Separate Cost Groupings) <u>1/</u> Y. Other(s) <u>1/</u> Z. Category or Pool not applicable <p><u>1/</u> List on a continuation sheet, the category and subgrouping(s) of expense involved and the allocation base(s) used.</p>	

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3.1.0	<p><u>Indirect Cost Categories - Accumulation and Allocation.</u> This item is directed at the identification, accumulation and allocation of all indirect costs of the institution. (Under the column heading, "Accumulation Method," insert "Yes" or "No" to indicate if the cost elements included in each indirect cost category are identified, recorded and accumulated in the institution's formal accounting system. If "No," describe on a continuation sheet, how the cost elements included in the indirect cost category are identified and accumulated. Under the column heading "Allocation Base," enter one of the allocation base codes A through P, Y, or Z, to indicate the basis used for allocating the accumulated costs of each indirect cost category to other applicable indirect cost categories, indirect cost pools, other institutional activities, specialized service facilities and other service centers. Under the column heading "Allocation Sequence," insert 1, 2, or 3 next to each of the first three indirect cost categories to indicate the sequence of the allocation process. If cross-allocation techniques are used, insert "CA." If an indirect cost category listed in this section is not used, insert "NA.")</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left; padding: 5px;"><u>Indirect Cost Category</u></th> <th style="text-align: center; padding: 5px;"><u>Accumulation Method</u></th> <th style="text-align: center; padding: 5px;"><u>Allocation Base Code</u></th> <th style="text-align: center; padding: 5px;"><u>Allocation Sequence</u></th> </tr> </thead> <tbody> <tr> <td style="padding: 5px;">(a) Depreciation/Use Allowances/Interest</td> <td></td> <td></td> <td></td> </tr> <tr> <td style="padding: 5px;"> Building</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> </tr> <tr> <td style="padding: 5px;"> Equipment</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td></td> </tr> <tr> <td style="padding: 5px;"> Capital Improvements to Land <u>1/</u></td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td></td> </tr> <tr> <td style="padding: 5px;"> Interest <u>1/</u></td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td></td> </tr> <tr> <td style="padding: 5px;">(b) Operation and Maintenance</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> </tr> <tr> <td style="padding: 5px;">(c) General Administration and General Expense</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> </tr> <tr> <td style="padding: 5px;">(d) Departmental Administration</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td></td> </tr> <tr> <td style="padding: 5px;">(e) Sponsored Projects Administration</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td></td> </tr> <tr> <td style="padding: 5px;">(f) Library</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td></td> </tr> <tr> <td style="padding: 5px;">(g) Student Administration and Services</td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td></td> </tr> <tr> <td style="padding: 5px;">(h) Other <u>1/</u></td> <td style="text-align: center;">—</td> <td style="text-align: center;">—</td> <td></td> </tr> </tbody> </table> <p style="padding: 5px;"><u>1/</u> Describe on a Continuation Sheet.</p>				<u>Indirect Cost Category</u>	<u>Accumulation Method</u>	<u>Allocation Base Code</u>	<u>Allocation Sequence</u>	(a) Depreciation/Use Allowances/Interest				Building	—	—	—	Equipment	—	—		Capital Improvements to Land <u>1/</u>	—	—		Interest <u>1/</u>	—	—		(b) Operation and Maintenance	—	—	—	(c) General Administration and General Expense	—	—	—	(d) Departmental Administration	—	—		(e) Sponsored Projects Administration	—	—		(f) Library	—	—		(g) Student Administration and Services	—	—		(h) Other <u>1/</u>	—	—	
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3.2.0	<p>Service Centers. Service centers are departments or functional units which perform specific technical or administrative services primarily for the benefit of other units within a reporting unit. Service Centers include "recharge centers" and the "specialized service facilities" defined in Section J of Circular A-21. (The codes identified below should be inserted on the appropriate line for each service center listed. The column numbers correspond to the paragraphs listed below that provide the codes. Explain on a Continuation Sheet if any of the services are charged to users on a basis other than usage of the services. Enter "Z" in Column 1, if not applicable.)</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 80%;"></th> <th style="width: 5%; text-align: center;">(1)</th> <th style="width: 5%; text-align: center;">(2)</th> <th style="width: 5%; text-align: center;">(3)</th> <th style="width: 5%; text-align: center;">(4)</th> <th style="width: 5%; text-align: center;">(5)</th> <th style="width: 5%; text-align: center;">(6)</th> </tr> </thead> <tbody> <tr> <td>(a) Scientific Computer Operations</td> <td style="text-align: center;">—</td> </tr> <tr> <td>(b) Business Data Processing</td> <td style="text-align: center;">—</td> </tr> <tr> <td>(d) Other Service Centers with Annual Operating Budgets exceeding \$1,000,000 or that generate significant charges to Federally sponsored agreements either as a direct or indirect cost. (Specify below; use a Continuation Sheet, if necessary)</td> <td style="text-align: center;">—</td> </tr> <tr> <td>_____</td> <td style="text-align: center;">—</td> </tr> <tr> <td>_____</td> <td style="text-align: center;">—</td> </tr> </tbody> </table> <p>(1) Category Code: Use code "A" if the service center costs are billed only as direct costs of final cost objectives; code "B" if billed only to indirect cost categories or indirect cost pools; code "C" if billed to both direct and indirect cost objectives.</p> <p>(2) Burden Code: Code "A" -- center receives an allocation of all applicable indirect costs; Code "B" --partial allocation of indirect costs; Code "C" -- no allocation of indirect costs.</p> <p>(3) Billing Rate Code: Code "A" -- billing rates are based on historical costs; Code "B" -- rates are based on projected costs; Code "C" -- rates are based on a combination of historical and projected costs; Code "D" -- billings are based on the actual costs of the billing period; Code "Y" -- other (explain on a Continuation Sheet).</p> <p>(4) User Charges Code: Code "A" -- all users are charged at the same billing rates; Code "B" -- some users are charged at different rates than other users (explain on a Continuation Sheet).</p> <p>(5) Actual Costs vs. Revenues Code: Code "A" -- billings (revenues) are compared to actual costs (expenditures) at least annually; Code "B" -- billings are compared to actual costs less frequently than annually.</p> <p>(6) Variance Code: Code "A" -- Annual variances between billed and actual costs are prorated to users (as credits or charges); Code "B" -- variances are carried forward as adjustments to billing rate of future periods; Code "C" -- annual variances are charged or credited to indirect costs; Code "Y" -- other (explain on a Continuation Sheet).</p>								(1)	(2)	(3)	(4)	(5)	(6)	(a) Scientific Computer Operations	—	—	—	—	—	—	(b) Business Data Processing	—	—	—	—	—	—	(d) Other Service Centers with Annual Operating Budgets exceeding \$1,000,000 or that generate significant charges to Federally sponsored agreements either as a direct or indirect cost. (Specify below; use a Continuation Sheet, if necessary)	—	—	—	—	—	—	_____	—	—	—	—	—	—	_____	—	—	—	—	—	—
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3.3.0	<p><u>Indirect Cost Pools and Allocation Bases</u></p> <p>(Identify all of the indirect cost pools established for the accumulation of indirect costs, excluding service centers, and the allocation bases used to distribute accumulated indirect costs to Federally sponsored agreements or similar cost objectives within each major function or activity. For all applicable indirect cost pools, enter the applicable Allocation Base Code A through P, Y, or Z, to indicate the basis used for allocating accumulated pool costs to Federally sponsored agreements or similar cost objectives.)</p> <table style="width: 100%; border: none;"> <thead> <tr> <th style="text-align: left; padding-left: 40px;"><u>Indirect Cost Pools</u></th> <th style="text-align: left;"><u>Allocation Base Code</u></th> </tr> </thead> <tbody> <tr> <td colspan="2">A. Instruction</td> </tr> <tr> <td style="padding-left: 20px;">___ On-Campus</td> <td>_____</td> </tr> <tr> <td style="padding-left: 20px;">___ Off-Campus</td> <td>_____</td> </tr> <tr> <td style="padding-left: 20px;">___ Other <u>1/</u></td> <td>_____</td> </tr> <tr> <td colspan="2">B. Organized Research</td> </tr> <tr> <td style="padding-left: 20px;">___ On-Campus</td> <td>_____</td> </tr> <tr> <td style="padding-left: 20px;">___ Off-Campus</td> <td>_____</td> </tr> <tr> <td style="padding-left: 20px;">___ Other <u>1/</u></td> <td>_____</td> </tr> <tr> <td colspan="2">C. Other Sponsored Activities</td> </tr> <tr> <td style="padding-left: 20px;">___ On-Campus</td> <td>_____</td> </tr> <tr> <td style="padding-left: 20px;">___ Off-Campus</td> <td>_____</td> </tr> <tr> <td style="padding-left: 20px;">___ Other <u>1/</u></td> <td>_____</td> </tr> <tr> <td colspan="2">D. Other Institutional Activities <u>1/</u></td> </tr> <tr> <td></td> <td>_____</td> </tr> </tbody> </table>		<u>Indirect Cost Pools</u>	<u>Allocation Base Code</u>	A. Instruction		___ On-Campus	_____	___ Off-Campus	_____	___ Other <u>1/</u>	_____	B. Organized Research		___ On-Campus	_____	___ Off-Campus	_____	___ Other <u>1/</u>	_____	C. Other Sponsored Activities		___ On-Campus	_____	___ Off-Campus	_____	___ Other <u>1/</u>	_____	D. Other Institutional Activities <u>1/</u>			_____
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3.4.0	<p><u>Composition of Indirect Cost Pools.</u> (For each pool identified under Items 3.1.0 and 3.2.0, describe on a continuation sheet the major organizational components, subgroupings of expenses, and elements of cost included.)</p>																															
	<p><u>1/</u> Describe on a Continuation Sheet.</p>																															

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART III - INDIRECT COSTS
		NAME OF REPORTING UNIT
Item No.	Item description	
3.5.0	<p><u>Composition of Allocation Bases.</u> (For each allocation base code used in Items 3.1.0 and 3.3.0, describe on a continuation sheet the makeup of the base. For example, if a modified total direct cost base is used, specify which of the elements of direct cost identified in Part II, Direct Costs, that are included, e.g., materials, salaries and wages, fringe benefits, travel costs, and excluded, e.g., subcontract costs over first \$25,000. Where applicable, explain if service centers are included or excluded. Specify the benefitting functions and activities included. If any cost objectives are excluded from the allocation base, such cost objectives and the alternate allocation method used should be identified. If an indirect cost allocation is based on Cost Analysis Studies, identify the study, and fully describe the study methods and techniques applied, the composition of the specific allocation base used, and the frequency of each recurring study.</p>	
3.6.0	<p><u>Allocation of Indirect Costs to Programs That Pay Less Than Full Indirect Costs.</u> Are appropriate direct costs of all programs and activities included in the indirect cost allocation bases, regardless of whether allocable indirect costs are fully reimbursed by the sponsoring organizations?</p> <p>A. ____ Yes</p> <p>B. ____ No ^{1/}</p>	
	<p>^{1/} Describe on a Continuation Sheet.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART IV - DEPRECIATION AND USE ALLOWANCES			
		NAME OF REPORTING UNIT			
Item No.	Item description				
4.1.0	Part IV				
<p><u>Depreciation Charged to Federally Sponsored Agreements or Similar Cost Objectives.</u> (For each asset category listed below, enter a code from A through C in Column (1) describing the method of depreciation; a code from A through D in Column (2) describing the basis for determining useful life; a code from A through C in Column (3) describing how depreciation methods or use allowances are applied to property units; and Code A or B in Column (4) indicating whether or not the estimated residual value is deducted from the total cost of depreciable assets. Enter Code Y in each column of an asset category where another or more than one method applies. Enter Code Z in Column (1) only, if an asset category is not applicable.)</p>					
<u>Asset Category</u>		<u>Depreciation Method</u> (1)	<u>Useful Life</u> (2)	<u>Property Unit</u> (3)	<u>Residual Value</u> (4)
		_____	_____	_____	_____
(a) Land Improvements		_____	_____	_____	_____
(b) Buildings		_____	_____	_____	_____
(c) Building Improvements		_____	_____	_____	_____
(d) Leasehold Improvements		_____	_____	_____	_____
(e) Equipment		_____	_____	_____	_____
(f) Furniture and Fixtures		_____	_____	_____	_____
(g) Automobiles and Trucks		_____	_____	_____	_____
(h) Tools		_____	_____	_____	_____
(i) Enter Code Y on this line if other asset categories are used and enumerate on a continuation sheet each such asset category and the applicable codes. (Otherwise enter Code Z.)		_____	_____	_____	_____
<u>Column (1)--Depreciation Method Code</u>		<u>Column (2)--Useful Life Code</u>			
A. Straight Line B. Expensed at Acquisition C. Use Allowance Y. Other or more than one method <u>1/</u>		A. Replacement Experience B. Term of Lease C. Estimated service life D. As prescribed for use allowance by Office of Management and Budget Circular No. A-21 Y. Other or more than one method <u>1/</u>			
<u>Column (3)--Property Unit Code</u>		<u>Column (4)--Residual Value Code</u>			
A. Individual units are accounted for separately B. Applied to groups of assets with similar service lives C. Applied to groups of assets with varying service lives Y. Other or more than one method <u>1/</u>		A. Residual value is deducted B. Residual value is not deducted Y. Other or more than one method <u>1/</u>			
<u>1/ Describe on a Continuation Sheet.</u>					

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART IV - DEPRECIATION AND USE ALLOWANCES
		NAME OF REPORTING UNIT
Item No.	Item description	
4.1.1	Asset Valuations and Useful Lives. Are the asset valuations and useful lives used in your indirect cost proposal consistent with those used in the institution's financial statements? (Mark one.) A. <input type="checkbox"/> Yes B. <input checked="" type="checkbox"/> No <u>1/</u>	
4.2.0	Fully Depreciated Assets. Is a usage charge for fully depreciated assets charged to Federally sponsored agreements or similar cost objectives? (Mark one. If yes, describe the basis for the charge on a continuation sheet.) A. <input type="checkbox"/> Yes B. <input type="checkbox"/> No	
4.3.0	Treatment of Gains and Losses on Disposition of Depreciable Property. Gains and losses are: (Mark the appropriate line(s) and if more than one is marked, explain on a continuation sheet.) A. <input type="checkbox"/> Excluded from determination of sponsored agreement costs B. <input type="checkbox"/> Credited or charged currently to the same pools to which the depreciation of the assets was originally charged C. <input type="checkbox"/> Taken into consideration in the depreciation cost basis of the new items, where trade-in is involved D. <input type="checkbox"/> Not accounted for separately, but reflected in the depreciation reserve account Y. <input type="checkbox"/> Other(s) <u>1/</u> Z. <input type="checkbox"/> Not applicable	
4.4.0	Criteria for Capitalization. (Enter (a) the minimum dollar amount of expenditures which are capitalized for acquisition, addition, alteration, donation and improvement of capital assets, and (b) the minimum number of expected life years of assets which are capitalized. If more than one dollar amount or number applies, show the information for the majority of your capitalized assets, and enumerate on a continuation sheet the dollar amounts and/or number of years for each category or subcategory of assets involved which differs from those for the majority of assets.) A. Minimum Dollar Amount _____ B. Minimum Life Years _____	
4.5.0	Group or Mass Purchase. Are group or mass purchases (initial complement) of similar items, which individually are less than the capitalization amount indicated above, capitalized? (Mark one.) A. <input checked="" type="checkbox"/> Yes <u>1/</u> B. <input type="checkbox"/> No	
<u>1/</u> Describe on a Continuation Sheet.		

<p align="center">COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS</p>		<p align="center">PART V - OTHER COSTS AND CREDITS</p>
		<p align="center">NAME OF REPORTING UNIT</p>
<p>Item No.</p>	<p align="center">Item description</p>	
	<p align="center">Part V</p> <p>5.1.0 <u>Method of Charging Leave Costs.</u> Do you charge vacation, sick, holiday and sabbatical leave costs to sponsored agreements on the cash basis of accounting (i.e., when the leave is taken or paid), or on the accrual basis of accounting (when the leave is earned)? (Mark applicable line(s))</p> <p>A. <input type="checkbox"/> Cash</p> <p>B. <input type="checkbox"/> Accrual <u>1/</u></p> <p>5.2.0 <u>Applicable Credits.</u> This item is directed at the treatment of "applicable credits" as defined in Section C of OMB Circular A-21 and other incidental receipts (e.g., purchase discounts, insurance refunds, library fees and fines, parking fees, etc.). (Indicate how the principal types of credits and incidental receipts the institution receives are usually handled.)</p> <p>A. <input type="checkbox"/> The credits/receipts are offset against the specific direct or indirect costs to which they relate.</p> <p>B. <input type="checkbox"/> The credits/receipts are handled as a general adjustment to the indirect pool.</p> <p>C. <input type="checkbox"/> The credits/receipts are treated as income and are not offset against costs.</p> <p>D. <input type="checkbox"/> Combination of methods <u>1/</u></p> <p>Y. <input type="checkbox"/> Other <u>1/</u></p> <p><u>1/</u> Describe on a Continuation Sheet.</p>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART VI - DEFERRED COMPENSATION AND INSURANCE COSTS
		NAME OF REPORTING UNIT
Item No.	Item description	
	<p>Instructions for Part VI</p> <p>This part covers the measurement and assignment of costs for employee pensions, post retirement benefits other than pensions (including post retirement health benefits) and insurance. Some organizations may incur all of these costs at the main campus level or for public institutions at the governmental unit level, while others may incur them at subordinate organization levels. Still others may incur a portion of these costs at the main campus level and the balance at subordinate organization levels.</p> <p>Where the segment (reporting unit) does not directly incur such costs, the segment should, on a continuation sheet, identify the organizational entity that incurs and records such costs. When the costs allocated to Federally sponsored agreements are material, and the reporting unit does not have access to the information needed to complete an item, the reporting unit should require that entity to complete the applicable portions of this Part VI. (See item 4, page (i), General Instructions)</p>	
6.1.0	<u>Pension Plans.</u>	
6.1.1	Defined-Contribution Pension Plans. Identify the types and number of pension plans whose costs are charged to Federally sponsored agreements. (Mark applicable line(s) and enter number of plans.)	
	<u>Type of Plan</u>	<u>Number of Plans</u>
	A. _____ Institution employees participate in State/Local Government Retirement Plan(s)	_____
	B. _____ Institution uses TIAA/CREF plan or other defined contribution plan that is managed by an organization not affiliated with the institution	_____
	C. _____ Institution has its own Defined-Contribution Plan(s) <u>1/</u>	_____
6.1.2	Defined-Benefit Pension Plan. (For each defined-benefit plan (other than plans that are part of a State or Local government pension plan) describe on a continuation sheet the actuarial cost method, the asset valuation method, the criteria for changing actuarial assumptions and computations, the amortization periods for prior service costs, the amortization periods for actuarial gains and losses, and the funding policy.)	
	<u>1/ Describe on a Continuation Sheet.</u>	

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART VI - DEFERRED COMPENSATION AND INSURANCE COSTS
		NAME OF REPORTING UNIT
Item No.	Item description	
6.2.0	<p><u>Post Retirement Benefits Other Than Pensions (including post retirement health care benefits) (PRBs).</u> (Identify on a continuation sheet all PRB plans whose costs are charged to Federally sponsored agreements. For each plan listed, state the plan name and indicate the approximate number and type of employees covered by each plan.)</p> <p>Z. <input type="checkbox"/> Not Applicable</p>	
6.2.1	<p>Determination of Annual PRB Costs. (On a continuation sheet, indicate whether PRB costs charged to Federally sponsored agreements are determined on the cash or accrual basis of accounting. If costs are accrued, describe the accounting practices used, including actuarial cost method, the asset valuation method, the criteria for changing actuarial assumptions and computations, the amortization periods for prior service costs, the amortization periods for actuarial gains and losses, and the funding policy.)</p>	
6.3.0	<p><u>Self-Insurance Programs (Employee Group Insurance).</u> Costs of the self-insurance programs are charged to Federally sponsored agreements or similar cost objectives: (Mark one.)</p> <p>A. <input type="checkbox"/> When accrued (book accrual only) B. <input type="checkbox"/> When contributions are made to a nonforfeitable fund C. <input type="checkbox"/> When contributions are made to a forfeitable fund D. <input type="checkbox"/> When the benefits are paid to an employee E. <input type="checkbox"/> When amounts are paid to an employee welfare plan Y. <input type="checkbox"/> Other or more than one method <u>1/</u> Z. <input type="checkbox"/> Not Applicable</p>	
6.4.0	<p><u>Self-Insurance Programs (Worker's Compensation, Liability and Casualty Insurance.)</u></p>	
6.4.1	<p>Worker's Compensation and Liability. Costs of such self-insurance programs are charged to Federally sponsored agreements or similar cost objectives: (Mark one.)</p> <p>A. <input type="checkbox"/> When claims are paid or losses are incurred (no provision for reserves) B. <input type="checkbox"/> When provisions for reserves are recorded based on the present value of the liability C. <input type="checkbox"/> When provisions for reserves are recorded based on the full or undiscounted value, as contrasted with present value, of the liability D. <input type="checkbox"/> When funds are set aside or contributions are made to a fund Y. <input type="checkbox"/> Other or more than one method <u>1/</u> Z. <input type="checkbox"/> Not Applicable</p>	
<p><u>1/</u> Describe on a Continuation Sheet.</p>		

COST ACCOUNTING STANDARDS BOARD DISCLOSURE STATEMENT REQUIRED BY PUBLIC LAW 100-679 EDUCATIONAL INSTITUTIONS		PART VII - CENTRAL SYSTEM OR GROUP EXPENSES
		NAME OF REPORTING UNIT
Item No.	Item description	
	<p>DISCLOSURE BY CENTRAL SYSTEM OFFICE, OR GROUP (INTERMEDIATE ADMINISTRATION) OFFICE, AS APPLICABLE.</p> <p style="text-align: center;">Instructions for Part VII</p> <p>This part should be completed <u>only</u> by the central system office or a group office of an educational system when that office is responsible for administering two or more segments, where it allocates its costs to such segments and where at least one of the segments is required to file Parts I through VI of the Disclosure Statement.</p> <p>The reporting unit (central system or group office) should disclose how costs of services provided by the reporting unit are, or will be, accumulated and allocated to applicable segments of the institution. For a central system office, disclosure should cover the entire institution. For a group office, disclosure should cover all of the subordinate organizations administered by that group office.</p> <p>7.1.0 <u>Organizational Structure.</u></p> <p>On a continuation sheet, list all segments of the university or university system, including hospitals, Federally Funded Research and Development Centers (FFRDC's), Government-owned Contractor-operated (GOCO) facilities, and lower-tier group offices serviced by the reporting unit.</p> <p>7.2.0 <u>Cost Accumulation and Allocation.</u></p> <p>On a continuation sheet, provide a description of:</p> <p>A. The services provided to segments of the university or university system (including hospitals, FFRDC's, GOCO facilities, etc.), in brief.</p> <p>B. How the costs of the services are identified and accumulated.</p> <p>C. The basis used to allocate the accumulated costs to the benefitting segments.</p> <p>D. Any costs that are transferred from a segment <u>to</u> the central system office or the intermediate administrative office, and which are reallocated to another segment(s). If none, so state.</p> <p>E. Any fixed management fees that are charged to a segment(s) in lieu of a prorata or allocation basis and the basis of such charges. If none, so state.</p>	

Subpart 9903.3—CAS Rules and Regulations**9903.301 Definitions.**

(a) The definitions set forth below apply to this chapter 99.

Accrued benefit cost method. See 9904.412-30.

Accumulating costs. See 9904.401-30.

Actual cash value. See 9904.416-30.

Actual cost. See 9904.401-30 for the broader definition and 9904.407-30 for a more restricted definition applicable only to the standard on the use of standard costs for direct material and direct labor.

Actuarial assumption. See 9904.412-30 or 9904.413-30.

Actuarial cost method. See 9904.412-30 or 9904.413-30.

Actuarial gain and loss. See 9904.412-30 or 9904.413-30.

Actuarial liability. See 9904.412-30 or 9904.413-30.

Actuarial valuation. See 9904.412-30 or 9904.413-30.

Allocate. See 9904.402-30, 9904.403-30, 9904.406-30, 9904.410-30, 9904.411-30, 9904.418-30 or 9904.420-30.

Asset accountability unit. See 9904.404-30.

Assignment of cost to cost accounting periods. See 9903.302-1(b).

Bid and proposal (B&P) cost. See 9904.420-30.

Business unit. See 9904.410-30, 9904.411-30 or 9904.414-30.

CAS-covered contract, as used in this part, means any negotiated contract or subcontract in which a CAS clause is required to be included.

Category of material. See 9904.411-30.

Change to a cost accounting practice. See 9903.302-2.

Compensated personal absence. See 9904.408-30.

Cost accounting practice. See 9903.302-1.

Cost input. See 9904.410-30.

Cost objective. See 9904.402-30, 9904.406-30, 9904.410-30 or 9904.411-30.

Cost of capital committed to facilities. See 9904.414-30.

Currently performing, as used in this part, means that a contractor has been awarded a contract, but has not yet received notification of final acceptance of all supplies, services, and data deliverable under the contract (including options).

Deferred compensation. See 9904.415-30.

Defined-benefit pension plan. See 9904.412-30.

Defined-contribution pension plan. See 9904.412-30.

Direct cost. See 9904.402-30 or 9904.418-30.

Directly associated cost. See 9904.405-30.

Disclosure statement, as used in this part, means the Disclosure Statement required by 9903.202-1.

Entitlement. See 9904.408-30.

Estimating costs. See 9904.401-30.

Expressly unallowable cost. See 9904.405-30.

Facilities capital. See 9904.414-30.

Final cost objective. See 9904.402-30 or 9904.410-30.

Fiscal year. See 9904.406-30.

Funded pension cost. See 9904.412-30.

Funding agency. See 9904.412-30.

General and administrative (G&A) expense. See 9904.410-30 or 9904.420-30.

Home office. See 9904.403-30 or 9904.420-30.

Immediate-gain actuarial cost method. See 9904.413-30.

Independent research and development (IR&D) cost. See 9904.420-30.

Indirect cost. See 9904.402-30, 9904.405-30, 9904.418-30 or 9904.420-30.

Indirect cost pool. See 9904.401-30, 9904.402-30, 9904.406-30 or 9904.418-30.

Insurance administration expenses. See 9904.416-30.

Intangible capital asset. See 9904.414-30 or 9904.417-30.

Labor cost at standard. See 9904.407-30.

Labor-rate standard. See 9904.407-30.

Labor-time standard. See 9904.407-30.

Material cost at standard. See 9904.407-30.

Material inventory record. See 9904.411-30.

Material-price standard. See 9904.407-30.

Material-quantity standard. See 9904.407-30.

Measurement of cost. See 9903.302-1(c).

Moving average cost. See 9904.411-30.

Multiemployer pension plan. See 9904.412-30.

Negotiated subcontract, as used in this part, means any subcontract except a firm fixed-priced subcontract made by a contractor or subcontractor after receiving offers from at least two persons not associated with each other or with such contractor or subcontractor, providing

(1) The solicitation to all competitors is identical,

(2) Price is the only consideration in selecting the subcontractor from among the competitors solicited, and

(3) The lowest offer received in compliance with the solicitation from among those solicited is accepted.

Net awards, as used in this chapter, means the total value of negotiated CAS-covered prime contract and subcontract awards, including the potential value of contract options, received during the reporting period minus cancellations, terminations, and other related credit transactions.

Normal cost. See 9904.412-30 or 9904.413-30.

Operating revenue. See 9904.403-30.

Original complement of low cost equipment. See 9904.404-30.

Pay-as-you-go cost method. See 9904.412-30.

Pension plan. See 9904.412-30 or 9904.413-30.

Pension plan participant. See 9904.413-30.

Pricing. See 9904.401-30.

Production unit. See 9904.407-30.

Projected average loss. See 9904.416-30.

Projected benefit cost method. See 9904.412-30 or 9904.413-30.

Proposal. See 9904.401-30.

Repairs and maintenance. See 9904.404-30.

Reporting costs. See 9904.401-30.

Residual value. See 9904.409-30.

Segment. See 9904.403-30, 9904.410-30, 9904.413-30 or 9904.420-30.

Self-insurance. See 9904.416-30.

Self-insurance charge. See 9904.416-30.

Service life. See 9904.409-30.

Small business, as used in this part, means any concern, firm, person, corporation, partnership, cooperative, or other business enterprise which, under 15 U.S.C. 637(b)(6) and the rules and regulations of the Small Business Administration in Part 121 of Title 13 of the Code of Federal Regulations, is determined to be a small business concern for the purpose of Government contracting.

Spread-gain actuarial cost method. See 9904.413-30.

Standard cost. See 9904.407-30.

Tangible capital asset. See 9904.403-30, 9904.404-30, 9904.409-30, 9904.414-30 or 9904.417-30.

Termination gain or loss. See 9904.413-30.

Unallowable cost. See 9904.405-30.

Variance. See 9904.407-30.

Weighted average cost. See 9904.411-30.

(b) The definitions set forth below are applicable exclusively to educational institutions and apply to this chapter 99.

Business unit. See 9903.201-2(c)(2)(ii).

Educational institution. See 9903.201-2(c)(2)(i).

Intermediate cost objective. See 9905.502-30(a)(7).

Segment. See 9903.201-2(c)(2)(ii).

Subpart 9903.302—Definitions, Explanations, and Illustrations of the Terms, "Cost Accounting Practice" and "Change to a Cost Accounting Practice"

9903.302-1 Cost accounting practice.

Cost accounting practice, as used in this part, means any disclosed or established accounting method or technique which is used for allocation of cost to cost objectives, assignment of cost to cost accounting periods, or measurement of cost.

(a) *Measurement of cost*, as used in this part, encompasses accounting methods and techniques used in defining the components of cost, determining the basis for cost measurement, and establishing criteria for use of alternative cost measurement techniques. The determination of the amount paid or a change in the amount paid for a unit of goods and services is not a cost accounting practice. Examples of cost accounting practices which involve measurement of costs are—

- (1) The use of either historical cost, market value, or present value;
- (2) The use of standard cost or actual cost; or

(3) The designation of those items of cost which must be included or excluded from tangible capital assets or pension cost.

(b) *Assignment of cost to cost accounting periods*, as used in this part, refers to a method or technique used in determining the amount of cost to be assigned to individual cost accounting periods. Examples of cost accounting practices which involve the assignment of cost to cost accounting periods are requirements for the use of specified accrual basis accounting or cash basis accounting for a cost element.

(c) *Allocation of cost to cost objectives*, as used in this part, includes both direct and indirect allocation of cost. Examples of cost accounting practices involving allocation of cost to cost objectives are the accounting methods or techniques used to accumulate cost, to determine whether a cost is to be directly or indirectly allocated to determine the composition of cost pools, and to determine the selection and composition of the appropriate allocation base.

9903.302-2 Change to a cost accounting practice.

Change to a cost accounting practice, as used in this part, means any alteration in a cost accounting practice, as defined in 9903.302-1, whether or not such practices are covered by a Disclosure Statement, except for the following:(a) The initial adoption of a cost accounting practice for the first time a cost is incurred, or a function is created, is not a change in cost accounting practice. The partial or total elimination of a cost or the cost of a function is not a change in cost accounting practice. As used here, function is an activity or group of activities that is identifiable in scope and has a purpose or end to be accomplished.

(b) The revision of a cost accounting practice for a cost which previously had been immaterial is not a change in cost accounting practice.

Subpart 9903.302-3—Illustrations of Changes Which Meet the Definition of "Change to a Cost Accounting Practice"

(a) The method or technique used for measuring costs has been changed.

Description	Accounting Treatment
(1) Contractor changes its actuarial cost method for computing pension costs.	(1)(i) Before change: The contractor computed pension costs using the aggregate cost method.
(2) Contractor uses standard costs to account for its direct labor. Labor cost at standard was computed by multiplying labor-time standard by actual labor rates. The contractor changes the computation by multiplying labor-time standard by labor-rate standard.	(2)(i) Before change: Contractor's direct labor cost was measured with only one component set at standard. (ii) After change: Contractor's direct labor cost is measured with both the time and rate components set at standard.

(b) The method or technique used for assignment of cost to cost accounting periods has been changed.

Description	Accounting Treatment
<p>(1) Contractor changes his established criteria for capitalizing certain classes of tangible capital assets whose acquisition costs totaled \$1 million per cost accounting period.</p>	<p>(1)(i) Before change: Items having acquisition costs of between \$200 and \$400 per unit were capitalized and depreciated over a number of cost accounting periods.</p> <p>(ii) After change: The contractor charges the value of assets costing between \$200 and \$400 per unit to an indirect expense pool which is allocated to the cost objectives of the cost accounting period in which the cost was incurred.</p>
<p>(2) Contractor changes his methods for computing depreciation for a class of assets.</p>	<p>(2)(i) Before change: The contractor assigned depreciation costs to cost accounting periods using an accelerated method.</p> <p>(ii) After change: The contractor assigns depreciation costs to cost accounting periods using the straight line method.</p>
<p>(3) Contractor changes his general method of determining asset lives for classes of assets acquired prior to the effective date of CAS 409.</p>	<p>(3)(i) Before change: The contractor identified the cost accounting periods to which the cost of tangible capital assets would be assigned using guideline class lives provided in IRS Rev. Pro. 72-10.</p> <p>(ii) After change: The contractor changes the method by which he identifies the cost accounting periods to which the costs of tangible capital assets will be assigned. He now uses the expected actual lives based on past usage.</p>

(c) The method or technique used for allocating costs has been changed.

Description	Accounting Treatment
<p>(1) Contractor changes his method of allocating G&A expenses under the requirements of Cost Accounting Standard 410.</p>	<p>(1)(i) Before change: The contractor operating under Cost Accounting Standard 410 has been allocating his general and administrative expense pool to final cost objectives on a total cost input base in compliance with the Standard. The contractor's business changes substantially such that there are significant new projects which have only insignificant quantities of material.</p> <p>(ii) After change: After the addition of the new work, an evaluation of the changed circumstances reveals that the continued use of a total cost input base would result in a significant distortion in the allocation of the G&A expense pool in relation to the benefits received. To remain in compliance with Standard 410, the contractor alters his G&A allocation base from a total cost input base to a value added base.</p>
<p>(2) The contractor changes the accounting for hardware common to all projects.</p>	<p>(2)(i) Before change: The contractor allocated the cost of purchased or requisitioned hardware directly to projects.</p> <p>(ii) After change: The contractor charges the cost of purchased or requisitioned hardware to an indirect expense pool which is allocated to projects using an appropriate allocation base.</p>
<p>(3) The contractor merges operating segments A and B which use different cost accounting practices in accounting for manufacturing overhead costs.</p>	<p>(3)(i) Before change: In segment A, the costs of the manufacturing overhead pool have been allocated to final cost objectives using a direct labor hours base; in segment B, the costs of the manufacturing overhead pool have been allocated to final cost objectives using a direct labor dollars base.</p> <p>(ii) After change: As a result of the merger of operations, the combined segment decides to allocate the cost of the manufacturing overhead pool to all final cost objectives, using a direct labor dollars base. Thus, for those final cost objectives referred to in segment A, the cost of the manufacturing overhead pool will be allocated to the final cost objectives of segment A using a direct labor dollars base instead of a direct labor hours base.</p>

9903.302-4 Illustrations of changes which do not meet the definition of "Change to a cost accounting practice."

Description	Accounting Treatment
(a) Changes in the interest rate levels in the national economy have invalidated the prior actuarial assumption with respect to anticipated investment earnings. The pension plan administrators adopted an increased (decreased) interest rate actuarial assumption. The company allocated the resulting pension costs to all final cost objectives.	(a) Adopting the increase (decrease) in the interest rate actuarial assumption is not a change in cost accounting practice.
(b) The basic benefit amount for a company's pension plan is increased from \$8 to \$10 per year of credited service. The change increases the dollar amount of pension cost allocated to all final cost objectives.	(b) The increase in the amount of the benefits is not a change in cost accounting practice.
(c) A contractor who has never paid pensions establishes for the first time a pension plan. Pension costs for the first year amounted to \$3.5 million.	(c) The initial adoption of an accounting practice for the first time incurrence of a cost is not a change in cost accounting practice.
(d) A contractor maintained a Deferred Incentive Compensation Plan. After several years' experience, the plan was determined not to be attaining its objective, so it was terminated, and no future entitlements were paid.	(d) There was a termination of the Deferred Incentive Compensation Plan. Elimination of a cost is not a change in cost accounting practice.
(e) A contractor eliminates a segment that was operated for the purpose of doing research for development of products related to nuclear energy.	(e) The projects and expenses related to nuclear energy projects have been terminated. No transfer of these projects and no further work in this area is planned. This is an elimination of cost and not a change in cost accounting practice.
(f) For a particular class of assets for which technological changes have rarely affected asset lives, a contractor starts with a 5-year average of historical lives to estimate future lives. He then considers technological changes and likely use. For the past several years the process resulted in an estimated future life of 10 years for this class of assets. This year a technological change leads to a prediction of a useful life of 7 years for the assets acquired this year for the class of assets.	(f) The change in estimate (not in method) is not a change in cost accounting practice. The contractor has not changed the method or technique used to determine the estimate. The methodology applied has indicated a change in the estimated life, and this is not a change in cost accounting practice.
(g) The marketing department of a segment has reported directly to the general manager of the segment. The costs of the marketing department have been combined as part of the segment's G&A expense pool. The company reorganizes and requires the marketing department to report directly to a vice president at corporate headquarters.	(g) After the organization change in the company's reporting structure, the parties agree that the appropriate recognition of the beneficial or causal relationship between the costs of the marketing department and the segment is to continue to combine these costs as part of the segment's G&A expense pool. Thus, the organizational change has not resulted in a change in cost accounting practice.

9903.303 Effect of filing Disclosure Statement.

(a) A disclosure of a cost accounting practice by a contractor does not determine the allowability of particular items of cost. Irrespective of the practices disclosed by a contractor, the question of whether or not, or the extent to which, a specific element of cost is allowed under a contract remains for consideration in each specific instance. Contractors are cautioned that the determination of the allowability of cost items will remain a responsibility of the contracting officers pursuant to the provisions of the applicable procurement regulations.

(b) The individual Disclosure Statement may be used in audits of contracts or in negotiation of prices leading to contracts. The authority of the audit agencies and the contracting officers is in no way abrogated by the material presented by the contractor in his

Disclosure Statement. Contractors are cautioned that their disclosures must be complete and accurate; the practices disclosed may have a significant impact on ways in which contractors will be required to comply with Cost Accounting Standards.

9903.304 Concurrent full and modified coverage.

Contracts subject to full coverage may be performed during a period in which a previously awarded contract subject to modified coverage is being performed. Compliance with full coverage may compel the use of cost accounting practices that are not required under modified coverage. Under these circumstances the cost accounting practices applicable to contracts subject to modified coverage need not be changed. Any resulting differences in practices between contracts subject to full coverage and those subject to modified coverage shall not constitute a violation of 9904.401 and

9904.402. This principle also applies to contracts subject to modified coverage being performed during a period in which a previously awarded contract subject to full coverage is being performed.

9903.305 Materiality.

In determining whether amounts of cost are material or immaterial, the following criteria shall be considered where appropriate; no one criterion is necessarily determinative:

(a) The absolute dollar amount involved. The larger the dollar amount, the more likely that it will be material.

(b) The amount of contract cost compared with the amount under consideration. The larger the proportion of the amount under consideration to contract cost, the more likely it is to be material.

(c) The relationship between a cost item and a cost objective. Direct cost items, especially if the amounts are themselves part of a base for allocation of indirect costs, will normally have more impact than the same amount of indirect costs.

(d) The impact on Government funding. Changes in accounting treatment will have more impact if they influence the distribution of costs between Government and non-Government cost objectives than if all cost objectives have Government financial support.

(e) The cumulative impact of individually immaterial items. It is appropriate to consider whether such impacts

(1) Tend to offset one another, or

(2) Tend to be in the same direction

and hence to accumulate into a material amount.

(f) The cost of administrative processing of the price adjustment modification shall be considered. If the

cost to process exceeds the amount to be recovered, it is less likely the amount will be material.

9903.306 Interpretations.

In determining amounts of increased costs in the clauses at 9903.201-4(a), Cost Accounting Standards, 9903.201-4(c), Disclosure and Consistency of Cost Accounting Practices, and 9903.201-4(d), Consistency in Cost Accounting, the following considerations apply:

(a) Increased costs shall be deemed to have resulted whenever the cost paid by the Government results from a change in a contractor's cost accounting practices or from failure to comply with applicable Cost Accounting Standards, and such cost is higher than it would have been had the practices not been changed or applicable Cost Accounting Standards complied with.

(b) If the contractor under any fixed-price contract, including a firm fixed-price contract, fails during contract performance to follow its cost accounting practices or to comply with applicable Cost Accounting Standards, increased costs are measured by the difference between the contract price agreed to and the contract price that would have been agreed to had the contractor proposed in accordance with the cost accounting practices used during contract performance. The determination of the contract price that would have been agreed to will be left to the contracting parties and will depend on the circumstances of each case.

(c) The statutory requirement underlying this interpretation is that the United States not pay increased costs, including a profit

enlarged beyond that in the contemplation of the parties to the contract when the contract costs, price, or profit is negotiated, by reason of a contractor's failure to use applicable Cost Accounting Standards, or to follow consistently its cost accounting practices. In making price adjustments under the Cost Accounting Standards clause at 9903.201-4(a) in fixed price or cost reimbursement incentive contracts, or contracts providing for prospective or retroactive price redetermination, the Federal agency shall apply this requirement appropriately in the circumstances.

(d) The contractor and the contracting officer may enter into an agreement as contemplated by subdivision (a)(4)(ii) of the Cost Accounting Standards clause at 9903.201-4(a), covering a change in practice proposed by the Government or the contractor for all of the contractor's contracts for which the contracting officer is responsible, provided that the agreement does not permit any increase in the cost paid by the Government. Such agreement may be made final and binding, notwithstanding the fact that experience may subsequently establish that the actual impact of the change differed from that agreed to.

(e) An adjustment to the contract price or of cost allowances pursuant to the Cost Accounting Standards clause at 9903.201-4(a) may not be required when a change in cost accounting practices or a failure to follow Standards or cost accounting practices is estimated to result in increased costs being paid under a particular contract by the United States. This circumstance may arise when a contractor is performing two or more covered contracts, and the change or failure affects all such contracts. The change or failure may increase the cost paid under one or more of the contracts, while decreasing the cost paid under one or more of the contracts. In such case, the Government will not require price adjustment for any increased costs paid by the United States, so long as the cost decreases under one or more contracts are at least equal to the increased cost under the other affected contracts, provided that the contractor and the affected contracting officers agree on the method by which the price adjustments are to be made for all affected contracts. In this situation, the contracting agencies would, of course, require an adjustment of the contract price or cost allowances, as appropriate, to the extent that the increases under certain contracts were not offset by the decreases under the remaining contracts.

(f) 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.

9903.307 Cost Accounting Standards Preambles.

Preambles to the Cost Accounting Standards published by the original Cost Accounting Standards Board, as well as those preambles published by the signatories to the Federal Acquisition Regulation respecting changes made under their regulatory authorities, are available by writing to the: Publications Office, Office of Administration, Executive Office of the President, 725 17th Street, N.W., Room 2200, Washington, D.C. 20500, or by calling (202) 395-7332.

PART 9904—COST ACCOUNTING STANDARDS**9904.400 [Reserved]****Subpart 9904.401—Cost Accounting Standard—Consistency in Estimating, Accumulating and Reporting Costs**

- 9904.401-10 [Reserved]
- 9904.401-20 Purpose.
- 9904.401-30 Definitions.
- 9904.401-40 Fundamental requirement.
- 9904.401-50 Techniques for application.
- 9904.401-60 Illustrations.
- 9904.401-61 Interpretation.
- 9904.401-62 Exemptions.
- 9904.401-63 Effective date.

Subpart 9904.402—Cost Accounting Standard—Consistency in Allocating Costs Incurred for the Same Purpose

- 9904.402-10 [Reserved]
- 9904.402-20 Purpose.
- 9904.402-30 Definitions.
- 9904.402-40 Fundamental requirement.
- 9904.402-50 Techniques for application.
- 9904.402-60 Illustrations.
- 9904.402-61 Interpretation.
- 9904.402-62 Exemption.
- 9904.402-63 Effective date.

Subpart 9904.403—Allocation of Home Office Expenses to Segments

- 9904.403-10 [Reserved]
- 9904.403-20 Purpose.
- 9904.403-30 Definitions.
- 9904.403-40 Fundamental requirement.
- 9904.403-50 Techniques for application.
- 9904.403-60 Illustrations.
- 9904.403-61 Interpretation.
- 9904.403-62 Exemption. [Reserved]
- 9904.403-63 Effective date.

Subpart 9904.404—Capitalization of Tangible Assets

- 9904.404-10 [Reserved]
- 9904.404-20 Purpose.
- 9904.404-30 Definitions.
- 9904.404-40 Fundamental requirement.
- 9904.404-50 Techniques for application.
- 9904.404-60 Illustrations.
- 9904.404-61 Interpretation. [Reserved]
- 9904.404-62 Exemption.
- 9904.404-63 Effective date.

Subpart 9904.405—Accounting for Unallowable Costs

- 9904.405-10 [Reserved]
- 9904.405-20 Purpose.
- 9904.405-30 Definitions.
- 9904.405-40 Fundamental requirement.
- 9904.405-50 Techniques for application.
- 9904.405-60 Illustrations.
- 9904.405-61 Interpretation. [Reserved]
- 9904.405-62 Exemptions.
- 9904.405-63 Effective date.

Subpart 9904.406—Cost Accounting Standard—Cost Accounting Period

- 9904.406-10 [Reserved]
- 9904.406-20 Purpose.
- 9904.406-30 Definitions.
- 9904.406-40 Fundamental requirement.
- 9904.406-50 Techniques for application.
- 9904.406-60 Illustrations.
- 9904.406-61 Interpretation.]
- 9904.406-62 Exemption.
- 9904.406-63 Effective date.

Subpart 9904.407—Use of Standard Costs for Direct Material and Direct Labor

- 9904.407-10 [Reserved]
- 9904.407-20 Purpose.
- 9904.407-30 Definitions.
- 9904.407-40 Fundamental requirement.
- 9904.407-50 Techniques for application.
- 9904.407-60 Illustrations.
- 9904.407-61 Interpretation. [Reserved]
- 9904.407-62 Exemption.
- 9904.407-63 Effective date.

Subpart 9904.408—Accounting for Costs of Compensated Personal Absence

- 9904.408-10 [Reserved]
- 9904.408-20 Purpose.
- 9904.408-30 Definitions.
- 9904.408-40 Fundamental requirement.
- 9904.408-50 Techniques for application.
- 9904.408-60 Illustrations.
- 9904.408-61 Interpretation. [Reserved]
- 9904.408-62 Exemption.
- 9904.408-63 Effective date.

Subpart 9904.409—Cost Accounting Standard—Depreciation of Tangible Capital Assets

- 9904.409-10 [Reserved]
- 9904.409-20 Purpose.
- 9904.409-30 Definitions.
- 9904.409-40 Fundamental requirement.
- 9904.409-50 Techniques for application.
- 9904.409-60 Illustrations.
- 9904.409-61 Interpretation. [Reserved]
- 9904.409-62 Exemption.
- 9904.409-63 Effective date.

Subpart 9904.410—Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives

- 9904.410-10 [Reserved]
- 9904.410-20 Purpose.
- 9904.410-30 Definitions.
- 9904.410-40 Fundamental requirement.
- 9904.410-50 Techniques for application.
- 9904.410-60 Illustrations.
- 9904.410-61 Interpretation. [Reserved]
- 9904.410-62 Exemption.
- 9904.410-63 Effective date.

Appendix A to Section 9904.410—Transition From a Cost of Sales or Sales Base to a Cost Input Base.**Subpart 9904.411—Cost Accounting Standard—Accounting for Acquisition Costs of Material**

- 9904.411-10 [Reserved]
- 9904.411-20 Purpose.
- 9904.411-30 Definitions.
- 9904.411-40 Fundamental requirement.
- 9904.411-50 Techniques for application.
- 9904.411-60 Illustrations.
- 9904.411-61 Interpretation. [Reserved]
- 9904.411-62 Exemption.
- 9904.411-63 Effective date.

Subpart 9904.412—Cost Accounting Standard for Composition and Measurement of Pension Cost

- 9904.412-10 [Reserved]
- 9904.412-20 Purpose.
- 9904.412-30 Definitions.
- 9904.412-40 Fundamental requirement.
- 9904.412-50 Techniques for application.
- 9904.412-60 Illustrations.
- 9904.412-61 Interpretation. [Reserved]
- 9904.412-62 Exemption.
- 9904.412-63 Effective date
- 9904.412-64 Transition method.

Subpart 9904.413—Adjustment and Allocation of Pension Cost

- 9904.413-10 [Reserved]
- 9904.413-20 Purpose.
- 9904.413-30 Definitions.
- 9904.413-40 Fundamental requirement.
- 9904.413-50 Techniques for application.
- 9904.413-60 Illustrations.
- 9904.413-61 Interpretation. [Reserved]
- 9904.413-62 Exemption.
- 9904.413-63 Effective date.
- 9904.413-64 Transition method.

Subpart 9904.414—Cost Accounting Standard—Cost of Money as an Element of the Cost of Facilities Capital

- 9904.414-10 [Reserved]
- 9904.414-20 Purpose.
- 9904.414-30 Definitions.
- 9904.414-40 Fundamental requirement.
- 9904.414-50 Techniques for application.
- 9904.414-60 Illustrations.
- 9904.414-61 Interpretation. [Reserved]
- 9904.414-62 Exemption.
- 9904.414-63 Effective date.

**Appendix A to Section 9904.414 - Instructions for Form CASB
CMF Appendix to Section 9904.414—Example—ABC Corporation****Subpart 9904.415—Accounting for the Cost of Deferred Compensation**

- 9904.415-10 [Reserved]
- 9904.415-20 Purpose.

- 9904.415-30 Definitions.
- 9904.415-40 Fundamental requirement.
- 9904.415-50 Techniques for application.
- 9904.415-60 Illustrations.
- 9904.415-61 Interpretation. [Reserved]
- 9904.415-62 Exemption.
- 9904.415-63 Effective date.

Subpart 9904.416—Accounting for Insurance Costs

- 9904.416-10 [Reserved]
- 9904.416-20 Purpose.
- 9904.416-30 Definitions.
- 9904.416-40 Fundamental requirement.
- 9904.416-50 Techniques for application.
- 9904.416-60 Illustrations.
- 9904.416-61 Interpretation. [Reserved]
- 9904.416-62 Exemption.
- 9904.416-63 Effective date.

Subpart 9904.417—Cost of Money as an Element of the Cost of Capital Assets Under Construction

- 9904.417-10 [Reserved]
- 9904.417-20 Purpose.
- 9904.417-30 Definitions.
- 9904.417-40 Fundamental requirement.
- 9904.417-50 Techniques for application.
- 9904.417-60 Illustrations.
- 9904.417-61 Interpretation. [Reserved]
- 9904.417-62 Exemption.
- 9904.417-63 Effective date.

Subpart 9904.418—Allocation of Direct and Indirect Costs

- 9904.418-10 [Reserved]
- 9904.418-20 Purpose.
- 9904.418-30 Definitions.
- 9904.418-40 Fundamental requirements.
- 9904.418-50 Techniques for application.
- 9904.418-60 Illustrations.
- 9904.418-61 Interpretation. [Reserved]
- 9904.418-62 Exemptions.
- 9904.418-63 Effective date.

Subpart 9904.419—[Reserved]**Subpart 9904.420—Accounting for Independent Research and Development Costs and Bid and Proposal Costs**

- 9904.420-10 [Reserved]
- 9904.420-20 Purpose.
- 9904.420-30 Definitions.
- 9904.420-40 Fundamental requirement.
- 9904.420-50 Techniques for application.
- 9904.420-60 Illustrations.
- 9904.420-61 Interpretation. [Reserved]
- 9904.420-62 Exemptions.
- 9904.420-63 Effective date.

AUTHORITY: Pub. L. 100-679, 102 Stat. 4056, 41 U.S.C. § 422.

Subpart 9904.400—[Reserved]

Subpart 9904.401—Cost Accounting Standard—Consistency in Estimating, Accumulating and Reporting Costs

9904.401-10 [Reserved]

9904.401-20 Purpose.

The purpose of this Cost Accounting Standard is to ensure that each contractor's practices used in estimating costs for a proposal are consistent with cost accounting practices used by him in accumulating and reporting costs. Consistency in the application of cost accounting practices is necessary to enhance the likelihood that comparable transactions are treated alike. With respect to individual contracts, the consistent application of cost accounting practices will facilitate the preparation of reliable cost estimates used in pricing a proposal and their comparison with the costs of performance of the resulting contract. Such comparisons provide one important basis for financial control over costs during contract performance and aid in establishing accountability for costs in the manner agreed to by both parties at the time of contracting. The comparisons also provide an improved basis for evaluating estimating capabilities.

9904.401-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

- (1) *Accumulating costs* means the collecting of cost data in an organized manner, such as through a system of accounts.
- (2) *Actual cost* means an amount determined on the basis of cost incurred (as distinguished from forecasted cost), including standard cost properly adjusted for applicable variance.
- (3) *Estimating costs* means the process of forecasting a future result in terms of cost, based upon information available at the time.
- (4) *Indirect cost pool* means a grouping of incurred costs identified with two or more objectives but not identified specifically with any final cost objective.
- (5) *Pricing* means the process of establishing the amount or amounts to be paid in return for goods or services.
- (6) *Proposal* means any offer or other submission used as a basis for pricing a contract, contract modification or termination settlement or for securing payments thereunder.
- (7) *Reporting costs* means provision of cost information to others.

(a) The following examples are illustrative of applications of cost accounting practices which are deemed to be consistent.

PRACTICES USED IN ESTIMATING COSTS FOR PROPOSALS	PRACTICES USED IN ACCUMULATING AND REPORTING COSTS OF CONTRACT PERFORMANCE
1. Contractor estimates an average direct labor rate for manufacturing direct labor by labor category or function.	1. Contractor records manufacturing direct labor based on actual cost for each individual and collects such costs by labor category or function.
2. Contractor estimates an average cost for minor standard hardware items, including nuts, bolts, washers, etc.	2. Contractor records actual cost for minor standard hardware items based upon invoices or material transfer slips.
3. Contractor uses an estimated rate for manufacturing overhead to be applied to an estimated direct labor base. He identifies the items included in his estimate of manufacturing overhead and provides supporting data for the estimated direct labor base.	3. Contractor accounts for manufacturing overhead by individual items of cost which are accumulated in a cost pool allocated to final cost objectives on a direct labor base.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.401-40 Fundamental requirement.

(a) A contractor's practices used in estimating costs in pricing a proposal shall be consistent with his cost accounting practices used in accumulating and reporting costs.

(b) A contractor's cost accounting practices used in accumulating and reporting actual costs for a contract shall be consistent with his practices used in estimating costs in pricing the related proposal.

(c) The grouping of homogeneous costs in estimates prepared for proposal purposes shall not per se be deemed an inconsistent application of cost accounting practices under paragraphs (a) and (b) of this section when such costs are accumulated and reported in greater detail on an actual cost basis during contract performance.

9904.401-50 Techniques for application.

(a) The standard allows grouping of homogeneous costs in order to cover those cases where it is not practicable to estimate contract costs by individual cost element or function. However, costs estimated for proposal purposes shall be presented in such a manner and in such detail that any significant cost can be compared with the actual cost accumulated and reported therefor. In any event the cost accounting practices used in estimating costs in pricing a proposal and in accumulating and reporting costs on the resulting contract shall be consistent with respect to:

- (1) The classification of elements or functions of cost as direct or indirect;
- (2) The indirect cost pools to which each element or function of cost is charged or proposed to be charged; and
- (3) The methods of allocating indirect costs to the contract.

(b) Adherence to the requirement of 9904.401-40(a) of this standard shall be determined as of the date of award of the contract, unless the contractor has submitted cost or pricing data pursuant to 10 U.S.C. 2306a or 41 U.S.C. 254(d) (Pub. L. 87-653), in which case adherence to the requirement of 9904.401-40(a) shall be determined as of the date of final agreement on price, as shown on the signed certificate of current cost or pricing data. Notwithstanding 9904.401-40(b), changes in established cost accounting practices during contract performance may be made in accordance with Part 99.

9904.401-60 Illustrations.

(b) The following examples are illustrative of application of cost accounting practices which are deemed not to be consistent.

PRACTICES USED FOR ESTIMATING COSTS FOR PROPOSALS	PRACTICES USED IN ACCUMULATING AND REPORTING COSTS OF CONTRACT PERFORMANCE
4. Contractor estimates a total dollar amount for engineering labor which includes disparate and significant elements or functions of engineering labor. Contractor does not provide supporting data reconciling this amount to the estimates for the same engineering labor cost functions for which he will separately account in contract performance.	4. Contractor accounts for engineering labor by cost function, i.e. drafting, designing, production, engineering, etc.
5. Contractor estimates engineering labor by cost function, i.e. drafting, production engineering, etc.	5. Contractor accumulates total engineering labor in one undifferentiated account.
6. Contractor estimates a single dollar amount for machining cost to cover labor, material and overhead.	6. Contractor records separately the actual costs of machining labor and material as direct costs, and factory overhead as indirect costs.

9904.401-61 Interpretation.

(a) 9904.401, Cost Accounting Standard—Consistency in Estimating, Accumulating and Reporting Costs, requires in 9904.401-40 that a contractor's "practices used in estimating costs in pricing a proposal shall be consistent with his cost accounting practices used in accumulating and reporting costs."

(b) In estimating the cost of direct material requirements for a contract, it is a common practice to first estimate the cost of the actual quantities to be incorporated in end items. Provisions are then made for additional direct material costs to cover expected material losses such as those which occur, for example, when items are scrapped, fail to meet specifications, are lost, consumed in the manufacturing process, or destroyed in testing and qualification processes. The cost of some or all of such additional direct material requirements is often estimated by the application of one or more percentage factors to the total cost of basic direct material requirements or to some other base.

(c) Questions have arisen as to whether the accumulation of direct material costs in an undifferentiated account where a contractor estimates a significant part of such costs by means of percentage factors is in compliance with 9904.401. The most serious questions pertain to such percentage factors which are not supported by the contractor with accounting, statistical, or other relevant data from past experience, nor by a program to accumulate actual costs for comparison with such percentage estimates. The accumulation of direct costs in an undifferentiated account in this circumstance is a cost accounting practice which is not consistent with the practice of estimating a significant part of costs by means of percentage factors. This situation is virtually identical with that described in Illustration 9904.401-60(b)(5), which deals with labor.

(d) 9904.401 does not, however, prescribe the amount of detail required in accumulating and reporting costs. The amount of detail required may vary considerably depending on the percentage factors used, the data presented in justification or lack thereof, and the significance of each situation. Accordingly, it is neither appropriate nor practical to prescribe a single set of accounting practices which would be consistent in all situations with the practices of estimating direct material costs by percentage factors. Therefore, the amount of accounting and statistical detail to be required and maintained in accounting for this portion of direct material costs has been and

continues to be a matter to be decided by Government procurement authorities on the basis of the individual facts and circumstances.

9904.401-62 Exemptions.

None for this Standard.

9904.401-63 Effective date.

This Standard is effective as of April 17, 1992.

Subpart 9904.402—Cost Accounting Standard—Consistency in Allocating Costs Incurred for the Same Purpose

9904.402-10 [Reserved]

9904.402-20 Purpose.

The purpose of this standard is to require that each type of cost is allocated only once and on only one basis to any contract or other cost objective. The criteria for determining the allocation of costs to a product, contract, or other cost objective should be the same for all similar objectives. Adherence to these cost accounting concepts is necessary to guard against the overcharging of some cost objectives and to prevent double counting. Double counting occurs most commonly when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools which are allocated to that cost objective.

9904.402-30 Definitions.

(a) The following are definitions of terms which are prominent in this standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b), of this section requires otherwise.

(1) *Allocate* means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Cost objective* means a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost to processes, products, jobs, capitalized projects, etc.

(3) *Direct cost* means any cost which is identified specifically with a particular final cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of

that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.

(4) *Final cost objective* means a cost objective which has allocated to it both direct and indirect costs, and in the contractor's accumulation system, is one of the final accumulation points.

(5) *Indirect cost* means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

(6) *Indirect cost pool* means a grouping of incurred costs identified with two or more cost objectives but not specifically identified with any final cost objective.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.402-40 Fundamental requirement.

All costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives. No final cost objective shall have allocated to it as an indirect cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective. Further, no final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that or any other final cost objective.

9904.402-50 Techniques for application.

(a) The Fundamental Requirement is stated in terms of cost incurred and is equally applicable to estimates of costs to be incurred as used in contract proposals.

(b) The Disclosure Statement to be submitted by the contractor will require that he set forth his cost accounting practices with regard to the distinction between direct and indirect costs. In addition, for those types of cost which are sometimes accounted for as direct and sometimes accounted for as indirect, the contractor will set forth in his Disclosure Statement the specific criteria and circumstances for making such distinctions. In essence, the Disclosure Statement submitted by the contractor, by distinguishing between direct and indirect costs, and by describing the criteria and circumstances for allocating those items which are sometimes direct and sometimes indirect, will be determinative as to whether or not costs are incurred for the same purpose. Disclosure Statement as used herein refers to the statement required to be submitted by contractors as a condition of contracting as set forth in Subpart 9903.2.

(c) In the event that a contractor has not submitted a Disclosure Statement, the determination of whether specific costs are directly allocable to contracts shall be based upon the contractor's cost accounting practices used at the time of contract proposal.

(d) Whenever costs which serve the same purpose cannot equitably be indirectly allocated to one or more final cost objectives in accordance with the contractor's disclosed accounting practices, the contractor may either:

(1) Use a method for reassigning all such costs which would provide an equitable distribution to all final cost objectives, or

(2) Directly assign all such costs to final cost objectives with which they are specifically identified.

In the event the contractor decides to make a change for either purpose, the Disclosure Statement shall be amended to reflect the revised accounting practices involved.

(e) Any direct cost of minor dollar amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives, provided that such treatment produces results which are substantially the same as the results which would have been obtained if such cost had been treated as a direct cost.

9904.402-60 Illustrations.

(a) Illustrations of costs which are incurred for the same purpose:

(1) Contractor normally allocates all travel as an indirect cost and previously disclosed this accounting practice to the Government. For purposes of a new proposal, contractor intends to allocate the travel costs of personnel whose time is accounted for as direct labor directly to the contract. Since travel costs of personnel whose time is accounted for as direct labor working on other contracts are costs which are incurred for the same purpose, these costs may no longer be included within indirect cost pools for purposes of allocation to any covered Government contract. Contractor's Disclosure Statement must be amended for the proposed changes in accounting practices.

(2) Contractor normally allocates planning costs indirectly and allocates this cost to all contracts on the basis of direct labor. A proposal for a new contract requires a disproportionate amount of planning costs. The contractor prefers to continue to allocate planning costs indirectly. In order to equitably allocate the total planning costs, the contractor may use a method for allocating all such costs which would provide an equitable distribution to all final cost objectives. For example, he may use the number of planning documents processed rather than his former allocation base of direct labor. Contractor's Disclosure Statement must be amended for the proposed changes in accounting practices.

(b) Illustrations of costs which are not incurred for the same purpose:

(1) Contractor normally allocates special tooling costs directly to contracts. The costs of general purpose tooling are normally included in the indirect cost pool which is allocated to contracts. Both of these accounting practices were previously disclosed to the Government. Since both types of costs involved were not incurred for the same purpose in accordance with the criteria set forth in the Contractor's Disclosure Statement, the allocation of general purpose tooling costs from the indirect cost pool to the contract, in addition to the directly allocated special tooling costs, is not considered a violation of the standard.

(2) Contractor proposes to perform a contract which will require three firemen on 24-hour duty at a fixed-post to provide protection against damage to highly inflammable materials used on the contract. Contractor presently has a firefighting force of 10 employees for general protection of the plant. Contractor's costs for these latter firemen are treated as indirect costs and allocated to all contracts; however, he wants to allocate the three fixed-post firemen directly to the particular contract requiring them and also allocate a portion of the cost of the general firefighting force to the same contract. He may do so but only on condition that his disclosed practices indicate that the costs of the separate classes of firemen serve different purposes and that it is his practice to allocate the general firefighting force indirectly and to allocate fixed-post firemen directly.

9904.402-61 Interpretation.

(a) 9904.402, Cost Accounting Standard—Consistency in Allocating Costs Incurred for the Same Purpose, provides, in 9904.402-40, that " * * * no final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that or any other final cost objective."

(b) This interpretation deals with the way 9904.402 applies to the treatment of costs incurred in preparing, submitting, and supporting proposals. In essence, it is addressed to whether or not, under the Standard, all such costs are incurred for the same purpose, in like circumstances.

(c) Under 9904.402, costs incurred in preparing, submitting, and supporting proposals pursuant to a specific requirement of an existing contract are considered to have been incurred in different circumstances from the circumstances under which costs are incurred in preparing proposals which do not result from such specific requirement. The circumstances are different because the costs of preparing proposals specifically required by the provisions of an existing contract relate only to that contract while other proposal costs relate to all work of the contractor.

(d) This interpretation does not preclude the allocation, as indirect costs, of costs incurred in preparing all proposals. The cost accounting practices used by the contractor, however, must be followed consistently and the method used to reallocate such costs, of course, must provide an equitable distribution to all final cost objectives.

9904.402-62 Exemption.

None for this Standard.

9904.402-63 Effective date.

This Standard is effective as of April 17, 1992.

Subpart 9904.403—Allocation of Home Office Expenses to Segments**9904.403-10 [Reserved]****9904.403-20 Purpose.**

(a) The purpose of this Cost Accounting Standard is to establish criteria for allocation of the expenses of a home office to the segments of the organization based on the beneficial or causal relationship between such expenses and the receiving segments. It provides for:

(1) Identification of expenses for direct allocation to segments to the maximum extent practical;

(2) Accumulation of significant nondirectly allocated expenses into logical and relatively homogeneous pools to be allocated on bases reflecting the relationship of the expenses to the segments concerned; and

(3) Allocation of any remaining or residual home office expenses to all segments.

Appropriate implementation of this Standard will limit the amount of home office expenses classified as residual to the expenses of managing the organization as a whole.

(b) This Standard does not cover the reallocation of a segment's share of home office expenses to contracts and other cost objectives.

9904.403-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Allocate* means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignments of cost and the reassignment of a share from an indirect cost pool.

(2) *Home office* means an office responsible for directing or managing two or more, but not necessarily all, segments of an organization. It typically establishes policy for, and provides guidance to the segments in their operations. It usually performs management, supervisory, or administrative functions, and may also perform service functions in support of the operations of the various segments. An organization which has intermediate levels, such as groups, may have several home offices which report to a common home office. An intermediate organization may be both a segment and a home office.

(3) *Operating revenue* means amounts accrued or charge to customers, clients, and tenants, for the sale of products manufactured or purchased for resale, for services, and for rentals of property held primarily for leasing to others. It includes both reimbursable costs and fees under cost-type contracts and percentage-of-completion sales accruals except that it includes only the fee for management contracts under which the contractor acts essentially as an agent of the Government in the erection or operation of Government-owned facilities. It excludes incidental interest, dividends, royalty, and rental income, and proceeds from the sale of assets used in the business.

(4) *Segment* means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. The term includes Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the organization has less than a majority of ownership, but over which it exercises control.

(5) *Tangible capital asset* means an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the services it yields.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.403-40 Fundamental requirement.

(a)(1) Home office expenses shall be allocated on the basis of the beneficial or causal relationship between supporting and receiving activities. Such expenses shall be allocated directly to segments to the maximum extent practical. Expenses not directly allocated, if significant in amount and in relation to total home office expenses, shall be grouped in logical and homogeneous expense pools and allocated pursuant to paragraph (b) of this subsection. Such allocations shall minimize to the extent practical the amount of expenses which may be categorized as residual (those of managing the orga-

nization as a whole). These residual expenses shall be allocated pursuant to paragraph (c) of this subsection.

(2) No segment shall have allocated to it as an indirect cost, either through a homogeneous expense pool, or the residual expense pool, any cost, if other costs incurred for the same purpose have been allocated directly to that or any other segment.

(b) The following subparagraphs provide criteria for allocation of groups of home office expenses.

(1) Centralized service functions. Expenses of centralized service functions performed by a home office for its segments shall be allocated to segments on the basis of the service furnished to or received by each segment. Centralized service functions performed by a home office for its segments are considered to consist of specific functions which, but for the existence of a home office, would be performed or acquired by some or all of the segments individually. Examples include centrally performed personnel administration and centralized data processing.

(2) Staff management of certain specific activities of segments. The expenses incurred by a home office for staff management or policy guidance functions which are significant in amount and in relation to total home office expenses shall be allocated to segments receiving more than a minimal benefit over a base, or bases, representative of the total specific activity being managed. Staff management or policy guidance to segments is commonly provided in the overall direction or support of the performance of discrete segment activities such as manufacturing, accounting, and engineering (but see subparagraph (b)(6) of this subsection).

(3) Line management of particular segments or groups of segments. The expense of line management shall be allocated only to the particular segment or group of segments which are being managed or supervised. If more than one segment is managed or supervised, the expense shall be allocated using a base or bases representative of the total activity of such segments. Line management is considered to consist of management or supervision of a segment or group of segments as a whole.

(4) Central payments or accruals. Central payments or accruals which are made by a home office on behalf of its segments shall be allocated directly to segments to the extent that all such payments or accruals of a given type or class can be identified specifically with individual segments. Central payments or accruals are those which but for the existence of a number of segments would be accrued or paid by the individual segments. Common examples include centrally paid or accrued pension costs, group insurance costs, State and local income taxes and franchise taxes, and payrolls paid by a home office on behalf of its segments. Any such types of payments or accruals which cannot be identified specifically with individual segments shall be allocated to benefited segments using an allocation base representative of the factors on which the total payment is based.

(5) Independent research and development costs and bid and proposal costs. Independent research and development costs and bid and proposal costs of a home office shall be allocated in accordance with 9904.420.

(6) Staff management not identifiable with any certain specific activities of segments. The expenses incurred by a home office for staff management, supervisory, or policy functions, which are not identifiable to specific activities of segments shall be allocated in

accordance with paragraph (c) of this subsection as residual expenses.

(c) *Residual expenses.* (1) All home office expenses which are not allocable in accordance with paragraph (a) of this subsection and paragraphs (b)(1) through (b)(5) of this subsection shall be deemed residual expenses. Typical residual expenses are those for the chief executive, the chief financial officer, and any staff which are not identifiable with specific activities of segments. Residual expenses shall be allocated to all segments under a home office by means of a base representative of the total activity of such segments, except where paragraph (c)(2) or (3) of this subsection applies.

(2) Residual expenses shall be allocated pursuant to 9904.403-50(c)(1) if the total amount of such expenses for the contractor's previous fiscal year (excluding any unallowable costs and before eliminating any amounts to be allocated in accordance with paragraph (c)(3) of this subsection) exceeds the amount obtained by applying the following percentage(s) to the aggregate operating revenue of all segments for such previous year: 3.35 percent of the first \$100 million; 0.95 percent of the next \$200 million; 0.30 percent of the next \$2.7 billion; 0.20 percent of all amounts over \$3 billion. The determination required by this paragraph for the 1st year the contractor is subject to this Standard shall be based on the pro forma application of this Standard to the home office expenses and aggregate operating revenue for the contractor's previous fiscal year.

(3) Where a particular segment receives significantly more or less benefit from residual expenses than would be reflected by the allocation of such expenses pursuant to paragraph (c)(1) or (2) of this subsection (see 9904.403-50(d)), the Government and the contractor may agree to a special allocation of residual expenses to such segment commensurate with the benefits received. The amount of a special allocation to any segment made pursuant to such an agreement shall be excluded from the pool of residual expenses to be allocated pursuant to paragraph (c)(1) or (2) of this subsection, and such segment's data shall be excluded from the base used to allocate this pool.

9904.403-50 Techniques for application.

(a)(1) Separate expense groupings will ordinarily be required to implement 9904.403-40. The number of groupings will depend primarily on the variety and significance of service and management functions performed by a particular home office. Ordinarily, each service or management function will have to be separately identified for allocation by means of an appropriate allocation technique. However, it is not necessary to identify and allocate different functions separately, if allocation in accordance with the relevant requirements of 9904.403-40(b) can be made using a common allocation base. For example, if the personnel department of a home office provides personnel services for some or all of the segments (a centralized service function) and also established personnel policies for the same segments (a staff management function), the expenses of both functions could be allocated over the same base, such as the number of personnel, and the separate functions do not have to be identified.

(2) Where the expense of a given function is to be allocated by means of a particular allocation base, all segments shall be included in the base unless:

(i) Any excluded segment did not receive significant benefits from, or contribute significantly to the cause of the expense to be allocated and,

(ii) Any included segment did receive significant benefits from or contribute significantly to the cause of the expense in question.

(b)(1) Section 9904.403-60 illustrates various expense pools which may be used together with appropriate allocation bases. The allocation of centralized service functions shall be governed by a hierarchy of preferable allocation techniques which represent beneficial or casual relationships. The preferred representation of such relationships is a measure of the activity of the organization performing the function. Supporting functions are usually labor-oriented, machine-oriented, or space-oriented. Measures of the activities of such functions ordinarily can be expressed in terms of labor hours, machine hours, or square footage. Accordingly, costs of these functions shall be allocated by use of a rate, such as a rate per labor hour, rate per machine hour or cost per square foot, unless such measures are unavailable or impractical to ascertain. In these latter cases the basis for allocation shall be a measurement of the output of the supporting function. Output is measured in terms of units of end product produced by the supporting function, as for example, number of printed pages for a print shop, number of purchase orders processed by a purchasing department, number of hires by an employment office.

(2) Where neither activity nor output of the supporting function can be practically measured, a surrogate for the beneficial, or causal relationship must be selected. Surrogates used to represent the relationship are generally measures of the activity of the segments receiving the service; for example, for personnel services reasonable surrogates would be number of personnel, labor hours, or labor dollars of the segments receiving the service. Any surrogate used should be a reasonable measure of the services received and, logically, should vary in proportion to the services received.

(c)(1) Where residual expenses are required to be allocated pursuant to 9904.403-40(c)(2), the three factor formula described below must be used. This formula is considered to result in appropriate allocations of the residual expenses of home offices. It takes into account three broad areas of management concern: The employees of the organization, the business volume, and the capital invested in the organization. The percentage of the residual expenses to be allocated to any segment pursuant to the three factor formula is the arithmetical average of the following three percentages for the same period:

(i) The percentage of the segment's payroll dollars to the total payroll dollars of all segments.

(ii) The percentage of the segment's operating revenue to the total operating revenue of all segments. For this purpose, the oper-

ating revenue of any segment shall include amounts charged to other segments and shall be reduced by amounts charged by other segments for purchases.

(iii) The percentage of the average net book value of the sum of the segment's tangible capital assets plus inventories to the total average net book value of such assets of all segments. Property held primarily for leasing to others shall be excluded from the computation. The average net book value shall be the average of the net book value at the beginning of the organization's fiscal year and the net book value at the end of the year.

(d) The following paragraphs provide guidance for implementing the requirements of 9904.403-40(c)(3). (1) An indication that a segment received significantly less benefit in relation to other segments can arise if a segment, unlike all or most other segments, performs on its own many of the functions included in the residual expense. Another indication may be that, in relation to its size, comparatively little or no costs are allocable to a segment pursuant to 9904.403-40(b)(1) through (5). Evidence of comparatively little communication or interpersonal relations between a home office and a segment, in relation to its size, may also indicate that the segment receives significantly less benefit from residual expenses. Conversely, if the opposite conditions prevail at any segment, a greater allocation than would result from the application of 9904.403-40(c)(1) or (2) may be indicated. This may be the case, for example, if a segment relies heavily on the home office for certain residual functions normally performed by other segments on their own.

(2) Segments which may require special allocations of residual expenses pursuant to 9904.403-40(c)(3) include, but are not limited to foreign subsidiaries, GOCO's, domestic subsidiaries with less than a majority ownership, and joint ventures.

(3) The portion of residual expenses to be allocated to a segment pursuant to 9904.403-40(c)(3) shall be the cost of estimated or recorded efforts devoted to the segments.

(e) Home office functions may be performed by an organization which for some purposes may not be a part of the legal entity with which the Government has contracted. This situation may arise, for example, in instances where the Government contracts directly with a corporation which is wholly or partly owned by another corporation. In this case, the latter corporation serves as a "home office," and the corporation with which the contract is made is a "segment" as those terms are defined and used in this Standard. For purposes of contracts subject to this Standard, the contracting corporation may only accept allocations from the other corporation to the extent that such allocations meet the requirements set forth in this Standard for allocation of home office expenses to segments.

9904.403-60 Illustrations.

(a) The following table lists some typical pools, together with illustrative allocation bases, which could be used in appropriate circumstances:

Home office expense or function	Illustrative allocation bases
<p><i>Centralized service functions:</i></p> <ol style="list-style-type: none"> 1. Personnel administration. 2. Data processing services 3. Centralized purchasing and subcontracting. 4. Centralized warehousing. 5. Company aircraft service. 6. Central telephone service 	<ol style="list-style-type: none"> 1. Number of personnel, labor hours, payroll, number of hires. 2. Machine time, number of reports. 3. Number of purchase orders, value of purchases, number of items. 4. Square footage, value of material, volume. 5. Actual or standard rate per hour, mile, passenger mile, or similar unit. 6. Usage costs, number of instruments.

(b) The selection of a base for allocating centralized service functions shall be governed by the criteria established in 9904.403-50(b).

(c) The listed allocation bases in this section are illustrative. Other bases for allocation of home office expenses to segments may be used if they are substantially in accordance with the beneficial or casual relationships outlined in 9904.403-40.

Home office expenses or function	Illustrative allocation bases
<p><i>Staff Management or specific activities:</i></p> <ol style="list-style-type: none"> 1. Personnel management 2. Manufacturing policies, (quality control, industrial engineering, production, scheduling, tooling, inspection and testing, etc.) 3. Engineering policies. 4. Material/purchasing policies. 5. Marketing policies. <p><i>Central Payments or accruals:</i></p> <ol style="list-style-type: none"> 1. Pension expenses. 2. Group insurance expenses. 3. State and local income taxes and franchise taxes. 	<ol style="list-style-type: none"> 1. Number of personnel, labor hours, payroll, number of hires. 2. Manufacturing cost input, manufacturing direct labor. 3. Total engineering costs, engineering direct labor, number of drawings. 4. Number of purchase orders, value of purchases. 5. Sales, segment marketing costs. 1. Payroll of other factor on which total payment is based. 2. Payroll or other factor on which total payment is based. 3. Any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction.

9904.403-61 Interpretation.

(a) Questions have arisen as to the requirements of 9904.403, Cost Accounting Standard, Allocation of Home Office Expenses to Segments, for the purpose of allocating State and local income taxes and franchise taxes based on income (hereinafter collectively referred to as income taxes) from a home office of an organization to its segments.

(b) By means of an illustrative allocation base in 9904.403-60, the Standard provides that income taxes are to be allocated by "any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction." This provision contains two essential criteria for the allocation of income taxes from a home office to segments. First, the taxes of any particular jurisdiction are to be allocated only to those segments that do business in the taxing jurisdiction. Second, where there is more than one segment in a taxing jurisdiction, the taxes are

to be allocated among those segments on the basis of "the same factors used to determine the taxable income for that jurisdiction." The questions that have arisen relate primarily to whether segment book income or loss is a "factor" for this purpose.

(c) Most States tax a fraction of total organization income, rather than the book income of segments that do business within the State. The fraction is calculated pursuant to a formula prescribed by State statute. In these situations the book income or loss of individual segments is not a factor used to determine taxable income for that jurisdiction. Accordingly, in States that tax a fraction of total organization income, rather than the book income of segments within the State, such book income is irrelevant for tax allocation purposes. Therefore, segment book income is to be used as a factor in allocating income tax expense from a home office to segments only where this amount is expressly used by the taxing jurisdiction in computing the income tax.

9904.403-62 Exemption. [Reserved]

9904.403-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

Subpart 9904.404—Capitalization of Tangible Assets**9904.404-10 [Reserved]****9904.404-20 Purpose.**

This Standard requires that, for purposes of cost measurement, contractors establish and adhere to policies with respect to capitalization of tangible assets which satisfy criteria set forth herein. Normally, cost measurements are based on the concept of enterprise continuity; this concept implies that major asset acquisitions will be capitalized, so that the cost applicable to current and future accounting periods can be allocated to cost objectives of those periods. A capitalization policy in accordance with this Standard will facilitate measurement of costs consistently over time.

9904.404-30 Definitions.

(a) The following are definitions of terms which are prominent in this standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Asset accountability unit* means a tangible capital asset which is a component of plant and equipment that is capitalized when acquired or whose replacement is capitalized when the unit is removed, transferred, sold, abandoned, demolished, or otherwise disposed of.

(2) *Original complement of low cost equipment* means a group of items acquired for the initial outfitting of a tangible capital asset or an operational unit, or a new addition to either. The items in the group individually cost less than the minimum amount established by the contractor for capitalization for the classes of assets acquired but in the aggregate they represent a material investment. The group, as a complement, is expected to be held for continued service beyond the current period. Initial outfitting of the unit is completed when the unit is ready and available for normal operations.

(3) *Repairs and maintenance* generally means the total endeavor to obtain the expected service during the life of tangible capital assets. Maintenance is the regularly recurring activity of keeping assets in normal or expected operating condition while repair is the activity of putting them back into such condition.

(4) *Tangible capital asset* means an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the service it yields.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.404-40 Fundamental requirement.

(a) The acquisition cost of tangible capital assets shall be capitalized. Capitalization shall be based upon a written policy that is reasonable and consistently applied.

(b) The contractor's policy shall designate economic and physical characteristics for capitalization of tangible assets.

(1) The contractor's policy shall designate a minimum service life criterion, which shall not exceed 2 years, but which may be a shorter period. The policy shall also designate a minimum acquisition cost criterion which shall not exceed \$5,000, but which may be a smaller amount.

(2) The contractor's policy may designate other specific characteristics which are pertinent to his capitalization policy decisions (e.g., class of asset, physical size, identifiability and controllability, the extent of integration or independence of constituent units).

(3) The contractor's policy shall provide for identification of asset accountability units to the maximum extent practical.

(4) The contractor's policy may designate higher minimum dollar limitations for original complement of low cost equipment and for betterments and improvements than the limitation established in accordance with paragraph (b)(1) of this subsection, provided such higher limitations are reasonable in the contractor's circumstances.

(c) Tangible assets shall be capitalized when both of the criteria in the contractor's policy as required in paragraph (b)(1) of this subsection are met, except that assets described in subparagraph (b)(4) of this subsection shall be capitalized in accordance with the criteria established in accordance with that paragraph.

(d) Costs incurred subsequent to the acquisition of a tangible capital asset which result in extending the life or increasing the productivity of that asset (e.g., betterments and improvements) and which meet the contractor's established criteria for capitalization shall be capitalized with appropriate accounting for replaced asset accountability units. However, costs incurred for repairs and maintenance to a tangible capital asset which either restore the asset to, or maintain it at, its normal or expected service life or production capacity shall be treated as costs of the current period.

9904.404-50 Techniques for application.

(a) The cost to acquire a tangible capital asset includes the purchase price of the asset and costs necessary to prepare the asset for use.

(1) The purchase price of an asset shall be adjusted to the extent practical by premiums and extra charges paid or discounts and credits received which properly reflect an adjustment in the purchase price.

(i) Purchase price is the consideration given in exchange for an asset and is determined by cash paid, or to the extent payment is not made in cash, in an amount equivalent to what would be the cash price basis. Where this amount is not available, the purchase price is determined by the current value of the consideration given in exchange for the asset. For example, current value for a credit instrument is the amount immediately required to settle the obligation or the amount of money which might have been raised directly through the use of the same instrument employed in making the credit purchase. The current value of an equity security is its market value. Market value is the current or prevailing price of the security as indicated by recent market quotations. If such values are unavailable or not appropriate (thin market, volatile price movement, etc.), an acceptable alternative is the fair value of the asset acquired.

(ii) Donated assets which, at the time of receipt, meet the contractor's criteria for capitalization shall be capitalized at their fair value at that time.

(2) Costs necessary to prepare the asset for use include the cost of placing the asset in location and bringing the asset to a condition necessary for normal or expected use. Where material in amount, such costs, including initial inspection and testing, installation and similar expenses, shall be capitalized.

(b) Tangible capital assets constructed or fabricated by a contractor for its own use shall be capitalized at amounts which include all indirect costs properly allocable to such assets. This requires the capitalization of general and administrative expenses when such expenses are identifiable with the constructed asset and are material in amount (e.g., when the in-house construction effort requires planning, supervisory, or other significant effort by officers or other personnel whose salaries are regularly charged to general and administrative expenses). When the constructed assets are identical with or similar to the contractor's regular product, such assets shall be capitalized at amounts which include a full share of indirect costs.

(c) In circumstances where the acquisition by purchase or donation of previously used tangible capital assets is not an arm's length transaction, acquisition cost shall be limited to the capitalized cost of the asset to the owner who last acquired the asset through an arm's-length transaction, reduced by depreciation charges from date of that acquisition to date of gift or sale.

(d) The capitalized values of tangible capital assets acquired in a business combination, accounted for under the "purchase method" of accounting, shall be assigned to these assets as follows:

(1) All the tangible capital assets of the acquired company that during the most recent cost accounting period prior to a business combination generated either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be capitalized by the buyer at the net book value(s) of the asset(s) as reported by the seller at the time of the transaction.

(2) All the tangible capital asset(s) of the acquired company that during the most recent cost accounting period prior to a business combination did not generate either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be assigned a portion of the cost of the acquired company not to exceed their fair value(s) at the date of acquisition. When the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess.

(e) Under the "pooling of interest method" of accounting for business combinations, the values established for tangible capital assets for financial accounting shall be the values used for determining the cost of such assets.

(f) Asset accountability units shall be identified and separately capitalized at the time the assets are acquired. However, whether or not the contractor identifies and separately capitalizes a unit initially, the contractor shall remove the unit from the asset accounts when it is disposed of and, if replaced, its replacement shall be capitalized.

9904.404-60 Illustrations.

(a) Illustrations of costs which must be capitalized. (1) Contractor has an established policy of capitalizing tangible assets which have a service life of more than 1 year and a cost of \$2,000. The contractor's policy must be modified to conform to the \$1,500 policy limitation on minimum acquisition cost established by the Standard.

(i) Contractor acquires a tangible capital asset with a life of 18 months at a cost of \$1,700. The Standard requires that the asset be capitalized in compliance with contractor's policy as to service life.

(ii) Contractor acquires a tangible asset with a life of 18 months at a cost of \$900. The asset need not be capitalized unless the contractor's revised policy establishes a minimum cost criterion below \$900.

(2) Contractor has an established policy of capitalizing tangible assets which have a service life of more than 1 year and a cost of \$250. Contractor acquires a tangible asset with a life of 18 months and a cost of \$300. The Standard requires that, based upon contractor's policy, the asset be capitalized.

(3) Contractor establishes a major new production facility. In the process, a number of large and small items of equipment were acquired to outfit it. The contractor has an established policy of capitalizing individual items of tangible assets which have a service life of over 1 year and a cost of \$500, and all items meeting these requirements were capitalized. In addition, the contractor's policy requires capitalization of an original complement which has a service life of over 1 year and a cost of \$5,000. Items of durable equipment acquired for the production facility costing less than \$500 each aggregated \$50,000. Based upon the contractor's policy, the durable equipment items must be capitalized as the original complement of low cost equipment. (The concept of original complement applies to such items as books in a new library, impact wrenches in a new factory, work benches and racks in a new production facility, or furniture and fixtures in a new office building.)

(4) Contractor has an established policy for treating its heavy presses and their power supplies as separate asset accountability units. A power supply is replaced during the service life of the related press. The Standard requires that, based upon the contractor's policy, the new power supply be capitalized with appropriate accounting for the replaced unit.

(b) Illustrations of costs which need not be capitalized. (1) The contractor has an established policy of capitalizing tangible assets which have a service life of 2 years and a cost of \$500. The contractor acquires an asset with a useful life of 18 months and a cost of \$5,000. The tangible asset should be expensed because it does not meet the 2-year criterion.

(2) The contractor establishes a new assembly line. In outfitting the line, the contractor acquires \$5,000 of small tools. On similar assembly lines under similar conditions, the original complement of small tools was expensed because the complement was replaced annually as a result of loss, pilferage, breakage, and physical wear and tear. Because the unit of original complement does not meet the contractor's service life criterion for capitalization (1 year), the small tools may be expensed.

9904.404-61 Interpretation. [Reserved]

9904.404-62 Exemption.

None for this Standard.

9904.404-63 Effective date.

(a) This Standard is effective April 15, 1996.

(b) This Standard shall be applied beginning with the contractor's next full cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow Standard 9904.404 in effect prior to April 15, 1996, until this Standard, effective April 15, 1996, becomes applicable after the receipt of a contract or subcontract to which this revised Standard applies.

Subpart 9904.405—Accounting for Unallowable Costs**9904.405-10 [Reserved]****9904.405-20 Purpose.**

(a) The purpose of this Cost Accounting Standard is to facilitate the negotiation, audit, administration and settlement of contracts by establishing guidelines covering:

(1) Identification of costs specifically described as unallowable, at the time such costs first become defined or authoritatively designated as unallowable, and

(2) The cost accounting treatment to be accorded such identified unallowable costs in order to promote the consistent application of sound cost accounting principles covering all incurred costs.

The Standard is predicated on the proposition that costs incurred in carrying on the activities of an enterprise—regardless of the allowability of such costs under Government contracts—are allocable to the cost objectives with which they are identified on the basis of their beneficial or causal relationships.

(b) This Standard does not govern the allowability of costs. This is a function of the appropriate procurement or reviewing authority.

9904.405-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Directly associated cost* means any cost which is generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred.

(2) *Expressly unallowable cost* means a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable.

(3) *Indirect cost* means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

(4) *Unallowable cost* means any cost which, under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost reimbursements, or settlements under a Government contract to which it is allocable.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.405-40 Fundamental requirement.

(a) Costs expressly unallowable or mutually agreed to be unallowable, including costs mutually agreed to be unallowable directly

associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract.

(b) Costs which specifically become designated as unallowable as a result of a written decision furnished by a contracting officer pursuant to contract disputes procedures shall be identified if included in or used in the computation of any billing, claim, or proposal applicable to a Government contract. This identification requirement applies also to any costs incurred for the same purpose under like circumstances as the costs specifically identified as unallowable under either this paragraph or paragraph (a) of this subsection.

(c) Costs which, in a contracting officer's written decision furnished pursuant to contract disputes procedures, are designated as unallowable directly associated costs of unallowable costs covered by either paragraph (a) or (b) of this subsection shall be accorded the identification required by paragraph (b) of this subsection.

(d) The costs of any work project not contractually authorized, whether or not related to performance of a proposed or existing contract, shall be accounted for, to the extent appropriate, in a manner which permits ready separation from the costs of authorized work projects.

(e) All unallowable costs covered by paragraphs (a) through (d) of this subsection shall be subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they shall remain in such base or bases. Where a directly associated cost is part of a category of costs normally included in an indirect-cost pool that will be allocated over a base containing the unallowable cost with which it is associated, such a directly associated cost shall be retained in the indirect-cost pool and be allocated through the regular allocation process.

(f) Where the total of the allocable and otherwise allowable costs exceeds a limitation-of-cost or ceiling-price provision in a contract, full direct and indirect cost allocation shall be made to the contract cost objective, in accordance with established cost accounting practices and Standards which regularly govern a given entity's allocations to Government contract cost objectives. In any determination of unallowable cost overrun, the amount thereof shall be identified in terms of the excess of allowable costs over the ceiling amount, rather than through specific identification of particular cost items or cost elements.

9904.405-50 Techniques for application.

(a) The detail and depth of records required as backup support for proposals, billings, or claims shall be that which is adequate to establish and maintain visibility of identified unallowable costs (including directly associated costs), their accounting status in terms of their allocability to contract cost objectives, and the cost accounting treatment which has been accorded such costs. Adherence to this cost accounting principle does not require that allocation of unallowable costs to final cost objectives be made in the detailed cost accounting records. It does require that unallowable costs be given appropriate consideration in any cost accounting determinations governing the content of allocation bases used for distributing indirect costs to cost objectives. Unallowable costs involved in the determination of rates used for standard costs, or for indirect-cost bidding or billing, need be identified only at the time rates are proposed, established, revised or adjusted.

(b)(1) The visibility requirement of paragraph (a) of this subsection, may be satisfied by any form of cost identification which is adequate for purposes of contract cost determination and verification. The Standard does not require such cost identification for purposes which are not relevant to the determination of Government contract cost. Thus, to provide visibility for incurred costs, acceptable alternative practices would include:

(i) The segregation of unallowable costs in separate accounts maintained for this purpose in the regular books of account,

(ii) The development and maintenance of separate accounting records or workpapers, or

(iii) The use of any less formal cost accounting techniques which establishes and maintains adequate cost identification to permit audit verification of the accounting recognition given unallowable costs.

(2) Contractors may satisfy the visibility requirements for estimated costs either:

(i) By designation and description (in backup data, workpapers, etc.) of the amounts and types of any unallowable costs which have specifically been identified and recognized in making the estimates, or

(ii) By description of any other estimating technique employed to provide appropriate recognition of any unallowable costs pertinent to the estimates.

(c) Specific identification of unallowable costs is not required in circumstances where, based upon considerations of materiality, the Government and the contractor reach agreement on an alternate method that satisfies the purpose of the Standard.

9904.405-60 Illustrations.

(a) An auditor recommends disallowance of certain direct labor and direct material costs, for which a billing has been submitted under a contract, on the basis that these particular costs were not required for performance and were not authorized by the contract. The contracting officer issues a written decision which supports the auditor's position that the questioned costs are unallowable. Following receipt of the contracting officer's decision, the contractor must clearly identify the disallowed direct labor and direct material costs in his accounting records and reports covering any subsequent submission which includes such costs. Also, if the contractor's base for allocation of any indirect cost pool relevant to the subject contract consists of direct labor, direct material, total prime cost, total cost input, etc., he must include the disallowed direct labor and material costs in his allocation base for such pool. Had the contracting officer's decision been against the auditor, the contractor would not, of course, have been required to account separately for the costs questioned by the auditor.

(b) A contractor incurs, and separately identifies, as a part of his manufacturing overhead, certain costs which are expressly unallowable under the existing and currently effective regulations. If manufacturing overhead is regularly a part of the contractor's base for allocation of general and administrative (G&A) or other indirect expenses, the contractor must allocate the G&A or other indirect expenses to contracts and other final cost objectives by means of a base which includes the identified unallowable manufacturing overhead costs.

(c) An auditor recommends disallowance of the total direct indirect costs attributable to an organizational planning activity. The

contractor claims that the total of these activity costs are allowable under the Federal Acquisition Regulation (FAR) as "Economic planning costs" (48 CFR 31.205-12); the auditor contends that they constitute "Organization costs" (48 CFR 31.205-27) and therefore are unallowable. The issue is referred to the contracting officer for resolution pursuant to the contract disputes clause. The contracting officer issues a written decision supporting the auditor's position that the total costs questioned are unallowable under the FAR. Following receipt of the contracting officer's decision, the contractor must identify the disallowed costs and specific other costs incurred for the same purpose in like circumstances in any subsequent estimating, cost accumulation or reporting for Government contracts, in which such costs are included. If the contracting officer's decision had supported the contractor's contention, the costs questioned by the auditor would have been allowable "Economic planning costs," and the contractor would not have been required to provide special identification.

(d) A defense contractor was engaged in a program of expansion and diversification of corporate activities. This involved internal corporate reorganization, as well as mergers and acquisitions. All costs of this activity were charged by the contractor as corporate or segment general and administrative (G&A) expense. In the contractor's proposals for final Segment G&A rates (including corporate home office allocations) to be applied in determining allowable costs of its defense contracts subject to 48 CFR Part 31, the contractor identified and excluded the expressly unallowable costs (as listed in 48 CFR 31.205-12) incurred for incorporation fees and for charges for special services of outside attorneys, accountants, promoters, and consultants. In addition, during the course of negotiation of interim bidding and billing G&A rates, the contractor agreed to classify as unallowable various in-house costs incurred for the expansion program, and various directly associated costs of the identifiable unallowable costs. On the basis of negotiations and agreements between the contractor and the contracting officers' authorized representatives, interim G&A rates were established, based on the net balance of allowable G&A costs. Application of the rates negotiated to proposals, and on an interim basis to billings, for covered contracts constitutes compliance with the Standard.

(e) An official of a company, whose salary, travel, and subsistence expenses are charged regularly as general and administrative (G&A) expenses, takes several business associates on what is clearly a business entertainment trip. The entertainment costs of such trips is expressly unallowable because it constitutes entertainment expense, and is separately identified by the contractor. The contractor does not regularly include his G&A expenses in any indirect-expense allocation base. In these circumstances, the official's travel and subsistence expenses would be directly associated costs for identification with the unallowable entertainment expense. However, unless this type of activity constituted a significant part of the official's regular duties and responsibilities on which his salary was based, no part of the official's salary would be required to be identified as a directly associated cost of the unallowable entertainment expense.

9904.405-61 Interpretation. [Reserved]

9904.405-62 Exemptions.

None for this Standard.

9904.405-63 Effective date.

This Standard is effective as of April 17, 1992.

Subpart 9904.406—Cost Accounting Standard—Cost Accounting Period

9904.406-10 [Reserved]**9904.406-20 Purpose.**

The purpose of this Cost Accounting Standard is to provide criteria for the selection of the time periods to be used as cost accounting periods for contract cost estimating, accumulating, and reporting. This Standard will reduce the effects of variations in the flow of costs within each cost accounting period. It will also enhance objectivity, consistency, and verifiability, and promote uniformity and comparability in contract cost measurements.

9904.406-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Allocate* means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Cost objective* means a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

(3) *Fiscal year* means the accounting period for which annual financial statements are regularly prepared, generally a period of 12 months, 52 weeks, or 53 weeks.

(4) *Indirect cost pool* means a grouping of incurred costs identified with two or more cost objectives but not identified specifically with any final cost objective.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.406-40 Fundamental requirement.

(a) A contractor shall use this fiscal year as his cost accounting period, except that:

(1) Costs of an indirect function which exists for only a part of a cost accounting period may be allocated to cost objectives of that same part of the period as provided in 9904.406-50(a).

(2) An annual period other than the fiscal year may, as provided in 9904.406-50(d), be used as the cost accounting period if its use is an established practice of the contractor.

(3) A transitional cost accounting period other than a year shall be used whenever a change of fiscal year occurs.

(4) Where a contractor's cost accounting period is different from the reporting period used for Federal income tax reporting purposes, the latter may be used for such reporting.

(b) A contractor shall follow consistent practices in his selection of the cost accounting period or periods in which any types of expense and any types of adjustment to expense (including prior-period adjustments) are accumulated and allocated.

(c) The same cost accounting period shall be used for accumulating costs in an indirect cost pool as for establishing its allocation base, except that the contracting parties may agree to use a different

period for establishing an allocation base as provided in 9904.406-50(e).

9904.406-50 Techniques for application.

(a) The cost of an indirect function which exists for only a part of a cost accounting period may be allocated on the basis of data for that part of the cost accounting period if the cost is:

(1) Material in amount,

(2) Accumulated in a separate indirect cost pool, and

(3) Allocated on the basis of an appropriate direct measure of the activity or output of the function during that part of the period.

(b) The practices required by 9904.406-40(b) of this Standard shall include appropriate practices for deferrals, accruals, and other adjustments to be used in identifying the cost accounting periods among which any types of expense and any types of adjustment to expense are distributed. If an expense, such as taxes, insurance or employee leave, is identified with a fixed, recurring, annual period which is different from the contractor's cost accounting period, the Standard permits continued use of that different period. Such expenses shall be distributed to cost accounting periods in accordance with the contractor's established practices for accruals, deferrals, and other adjustments.

(c) Indirect cost allocation rates, based on estimates, which are used for the purpose of expediting the closing of contracts which are terminated or completed prior to the end of a cost accounting period need not be those finally determined or negotiated for that cost accounting period. They shall, however, be developed to represent a full cost accounting period, except as provided in paragraph (a) of this subsection.

(d) A contractor may, upon mutual agreement with the Government, use as his cost accounting period a fixed annual period other than his fiscal year, if the use of such a period is an established practice of the contractor and is consistently used for managing and controlling the business, and appropriate accruals, deferrals or other adjustments are made with respect to such annual periods.

(e) The contracting parties may agree to use an annual period which does not coincide precisely with the cost accounting period for developing the data used in establishing an allocation base: Provided,

(1) The practice is necessary to obtain significant administrative convenience,

(2) The practice is consistently followed by the contractor,

(3) The annual period used is representative of the activity of the cost accounting period for which the indirect costs to be allocated are accumulated, and

(4) The practice can reasonably be estimated to provide a distribution to cost objectives of the cost accounting period not materially different from that which otherwise would be obtained.

(f) When a transitional cost accounting period is required under the provisions of 9904.406-40(a)(3), the contractor may select any one of the following:

(1) The period, less than a year in length, extending from the end of his previous cost accounting period to the beginning of his next regular cost accounting period,

(2) A period in excess of a year, but not longer than 15 months, obtained by combining the period described in paragraph (f)(1) of this subsection with the previous cost accounting period, or

(3) A period in excess of a year, but not longer than 15 months, obtained by combining the period described in paragraph (f)(1) of this subsection with the next regular cost accounting period.

A change in the contractor's cost accounting period is a change in accounting practices for which an adjustment in the contract price may be required in accordance with paragraph (a)(4)(ii) or (iii) of the contract clause set out at 9903.201-4(a).

9904.406-60 Illustrations.

(a) A contractor allocates general management expenses on the basis of total cost input. In a proposal for a covered negotiated fixed-price contract, he estimates the allocable expenses based solely on the estimated amount of the general management expense pool and the amount of the total cost input base estimated to be incurred during the 8 months in which performance is scheduled to be commenced and completed. Such a proposal would be in violation of the requirements of this Standard that the calculation of the amounts of both the indirect cost pools and the allocation bases be based on the contractor's cost accounting period.

(b) A contractor whose cost accounting period is the calendar year, installs a computer service center to begin operations on May 1. The operating expense related to the new service center is expected to be material in amount, will be accumulated in a separate indirect cost pool, and will be allocated to the benefiting cost objectives on the basis of measured usage. The total operating expenses of the computer service center for the 8-month part of the cost accounting period may be allocated to the benefiting cost objectives of that same 8-month period.

(c) A contractor changes his fiscal year from a calendar year to the 12-month period ending May 31. For financial reporting purposes, he has a 5-month transitional "fiscal year." The same 5-month period must be used as the transitional cost accounting period; it may not be combined as provided in 9904.406-50(f), because the transitional period would be longer than 15 months. The new fiscal year must be adopted thereafter as his regular cost accounting period. The change in his cost accounting period is a change in accounting practices; adjustments of the contract prices may thereafter be required in accordance with paragraph (a)(4)(ii) or (iii) of the contract clause at 9903.201-4(a).

(d) Financial reports to stockholders are made on a calendar year basis for the entire contractor corporation. However, the contracting segment does all internal financial planning, budgeting, and internal reporting on the basis of a "model year." The contracting parties agree to use a "model year" and they agree to overhead rates on the "model year" basis. They also agree on a technique for prorating fiscal year assignment of corporate home office expenses between model years. This practice is permitted by the Standard.

(e) Most financial accounts and contract cost records are maintained on the basis of a fiscal year which ends November 30 each year. However, employee vacation allowances are regularly managed on the basis of a "vacation year" which ends September 30 each year. Vacation expenses are estimated uniformly during each "vacation year." Adjustments are made each October to adjust the accrued liability to actual, and the estimating rates are modified to the extent deemed appropriate. This use of a separate annual period for determining the amounts of vacation expense is permitted under 9904.406-50(b).

9904.406-61 Interpretation.

(a) Questions have arisen as to the allocation and period cost assignment of certain contract costs (primarily under defense contracts and subcontracts). This section deals primarily with the assignment of restructuring costs to cost accounting periods. In essence, it 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.

(b) "Restructuring costs" as used in this Interpretation means costs that are incurred after an entity decides to make a significant nonrecurring change in its business operations or structure in order to reduce overall cost levels in future periods through work force reductions, the elimination of selected operations, functions or activities, and/or the combination of ongoing operations, including plant relocations. Restructuring activities do not include ongoing routine changes an entity makes in its business operations or organizational structure. Restructuring costs are comprised both of direct and indirect costs associated with contractor restructuring activities taken after a business combination is effected or after a decision is made to execute a significant restructuring event not related to a business combination. Typical categories of costs that have been included in the past and may be considered in the future as restructuring charges include severance pay, early retirement incentives, retraining, employee relocation, lease cancellation, asset disposition and write-offs, and relocation and rearrangement of plant and equipment. Restructuring costs do not include the cost of such activities when they do not relate either to business combinations or to other significant nonrecurring restructuring decisions.

(c) The costs of betterments or improvements of capital assets that result from restructuring activities shall be capitalized and depreciated in accordance with the provisions of 9904.404 and 9904.409.

(d) When a procuring agency imposes a net savings requirement for the payment of restructuring costs, the contractor shall submit data specifying

- (1) the estimated restructuring costs by period,
- (2) the estimated restructuring savings by period (if applicable), and
- (3) the cost accounting practices by which such costs shall be allocated to cost objectives.

(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.

(f) 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 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 9903.201-6). Changes in cost accounting practices for restructuring

costs shall be subject to disclosure statement revision requirements (see 9903.202-3), if applicable.

(g) Business changes giving rise to restructuring costs may result in changes in cost accounting practice (see 9903.302). If a contract price or cost allowance is affected by such changes in cost accounting practice, adjustments shall be made in accordance with subparagraph (a)(4) of the CAS clause (see 9903.201-4(a)(2), 9903.201-4(c)(2) and 9903.201-4(e)(2)).

(h) 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.

(i) Restructuring costs that are deferred shall not be included in the computation to determine facilities capital cost of money (see 9904.414). Specifically, deferred charges are not tangible or intangible capital assets and therefore are excluded from the facilities capital values for the computation of facilities capital cost of money.

(j) Restructuring costs incurred at a home office level shall be treated in accordance with the provisions of 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 9904.403. Restructuring costs incurred at the segment level that benefit only that segment shall be treated in accordance with the provisions of 9904.418. If one or more indirect cost pools do not comply with the homogeneity requirements of 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.

(k) This section is applicable to contractor "restructuring costs" paid or approved on or after August 15, 1994.

9904.406-62 Exemption.

None for this Standard.

9904.406-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

Subpart 9904.407—Use of Standard Costs for Direct Material and Direct Labor

9904.407-10 [Reserved]

9904.407-20 Purpose.

(a) The purpose of this Cost Accounting Standard is to provide criteria under which standard costs may be used for estimating, accumulating, and reporting costs of direct material and direct labor; and to provide criteria relating to the establishment of standards, accumulation of standard costs, and accumulation and disposition of variances from standard costs. Consistent application of these criteria where standard costs are in use will improve cost measurement and cost assignment.

(b) This Cost Accounting Standard is not intended to cover the use of preestablished measures solely for estimating.

9904.407-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Labor cost at standard* means a pre-established measure of the labor element of cost, computed by multiplying labor-rate standard by labor-time standard.

(2) *Labor-rate standard* means a pre-established measure, expressed in monetary terms, of the price of labor.

(3) *Labor-time standard* means a pre-established measure, expressed in temporal terms, of the quantity of labor.

(4) *Material cost at standard* means a pre-established measure of the material element of cost, computed by multiplying material-price standard by material-quantity standard.

(5) *Material-price standard* means a pre-established measure, expressed in monetary terms, of the price of material.

(6) *Material-quantity standard* means a pre-established measure, expressed in physical terms, of the quantity of material.

(7) *Production unit* means a grouping of activities which either uses homogeneous inputs of direct material and direct labor or yields homogeneous outputs such that the costs or statistics related to these homogeneous inputs or outputs are appropriate as bases for allocating variances.

(8) *Standard cost* means any cost computed with the use of pre-established measures.

(9) *Variance* means the difference between a pre-established measure and an actual measure.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard:

(1) *Actual cost.* An amount determined on the basis of cost incurred.

(2) [Reserved]

9904.407-40 Fundamental requirement.

Standard costs may be used for estimating, accumulating, and reporting costs of direct material and direct labor only when all of the following criteria are met:

(a) Standard costs are entered into the books of account.

(b) Standard costs and related variances are appropriately accounted for at the level of the production unit.

(c) Practices with respect to the setting and revising of standards, use of standard costs, and disposition of variances are stated in writing and are consistently followed.

9904.407-50 Techniques for application.

(a)(1) A contractor's written statement of practices with respect to standards shall include the bases and criteria (such as engineering studies, experience, or other supporting data) used in setting and revising standards; the period during which standards are to remain effective; the level (such as ideal or realistic) at which material-quantity standards and labor-time standards are set; and conditions (such as those expected to prevail at the beginning of a period) which material-price standards and labor-rate standards are designed to reflect.

(2) Where only either the material price or material quantity is set at standard, with the other component stated at actual, the result of the multiplication shall be treated as material cost at standard. Similarly, where only either the labor rate or labor time is set at standard, with the other component stated at actual, the result of the multiplication shall be treated as labor cost at standard.

(3) A labor-rate standard may be set to cover a category of direct labor only if the functions performed within that category are not material lydisparate and the employees involved are interchangeable with respect to the functions performed.

(4) A labor-rate standard may be set to cover a group of direct labor workers who perform disparate functions only under either one of the following conditions:

(i) Where that group of workers all work in a single production unit yielding homogeneous outputs (in this case, the same labor-rate standard shall be applied to each worker in that group).

(ii) Where that group of workers, in the performance of their respective functions, forms an integral team (in this case, a labor-rate standard shall be set for each integral team).

(b)(1) Material-price standards may be used and their related variances may be recognized either at the time purchases of material are entered into the books of account, or at the time material cost is allocated to production units.

(2) Where material-price standards are used and related variances are recognized at the time purchases of material are entered into the books of account, they shall be accumulated separately by homogeneous groupings of material. Examples of homogeneous groupings of material are:

(i) Where prices of all items in that grouping of material are expected to fluctuate in the same direction and at substantially the same rate, or

(ii) Where items in that grouping of material are held for use in a single production unit yielding homogeneous outputs.

(3) Where material-price variances are recognized at the time purchases of material are entered into the books of account, variances of each homogeneous grouping of material shall be allocated (except as provided in paragraph (b)(4) of this subsection), at least annually, to items in purchased-items inventory and to production units receiving items from that homogeneous grouping of material, in accordance with either one of the following practices, which shall be consistently followed:

(i) Items in purchased-items inventory of a homogeneous grouping of material are adjusted from standard cost to actual cost; the balance of the material-price variance, after reflecting these adjustments, shall be allocated to production units on the basis of the total of standard cost of material received from that homogeneous grouping of material by each of the production units; or

(ii) Items, at standard cost, in purchased-items inventory of a homogeneous grouping of material, are treated, collectively, as a production unit; the material-price variance shall be allocated to production units on the basis of standard cost of material received from that homogeneous grouping of material by each of the production units.

(4) Where material-price variances are recognized at the time purchases of material are entered into the books of account, variances of each homogeneous grouping of material which are insignificant may be included in appropriate indirect cost pools for allocation to applicable cost objectives.

(5) Where a material-price variance is allocated to a production unit in accordance with paragraph (b)(3) of this subsection, it may be combined with material-quantity variance into one material-cost variance for that production unit. A separate material-cost variance shall be accumulated for each production unit

(6) Where material-price variances are recognized at the time material cost is allocated to production units, these variances and material-quantity variances may be combined into one material-cost variance account.

(c) Labor-cost variances shall be recognized at the time labor cost is introduced into production units. Labor-rate variances and labor-time variances may be combined into one labor-cost variance account. A separate labor-cost variance shall be accumulated for each production unit.

(d) A contractor's established practice with respect to the disposition of variances accumulated by production unit shall be in accordance with one of the following subparagraphs:

(1) Variances are allocated to cost objectives (including ending in-process inventory) at least annually. Where a variance related to material is allocated, the allocation shall be on the basis of the material cost at standard, or, where outputs are homogeneous, on the basis of units of output. Similarly, where a variance related to labor is allocated, the allocation shall be on the basis of the labor cost at standard or labor hours at standard or, where outputs are homogeneous, on the basis of units of output; or

(2) Variances which are immaterial may be included in appropriate indirect cost pools for allocation to applicable cost objectives.

(e) Where variances applicable to covered contracts are allocated by memorandum worksheet adjustments rather than in the books of account, the bases used for adjustment shall be in accordance with those stated in paragraph (b)(3) and paragraph (d) of this subsection.

9904.407-60 Illustrations.

(a) Contractor A's written practice is to set his material-price standard for an item on the basis of average purchase prices expected to prevail during the calendar year. For that item whose usage from month to month is stable, a purchase contract is generally signed on May 1 of each year for a 1-year commitment. The current purchase contract calls for a purchase price of \$3 per pound; an increase of 5 percent, or 15¢ per pound, has been announced by the vendor when the new purchase contract comes into effect next May. Contractor A sets his material-price standard for this item at \$3.10 per pound for the year $([\$3.00 \times 4 + \$3.15 \times 8] / 12)$. Since Contractor A sets his material-price standard in accordance with his written practice, he complies with provisions of 9904.407-40(c) of this Cost Accounting Standard.

(b) Contractor B accumulates, in one account, labor cost at standard for a department in which several categories of direct labor of disparate functions, in different combinations, are used in the manufacture of various dissimilar outputs of the department. Contractor B's department is not a production unit as defined in 9904.407-30(a)(7) of this Cost Accounting Standard. Modifying his practice so as to comply with the definition of production unit in 9904.407-30(a)(7), he could accumulate the standard costs and variances separately,

(1) For each of the several categories of direct labor, or

(2) For each of several subdepartments, with homogeneous output for each of the subdepartments.

(c) Contractor C allocates variances at the end of each month. During the month of March, a production unit has accumulated the following data with respect to labor:

	LABOR HOURS AT STANDARD	LABOR DOLLARS AT STANDARD	LABOR COST VARIANCE
Balance, March 1	5,000	\$25,000	\$2,000
Additions in March	<u>15,000</u>	<u>75,000</u>	<u>5,000</u>
Total	20,000	100,000	7,000
Transfers-out in March	<u>8,000</u>	<u>40,000</u>	_____
Balance, March 31	12,000	\$60,000	_____

Using labor hours at standard as the base, Contractor C establishes a labor-cost variance rate of \$.35 per standard labor hour (\$7,000 / 20,000), and deducts \$2,800 (\$.35 X 8,000) from the labor-cost variance account, leaving a balance of \$4,200 (\$7,000 - \$2,800). Contractor C's practice complies with provisions of 9904.407-50(d)(1) of this Cost Accounting Standard.

(d) Contractor D, who uses materials the prices of which are expected to fluctuate at different rates, recognizes material-price variances at the time purchases of material are entered into the books of account. He maintains one purchase-price variance account for the whole plant. Purchased items are requisitioned by various production units in the plant. Since prices of material are expected to fluctuate at different rates, this plant-wide grouping

does not constitute a homogeneous grouping of material. Contractor D's practice does not comply with provisions of 9904.407-50(b)(2) of this Cost Accounting Standard. However, if he would maintain several purchased-items inventory accounts, each representing a homogeneous grouping of material, and maintain a material-price variance account for each of these homogeneous groupings of material, Contractor D's practice would comply with 9904.407-50(b)(2) of this Cost Accounting Standard.

(e)(1) Contractor E recognizes material-price variances at the time purchases of material are entered into the books of account and allocates variances at the end of each month. During the month of May, a homogeneous grouping of material has accumulated the following data:

	MATERIAL COST AT STANDARD	MATERIAL PRICE VARIANCE
Inventory, May 1	\$ 150,000	\$20,000
Additions in May	1,850,000	120,000
Total:	2,000,000	140,000
Requisitions:	\$900,000	_____
Production Unit 1	450,000	_____
Production Unit 2	300,000	_____
Production Unit 3	150,000	_____
Production Unit 4	_____	_____
Inventory, May 31	\$200,000	_____

(2) Contractor E establishes a material-price variance rate of 7% (\$140,000 / \$2,000,000) and allocates as follows:

	MATERIAL COST AT STANDARD	MATERIAL PRICE VARIANCE RATE %	MATERIAL PRICE VARIANCE ALLOCATION
Production Unit 1	\$900,000	7	\$ 63,000
Production Unit 2	450,000	7	31,500
Production Unit 3	300,000	7	21,000
Production Unit 4	150,000	7	10,500
		7	
Ending inventory of homogeneous grouping of material	200,000	7	14,000
Total	2,000,000	_____	140,000

Contractor E's practice complies with provisions of 9904.407-50(b)(3)(ii) of this Cost Accounting Standard.

(f)(1) Contractor F makes year-end adjustments for variances attributable to covered contracts. During the year just ended, a covered contract was processed in four production units, each with homogeneous outputs. Data with respect to output and to labor of each of the four production units are as follows:

PRODUCTION UNIT	TOTAL UNITS OF OUTPUT	TOTAL UNITS USED BY THE COVERED CONTRACT	TOTAL LABOR COSTS AT STANDARD	TOTAL LABOR-COST VARIANCE
1.....	100,000	10,000	\$400,000	\$20,000
2.....	6,000	6,000	900,000	30,000
3.....	5,000	5,000	600,000	10,000
4.....	10,000	4,000	500,000	20,000

(2) Since the outputs of each production unit are homogeneous, Contractor F uses the units of output as the basis of making memorandum worksheet adjustments concerning applicable variances, and establishes the following figures:

	LABOR-COST VARIANCES PER UNIT OF UNIT	UNITS USED BY THE COVERED CONTRACT	LABOR-COST VARIANCE ATTRIBUTABLE TO THE COVERED CONTRACT
Production unit 1	\$0.20	10,000	\$2,000
Production unit 2	1.00	6,000	6,000
Production unit 3	.50	5,000	2,500
Production unit 4	2.00	4,000	8,000
Total labor-cost variance attributable to the covered contract			18,500

(3) Contractor F makes a year-end adjustment of \$18,500 as the labor-cost variances attributable to the covered contract. Contractor F's practice complies with provisions of 9904.407-50(e) of this Cost Accounting Standard.

9904.407-61 Interpretation. [Reserved]

9904.407-62 Exemption.

None for this Standard.

9904.407-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

Subpart 9904.408—Accounting For Costs of Compensated Personal Absence

9904.408-10 [Reserved].

9904.408-20 Purpose.

The purpose of this Standard is to improve, and provide uniformity in, the measurement of costs of vacation, sick leave, holiday, and other compensated personal absence for a cost accounting period, and thereby increase the probability that the measured costs are allocated to the proper cost objectives.

9904.408-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Compensated personal absence* means any absence from work for reasons such as illness, vacation, holidays, jury duty or military training, or personal activities, for which an employer pays compensation directly to an employee in accordance with a plan or custom of the employer.

(2) *Entitlement* means an employee's right, whether conditional or unconditional, to receive a determinable amount of compensated personal absence, or pay in lieu thereof.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.408-40 Fundamental requirement.

(a) The costs of compensated personal absence shall be assigned to the cost accounting period or periods in which the entitlement was earned.

(b) The costs of compensated personal absence for an entire cost accounting period shall be allocated prorata on an annual basis among the final cost objectives of that period.

9904.408-50 Techniques for application.

(a) *Determinations.* Each plan or custom for compensated personal absence shall be considered separately in determining when entitlement is earned. If a plan or custom is changed or a new plan or custom is adopted, then a new determination shall be made beginning with the first cost accounting period to which such new or changed plan or custom applies.

(b) *Measurement of entitlement.* (1) For purposes of compliance with 9904.408-40(a), compensated personal absence is earned at the same time and in the same amount as the employer becomes liable to compensate the employee for such absence if the employer terminates the employee's employment for lack of work or other reasons not involving disciplinary action, in accordance with a plan or custom of the employer. Where a new employee must complete a probationary period before the employer becomes liable, the employer may nonetheless treat such service as creating entitlement in any computations required by this Standard, provided that he does so consistently.

(2) Where a plan or custom provides for entitlement to be determined as of the first calendar day or the first business day of a cost accounting period based on service in the preceding cost accounting period, the entitlement shall be considered to have been earned, and the employer's liability to have arisen, as of the close of the preceding cost accounting period.

(3) In the absence of a determinable liability, in accordance with paragraph (b)(1) of this subsection, compensated personal absence will be considered to be earned only in the cost accounting period in which it is paid.

(c) *Determination of employer's liability.* In computing the cost of compensated personal absence, the computation shall give effect to the employer's liability in accordance with the following paragraphs:

(1) The estimated liability shall include all earned entitlement to compensated personal absence which exists at the time the liability is determined, in accordance with paragraph (b) of this subsection.

(2) The estimated liability shall be reduced to allow for anticipated nonutilization, if material.

(3) The liability shall be estimated consistently either in terms of current or of anticipated wage rates. Estimates may be made with respect to individual employees, but such individual estimates shall not be required if the total cost with respect to all employees in the plan can be estimated with reasonable accuracy by the use of sample data, experience or other appropriate means.

(d) *Adjustments.* (1) The estimate of the employer's liability for compensated personal absence at the beginning of the first cost accounting period for which a contractor must comply with this Standard shall be based on the contractor's plan or custom applicable to that period, notwithstanding that some part of that liability has not previously been recognized for contract costing purposes. Any excess of the amount of the liability as determined in accordance with paragraph (c) of this subsection over the corresponding amount of the liability as determined in accordance with the contractor's previous practice shall be held in suspense and accounted for as described in subparagraph (d)(3) of this subsection.

(2) If a plan or custom is changed or a new plan or custom is adopted, and the new determination made in accordance with paragraph (a) of this subsection results in an increase in the estimate of the employer's liability for compensated personal absence at

the beginning of the first cost accounting period for which the new plan is effective over the estimate made in accordance with the contractor's prior practice, then the amount of such increase shall be held in suspense and accounted for as described in paragraph (d)(3) of this subsection.

(3) At the close of each cost accounting period, the amount held in suspense shall be reduced by the excess of the amount held in

suspense at the beginning of the cost accounting period over the employer's liability (as estimated in accordance with paragraph (c) of this subsection) at the end of that cost accounting period. The cost of compensated personal absence assigned to that cost accounting period shall be increased by the amount of the excess.

(e) *Allocations.* Except where the use of a longer or shorter period is permitted by the provisions of the Cost Accounting Standard on Cost Accounting Period (9904.406), the costs of compensated personal absence shall be allocated to cost objectives on a prorata basis which reflects the total of such costs and the total of the allocation base for the entire cost accounting period. However, this provision shall not preclude revisions to an allocation rate during a cost accounting period based on revised estimates of period totals.

9904.408-60 Illustrations.

(a) Company A's vacation plan provides that, on the anniversary of each employee's hiring date, that employee shall become eligible to receive a 2-week vacation with pay. Vacation entitlement must be used within 2 years or forfeited. An employee who leaves the company voluntarily will be paid for any remaining unused vacation entitlement which was earned through the employee's last anniversary date. An employee who is laid off for lack of work will also be paid a prorata vacation allowance for service since the employee's last anniversary date. Company A accrues vacation costs each month based on an estimate of the anniversary years which will be completed in that month. At the end of its cost accounting period, Company A adjusts its estimated liability to agree with its actual liability for completed years of service on an individual employee basis.

(1) In order to comply with 9904.408-50(c), Company A must increase its estimated liability for vacation pay at all times to include the estimated additional amount which would be payable to employees in the event of layoff. The additional liability may be calculated on an individual employee basis or it may be estimated for the employees as a group by the use of sample or historical data.

(2) The following illustrates one method of estimating Company A's liability at the end of its cost accounting period, December 31, with respect to individual employees, in accordance with 9904.408-50(c).

John Doe, Anniversary date July 10:	
Unused entitlement resulting from completed service years, 24 hrs. at \$5	\$120
Full months of service since anniversary, 5:	
Pro-rata entitlement on lay off = 80 hrs. x 5/12 = 33.3 hrs. at 15	167
Total	287
Less estimated allowance for forfeitures, 3 1/2 percent	10
Net liability	277

(b) Company B has a vacation plan similar to Company A's, but Company B does not pay pro-rata vacation pay on lay-off for service since the last anniversary date. Company B must include in its estimate of its liability at the end of its cost accounting period only

that unused vacation entitlement which results from completed years of service, with allowance for forfeitures if material.

(c) Company C's sick leave plan provides that an employee will accumulate one-half day of sick leave entitlement for each full month of service. Sick leave entitlement may be accumulated without limit, but an employee is paid for sick leave only during actual illness; the Company does not pay for unused sick leave on lay-off. Despite the fact that Company C might be able to estimate the amount which will be paid for sick leave in a future cost accounting period with a high degree of accuracy, it has no liability for payment for unused sick leave entitlement in the event of lay-off. Therefore, in accordance with 9904.408-50(b)(3), it must assign to each cost accounting period only the costs of sick leave which it pays in that period.

(d) Company D's vacation plan provides that on July 1, each employee who has been employed by the Company for at least 1 year shall be entitled to 2 weeks of vacation. All vacation must be taken between July 1 and September 30. An employee who terminates after September 30 and before July 1 receives no vacation pay. Company D has a cost accounting period which ends on December 31; however, Company D customarily accrues its anticipated liability for vacation pay at July 1 in 12 equal installments over the "vacation year" starting on July 1 of the previous year and ending on June 30 of the current year. Company D has no liability for vacation pay at January 1 or at December 31. In accordance with 9904.408-50(b)(3), the amount of vacation cost which Company D must assign to each cost accounting period is the amount of such costs paid in that period. Therefore, Company D may not use the "vacation year" ending June 30 to apportion these costs between cost accounting periods.

(e) Company E's cost accounting period ends on December 31. Its vacation plan provides that on January 1, each employee who has been employed for at least 1 year shall become entitled to 2 weeks of vacation. The Company does not recognize a liability for vacation pay at December 31 because an employee must be employed on January 1 to be eligible.

(1) Despite the requirement that the employee also be employed on January 1, the necessary service was completed in the preceding cost accounting period. If the other terms of the plan are such that in accordance with this Standard, Company E must recognize its vacation costs on the accrual basis, then in accordance with 9904.408-50(b)(2), Company E must estimate its vacation costs as if the liability arose on December 31 rather than on the following January 1.

(2) Assume that Company E must comply with this Standard beginning on January 1, 1976. Assume that the employees of Company E earned \$90,000 in vacation pay in 1975, all of which will be taken in 1976. Assume, further, that because of reduced employment levels, the employees of Company E will earn only \$80,000 in vacation pay in 1976, \$5,000 of which will be paid in 1976 because

of layoffs. The following example illustrates the computation of vacation pay costs for Company E in 1976:

1976 beginning liability With Standard (9904.408-50(d)(1))	\$90,000
Without Standard	<u>0</u>
Amount to be held in suspense (9904.408-50(d)(1))	<u>90,000</u>
1976 ending liability	75,000
Plus: Paid in 1976	95,000
Subtotal	<u>170,000</u>
Less: 1976 beginning liability	<u>90,000</u>
1976 vacation cost, basic amount	<u>80,000</u>
Amount in suspense at beginning of 1976	90,000
Less: 1976 ending liability	<u>75,000</u>
Suspense to be written off in 1976; additional 1976 vacation cost (9904.408-50(d)(3))	15,000
1976 basic vacation cost	80,000
Plus: 1976 reduction of suspense	15,000
1976 total vacation cost	<u>95,000</u>

(3) Assume, further, that all of the vacation entitlement which remained at December 31, 1976 (\$75,000), is taken in 1977. Also, Company E hires a substantial number of additional employees in 1977, so that the amount of vacation entitlement earned in 1977 is \$85,000. The following example illustrates the computation of vacation pay costs for Company E in 1977:

1977 ending liability:	\$85,000
Plus: Paid in 1977	75,000
Subtotal	<u>160,000</u>
Less: 1977 beginning liability	75,000
1977 vacation cost, basic amount	<u>85,000</u>
Amount in suspense at beginning of 1977 (Note 1)	75,000
1977 ending liability (Note 1)	<u>85,000</u>
1977 basic vacation cost	85,000
Plus: reduction of suspense (Note 1)	\$0
1977 total vacation cost	<u>85,000</u>

Note 1--Because the 1977 ending liability exceeds the amount in suspense at the beginning of 1977, there is no reduction of suspense in 1977.

(4) Assume further, that Company E goes out of business in 1978. All employees are terminated and paid both for the \$85,000

vacation liability at the end of 1977 and an additional \$40,000 earned in 1978. The following example illustrates the computation of vacation pay costs for Company E in 1978:

1978 ending liability:	\$0
Plus: Paid in 1978	125,000
Subtotal	125,000
Less: 1978 beginning liability	85,000
1978 vacation cost, basic amount	40,000
Amount in suspense at beginning of 1978	75,000
Less: 1978 ending liability	0
Suspense to be written off in 1978; additional 1978 vacation cost (9904.408-50(d)(3))	75,000
1978 vacation cost (9904.408-50(d)(3))	75,000
1978 basic vacation cost	40,000
Plus: 1978 reduction in suspense	75,000
1978 total vacation cost	115,000

(f) All of the salary costs of Company F's salaried employees are charged to service, administrative, or overhead functions. No accounting entries are made to segregate costs of compensated personal absence of these employees from their other salary costs, although other records are maintained to control the total amount of such absences.

(1) This policy does not violate the requirement of 9904.408-40(b) if such salaries are charged to overhead or indirect cost pools for subsequent allocation to final cost objectives over annually determined allocation bases which are appropriate for those pools.

(2) If the same policy were followed in the case of engineers whose salaries were directly allocated to two or more final cost objectives, or to both intermediate and final cost objectives, so that costs of compensated personal absence were charged directly to the jobs on which the individuals were working when paid, then this would violate the requirement of 9904.408-40(b) that these costs be allocated among cost objectives on the basis of the costs of the entire cost accounting period. Only if all salaries were directly allocated to a single final cost objective, as might be the case with personnel assigned to an overseas base for the performance of a single contract, would this practice be in accord with that requirement.

(g) Company G determines a "charging rate" for each employee. The charging rate includes an allowance for compensated personal absence based on average experience. As the employee performs services, the related cost objectives are charged for the services at the charging rate, the employee is paid at his base rate, and the excess is credited to the accrued liability for each benefit. As benefits are paid, the costs are charged against the accrued liabilities. The amount of each accrued liability is adjusted at the end of the cost accounting period, and any difference is adjusted through appropriate overhead accounts in accordance with company policy.

(1) This method is not a violation of 9904.408-40(b) if it results in allocating the estimated annual costs of compensated personal

absence at a rate which reflects the anticipated costs of the entire cost accounting period.

(2) The computation itself must comply with the criteria of 9904.408-40(a). For example, if the terms of the Company's sick leave plan are such that in accordance with this Standard, the costs should be recognized in the cost accounting period when they are paid, then the computation should be intended to amortize the expected costs of sick leave over the activity of that cost accounting period, leaving no accrued liability for sick leave at the end of the cost accounting period.

9904.408-61 Interpretation. [Reserved]

9904.408-62 Exemption.

This Standard shall not apply to contracts and grants with state, local, and Federally recognized Indian Tribal Governments.

9904.408-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

9904.409 Cost Accounting Standard—Depreciation of Tangible Capital Assets

9904.409-10 [Reserved]

9904.409-20 Purpose.

The purpose of this Standard is to provide criteria and guidance for assigning costs of tangible capital assets to cost accounting periods and for allocating such costs in cost objectives within such periods in an objective and consistent manner. The Standard is based on the concept that depreciation costs identified with cost accounting periods and benefiting cost objectives within periods should be a reasonable measure of the expiration of service potential of the tangible assets subject to depreciation. Adherence to this Standard should provide a systematic and rational flow of the costs of tangible capital assets to benefited cost objectives over the expected service lives of the assets. This Standard does not cover nonwasting assets or natural resources which are subject to depletion.

9904.409-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Residual value* means the proceeds (less removal and disposal costs, if any) realized upon disposition of a tangible capital asset. It usually is measured by the net proceeds from the sale or other disposition of the asset, or its fair value if the asset is traded in on another asset. The estimated residual value is a current forecast of the residual value.

(2) *Service life* means the period of usefulness of a tangible asset (or group of assets) to its current owner. The period may be expressed in units of time or output. The estimated service life of a tangible capital asset (or group of assets) is a current forecast of its service life and is the period over which depreciation cost is to be assigned.

(3) *Tangible capital asset* means an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the services it yields.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.409-40 Fundamental requirement.

(a) The depreciable cost of a tangible capital asset (or group of assets) shall be assigned to cost accounting periods in accordance with the following criteria:

(1) The depreciable cost of a tangible capital asset shall be its capitalized cost less its estimated residual value.

(2) The estimated service life of a tangible capital asset (or group of assets) shall be used to determine the cost accounting periods to which the depreciable cost will be assigned.

(3) The method of depreciation selected for assigning the depreciable cost of a tangible capital asset (or group of assets) to the cost accounting periods representing its estimated service life shall reflect the pattern of consumption of services over the life of the asset.

(4) The gain or loss which is recognized upon disposition of a tangible capital asset shall be assigned to the cost accounting period in which the disposition occurs.

(b) The annual depreciation cost of a tangible capital asset (or group of assets) shall be allocated to cost objectives for which it provides service in accordance with the following criteria:

(1) Depreciation cost may be charged directly to cost objectives only if such charges are made on the basis of usage and only if depreciation costs of all like assets used for similar purposes are charged in the same manner.

(2) Where tangible capital assets are part of, or function as, an organizational unit whose costs are charged to other cost objectives based on measurement of the services provided by the organizational unit, the depreciation cost of such assets shall be included as part of the cost of the organizational unit.

(3) Depreciation costs which are not allocated in accordance with paragraph (b)(1) or (2) of this subsection, shall be included in appropriate indirect cost pools.

(4) The gain or loss which is recognized upon disposition of a tangible capital asset, where material in amount, shall be allocated in the same manner as the depreciation cost of the asset has been or would have been allocated for the cost accounting period in which the disposition occurs. Where such gain or loss is not material, the amount may be included in an appropriate indirect cost pool.

9904.409-50 Techniques for application.

(a) Determination of the appropriate depreciation charges involves estimates both of service life and of the likely pattern of consumption of services in the cost accounting periods included in such life. In selecting service life estimates and in selecting depreciation methods, many of the same physical and economic factors should be considered. The following are among the factors which may be taken into account: quantity and quality of expected output, and the timing thereof; costs of repair and maintenance, and the timing thereof; standby or incidental use and the timing thereof; and technical or economic obsolescence of the asset (or group of assets), or of the product or service it is involved in producing.

(b) Depreciation of a tangible capital asset shall begin when the asset and any others on which its effective use depends are ready for use in a normal or acceptable fashion. However, where partial utilization of a tangible capital asset is identified with a specific operation, depreciation shall commence on any portion of the asset which is substantially completed and used for that operation. Depreciable spare parts which are required for the operation of such tangible capital assets shall be accounted for over the service life of the assets.

(c) A consistent policy shall be followed in determining the depreciable cost to be assigned to the beginning and ending cost accounting periods of asset use. The policy may provide for any reasonable starting and ending dates in computing the first and last year depreciable cost.

(d) Tangible capital assets may be accounted for by treating each individual asset as an accounting unit, or by combining two or more assets as a single accounting unit, provided such treatment is consistently applied over the service life of the asset or group of assets.

(e) Estimated service lives initially established for tangible capital assets (or groups of assets) shall be reasonable approximations of their expected actual periods of usefulness, considering the factors mentioned in paragraph (a) of this subsection. The estimate of the expected actual periods of usefulness need not include the additional period tangible capital assets are retained for standby or incidental use where adequate records are maintained which reflect the withdrawal from active use.

(1) The expected actual periods of usefulness shall be those periods which are supported by records of either past retirement or, where available, withdrawal from active use (and retention for standby or incidental use) for like assets (or groups of assets) used in similar circumstances appropriately modified for specifically identified factors expected to influence future lives. The factors which can be used to modify past experience include:

(i) Changes in expected physical usefulness from that which has been experienced such as changes in the quantity and quality of expected output.

(ii) Changes in expected economic usefulness, such as changes in expected technical or economic obsolescence of the asset (or group of assets), or of the product or service produced.

(2) Supporting records shall be maintained which are adequate to show the age at retirement or, if the contractor so chooses, at withdrawal from active use (and retention for standby or incidental use) for a sample of assets for each significant category. Whether assets are accounted for individually or by groups, the basis for estimating service life shall be predicated on supporting records of experienced lives for either individual assets or any reasonable grouping of assets as long as that basis is consistently used. The burden shall be on the contractor to justify estimated service lives which are shorter than such experienced lives.

(3) The records required in subparagraphs (e)(1) and (2) of this subsection, if not available on the date when the requirements of this Standard must first be followed by a contractor, shall be developed from current and historical fixed asset records and be available following the second fiscal year after that date. They shall be used as a basis for estimates of service lives of tangible capital assets acquired thereafter. Estimated service lives used for financial accounting purposes (or other accounting purposes where depreciation is not recorded for financial accounting purposes for some non-

commercial organizations), if not unreasonable under the criteria specified in paragraph (e) of this subsection, shall be used until adequate supporting records are available.

(4) Estimated service lives for tangible capital assets for which the contractor has no available data or no prior experience for similar assets shall be established based on a projection of the expected actual period of usefulness, but shall not be less than asset guideline periods (mid-range) established for asset guideline classes under Internal Revenue Procedures which are in effect as of the first day of the cost accounting period in which the assets are acquired. Use of this alternative procedure shall cease as soon as the contractor is able to develop estimates which are appropriately supported by his own experience.

(5) The contracting parties may agree on the estimated service life of individual tangible capital assets where the unique purpose for which the equipment was acquired or other special circumstances warrant a shorter estimated service life than the life determined in accordance with the other provisions of this 9904.409-50(e) and where the shorter life can be reasonably predicted.

(f)(1) The method of depreciation used for financial accounting purposes (or other accounting purposes where depreciation is not recorded for financial accounting purposes) shall be used for contract costing unless:

(i) Such method does not reasonably reflect the expected consumption of services for the tangible capital asset (or group of assets) to which applied, or

(ii) The method is unacceptable for Federal income tax purposes.

If the contractor's method of depreciation used for financial accounting purposes (or other accounting purposes as provided above) does not reasonably reflect the expected consumption of services or is unacceptable for Federal income tax purposes, he shall establish a method of depreciation for contract costing which meets these criteria, in accordance with subparagraph (f)(3) of this subsection.

(2) After the date of initial applicability of this Standard, selection of methods of depreciation for newly acquired tangible capital assets, which are different from the methods currently being used for like assets in similar circumstances, shall be supported by projections of the expected consumption of services of those assets (or groups of assets) to which the different methods of depreciation shall apply. Support in accordance with paragraph (f)(3) of this subsection shall be based on the expected consumption of services of either individual assets or any reasonable grouping of assets as long as the basis selected for grouping assets is consistently used.

(3) The expected consumption of asset services over the estimated service life of a tangible capital asset (or group of assets) is influenced by the factors mentioned in paragraph (a) of this subsection which affect either potential activity or potential output of the asset (or group of assets). These factors may be measured by the expected activity or the expected physical output of the assets, as for example: hours of operation, number of operations performed, number of units produced, or number of miles traveled. An acceptable surrogate for expected activity or output might be a monetary measure of that activity or output generated by use of tangible capital assets, such as estimated labor dollars, total cost incurred or total revenues, to the extent that such monetary measures can reasonably be related to the usage of specific tangible capital assets (or groups

of assets). In the absence of reliable data for the measurement or estimation of the consumption of asset services by the techniques mentioned, the expected consumption of services may be represented by the passage of time. The appropriate method of depreciation should be selected as follows:

(i) An accelerated method of depreciation is appropriate where the expected consumption of asset services is significantly greater in early years of asset life.

(ii) The straight-line method of depreciation is appropriate where the expected consumption of asset services is reasonably level over the service life of the asset (or group of assets).

(g) The estimated service life and method of depreciation to be used for an original complement of low-cost equipment shall be based on the expected consumption of services over the expected useful life of the complement as a whole and shall not be based on the individual items which form the complement.

(h) Estimated residual values shall be determined for all tangible capital assets (or groups of assets). For tangible personal property, only estimated residual values which exceed ten percent of the capitalized cost of the asset (or group of assets) need be used in establishing depreciable costs. Where either the declining balance method of depreciation or the class life asset depreciation range system is used consistent with the provisions of this Standard, the residual value need not be deducted from capitalized cost to determine depreciable costs. No depreciation cost shall be charged which would significantly reduce book value of a tangible capital asset (or group of assets) below its residual value.

(i) Estimates of service life, consumption of services, and residual value shall be reexamined for tangible capital assets (or groups of assets) whenever circumstances change significantly. Where changes are made to the estimated service life, residual value, or method of depreciation during the life of a tangible capital asset, the remaining depreciable costs for cost accounting purposes shall be limited to the undepreciated cost of the assets and shall be assigned only to the cost accounting period in which the change is made and to subsequent periods.

(j)(1) Gains and losses on disposition of tangible capital assets shall be considered as adjustments of depreciation costs previously recognized and shall be assigned to the cost accounting period in which disposition occurs except as provided in subparagraphs (j)(2) and (3) of this subsection. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds in the event of involuntary conversion, and its undepreciated balance. However, the gain to be recognized for contract costing purposes shall be limited to the difference between the original acquisition cost of the asset and its undepreciated balance.

(2) Gains and losses on the disposition of tangible capital assets shall not be recognized where:

(i) Assets are grouped and such gains and losses are processed through the accumulated depreciation account, or,

(ii) The asset is given in exchange as part of the purchase price of a similar asset and the gain or loss is included in computing the depreciable cost of the new asset.

Where the disposition results from an involuntary conversion and the asset is replaced by a similar asset, gains and losses may either be recognized in the period of disposition or used to adjust the depreciable cost base of the new asset.

(3) The contracting parties may account for gains and losses arising from mass or extraordinary dispositions in a manner which will result in treatment equitable to all parties.

(4) Gains and losses on disposition of tangible capital assets transferred in other than an arms-length transaction and subsequently disposed of within 12 months from the date of transfer shall be assigned to the transferor.

(5) The provisions of this subsection 9904.409-50(j) do not apply to business combinations. The carrying values of tangible capital assets acquired subsequent to a business combination shall be established in accordance with the provisions of 9904.404-50(d).

(k) Where, in accordance with 9904.409-40(b)(1), the depreciation costs of like tangible capital assets used for similar purposes are directly charged to cost objectives on the basis of usage, average charging rates based on cost shall be established for the use of such assets. Any variances between total depreciation cost charged to cost objectives and total depreciation cost for the cost accounting period shall be accounted for in accordance with the contractor's established practice for handling such variances.

(l) Practices for determining depreciation methods, estimated service lives and estimated residual values need not be changed for assets acquired prior to compliance with this Standard if otherwise acceptable under applicable procurement regulations. However, if changes are effected such changes must conform to the criteria established in this Standard and may be effected on a prospective basis to cover the undepreciated balance of cost by agreement between the contracting parties pursuant to negotiation under subdivision (a)(4)(ii) or (iii) of the contract clause set out at 9903.201-4(a).

9904.409-60 Illustrations.

The following examples are illustrative of the provisions of this Standard.

(a) Companies X, Y, and Z purchase identical milling machines to be used for similar purposes.

(1) Company X estimates service life for tangible capital assets on a individual asset basis. Its experience with similar machines is that the average replacement period is 14 years. Under the provisions of the Standard, Company X shall use the estimated service life of 14 years for the milling machine unless it can demonstrate changed circumstances or new circumstances to support a different estimate.

(2) Company Y estimates service life for tangible capital assets by grouping assets of the same general kind and with similar service lives. Accordingly, all machine tools are accounted for as a single group. The average replacement life for machine tools for Company Y is 12 years. In accordance with the provisions of the Standard, Company Y shall use a life of 12 years for the acquisition unless it can support a different estimate for the entire group.

(3) Company Z estimates service life for tangible capital assets by grouping assets according to use without regard to service lives. Accordingly, all machinery and equipment is accounted for as a single group. The average replacement life for machinery and equipment in Company Z is 10 years. In accordance with the provisions of the Standard, Company Z shall use an estimated service life of ten years for the acquisition unless it can support a different estimate for the entire group.

(b) Company X desires to charge depreciation of the milling machine described in paragraph (a) of this subsection, directly to final cost objectives. Usage of the milling machine can be measured readily based on hours of operation. Company X may charge depreciation cost directly on a unit of time basis provided he uses one depreciation charging rate for all like milling machines in the machine shop and charges depreciation for all such milling machines directly to benefiting cost objectives.

(c) A contractor acquires, and capitalizes as an asset accountability unit, a new lathe. The estimated service life is 10 years for the lathe. He acquires, and capitalizes as an original complement of low-cost equipment related to the lathe, a collection of tool holders, chucks, indexing heads, wrenches, and the like. Although individual items comprising the complement have an average life of 6 years, replacements of these items will be made as needed and, therefore, the expected useful life of the complement is equal to the life of the lathe. An estimated service life of 10 years should be used for the original complement.

(d) A contractor acquires a test facility with an estimated physical life of 10 years, to be used on contracts for a new program. The test facility was acquired for \$5 million. It is expected that the program will be completed in 6 years and the test facility acquired is not expected to be required for other products of the contractor. Although the facility will last 10 years, the contracting parties may agree in advance to depreciate the facility over 6 years.

(e) Contractor acquires a building by donation from its local Government. The building had been purchased new by another company and subsequently acquired by the local Government. Contractor capitalizes the building at its fair value. Under the Standard the depreciable cost of the asset based on that value may be accounted for over its estimated service life and allocated to cost objectives in accordance with contractor's cost allocation practices.

(f) A major item of equipment which was acquired prior to the applicability of this Standard was estimated, at acquisition, to have a service life of 12 years and a residual value of no more than 10 percent of acquisition cost. After 4 years of service, during which time this Standard has become applicable, a change in the production situation results in a well-supported determination to shorten the estimated service life to a total of 7 years. The revised estimated residual value is 15 percent of acquisition cost. The annual depreciation charges based on this particular asset will be appropriately increased to amortize the remaining cost, less the current estimate of residual value, over the remaining 3 years of expected usefulness. This change is not a change of cost accounting practice, but a correction of numeric estimates. The requirement of 9904.409-50(l) for an adjustment pursuant to subdivision (a)(4)(ii) or (iii) of the CAS clause does not apply.

(g) The support required by 9904.409-50(e) can, in all likelihood, be derived by sampling from almost any reasonable fixed asset records. Of course, the more complete the data in the records which are available, the more confidence there can be in determinations of asset service lives. The following descriptions of sampling methods are illustrations of techniques which may be useful even with limited fixed asset records.

(1) A company maintains an inventory of assets in use. The company should select a sampling time period which, preferably, is significantly longer than the anticipated life of the assets for which lives are to be established. Of course, the inventory must be avail-

able for each year in the sampling time period. The company would then select a random sample of items in each year except the most recent year of the time period. Each item in the sample would be compared to the subsequent year's inventory to determine if the asset is still in service; if not, then the asset had been retired in the year from which the sample was drawn. The item is then traced to prior year inventories to determine the year in which acquired.

Note: Sufficient items must be drawn in each year to ensure an adequate sample.

(2) A company maintains an inventory of assets in use and also has a record of retirements. In this case the company does not have to compare the sample to subsequent years to determine if disposition has occurred. As in Example (g)(1) of this subsection, the sample items are traced to prior years to determine the year in which acquired.

(3) A company maintains retirement records which show acquisition dates. The company should select a sampling time period which, preferably, is significantly longer than the anticipated life of the assets for which lives are to be estimated. The company would then select a random sample of items retired in each year of the sampling time period and tabulate age at retirement.

(4) A company maintains only a record of acquisitions for each year. The company should select a random sample of items acquired in the most recent complete year and determine from current records or observations whether each item is currently in service. The acquisitions of each prior year should be sampled in turn to determine if sample items are currently in service. This sampling should be performed for a time period significantly longer than the anticipated life of assets for which the lives are to be established, but can be discontinued at the point at which sample items no longer appear in current use. From the data obtained, mortality tables can be constructed to determine average asset life.

(5) A company does not maintain accounting records on fully depreciated assets. However, property records are maintained, and such records are retained for 3 years after disposition of an asset in groups by year of disposition. An analysis of these retirements may be made by selecting the larger dollar items for each category of assets for which lives are to be determined (for example, at least 75 percent of the acquisition values retired each year). The cases cited above are only examples and many other examples could have been used. Also, in any example, a company's individual circumstances must be considered in order to take into account possible biased results because of changes in organizations, products, acquisition policies, economic factors, etc. The results from example (g)(5) of this subsection, for instance, might be substantially distorted if the 3-year period was unusual with respect to dispositions. Therefore, the examples are illustrative only and any sampling performed in compliance with this Standard should take into account all relevant information to ensure that reasonable results are obtained.

9904.409-61 Interpretation. [Reserved]

9904.409-62 Exemption.

This Standard shall not apply where compensation for the use of tangible capital assets is based on use rates or allowances provided by other appropriate Federal acquisition regulations such as those governing:

- (a) Educational institutions,

- (b) State, local, and Federally recognized Indian tribal government, or

- (c) Construction equipment rates (See 48 CFR 31.105(d)).

9904.409-63 Effective date.

- (a) This Standard is effective April 15, 1996.

- (b) This Standard shall be applied beginning with the contractor's next full cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

- (c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow Standard 9904.409 in effect prior to April 15, 1996, until this Standard, effective April 15, 1996, becomes applicable after the receipt of a contract or subcontract to which this revised Standard applies.

Subpart 9904.410—Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives

9904.410-10 [Reserved]

9904.410-20 Purpose.

The purpose of this Cost Accounting Standard is to provide criteria for the allocation of business unit general and administrative (G&A) expenses to business unit final cost objectives based on their beneficial or causal relationship. These expenses represent the cost of the management and administration of the business unit as a whole. The Standard also provides criteria for the allocation of home office expenses received by a segment to the cost objectives of that segment. This Standard will increase the likelihood of achieving objectivity in the allocation of expenses to final cost objectives and comparability of cost data among contractors in similar circumstances.

9904.410-30 Definitions.

- (a) The following are definitions of terms which are prominent in this standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this section, requires otherwise.

- (1) *Allocate* means to assign an item of cost or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

- (2) *Business unit* means any segment of an organization, or an entire business organization which is not divided into segments.

- (3) *Cost input* means the cost, except G&A expenses, which for contract costing purposes is allocable to the production of goods and services during a cost accounting period.

- (4) *Cost objective* means a function, organizational subdivision, contract or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

- (5) *Final cost objective* means a cost objective which has allocated to it both direct and indirect costs, and, in the contractor's accumulation systems, is one of the final accumulation points.

- (6) *General and administrative (G&A) expense* means any management, financial, and other expense which is incurred by or allocated to a business unit and which is for the general management and administration of the business unit as a whole. G&A expense does not include those management expenses whose beneficial or causal relationship to cost objectives can be more directly measured

by a base other than a cost input base representing the total activity of a business unit during a cost accounting period.

(7) *Segment* means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. The terms include Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the organization has less than a majority of ownership, but over which it exercises control.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.410-40 Fundamental requirement.

(a) Business unit G&A expenses shall be grouped in a separate indirect cost pool which shall be allocated only to final cost objectives.

(b)(1) The G&A expense pool of a business unit for a cost accounting period shall be allocated to final cost objectives of that cost accounting period by means of a cost input base representing the total activity of the business unit except as provided in subparagraph (b)(2) of this subsection. The cost input base selected shall be the one which best represents the total activity of a typical cost accounting period.

(2) The allocation of the G&A expense pool to any particular final cost objectives which receive benefits significantly different from the benefits accruing to other final cost objectives shall be determined by special allocation (9904.410-50(j)).

(c) Home office expenses received by a segment shall be allocated to segment cost objectives as required by 9904.410-50(g).

(d) Any costs which do not satisfy the definition of G&A expense but which have been classified by a business unit as G&A expenses, can remain in the G&A expense pool unless they can be allocated to business unit cost objectives on a beneficial or causal relationship which is best measured by a base other than a cost input base.

9904.410-50 Techniques for application.

(a) G&A expenses of a segment incurred by another segment shall be removed from the incurring segment's G&A expense pool. They shall be allocated to the segment for which the expenses were incurred on the basis of the beneficial or causal relationship between the expenses incurred and all benefiting or causing segments. If the expenses are incurred for two or more segments, they shall be allocated using an allocation base common to all such segments.

(b) The G&A expense pool may be combined with other expenses for allocation to final cost objectives provided that -

(1) The allocation base used for the combined pool is appropriate both for the allocation of the G&A expense pool under this Standard and for the allocation of the other expenses; and

(2) Provision is made to identify the components and total of the G&A expense pool separately from the other expenses in the combined pool.

(c) Expenses which are not G&A expenses and are insignificant in amount may be included in the G&A expense pool for allocation to final cost objectives.

(d) The cost input base used to allocate the G&A expense pool shall include all significant elements of that cost input which represent the total activity of the business unit. The cost input base selected to represent the total activity of a business unit during a cost accounting period may be: total cost input; value-added cost input; or single element cost input. The determination of which cost input base best represents the total activity of a business unit must be judged on the basis of the circumstances of each business unit.

(1) A total cost input base is generally acceptable as an appropriate measure of the total activity of a business unit.

(2) Value-added cost input shall be used as an allocation base where inclusion of material and subcontract costs would significantly distort the allocation of the G&A expense pool in relation to the benefits received, and where costs other than direct labor are significant measures of total activity. A value-added cost input base is total cost input less material and subcontract costs.

(3) A single element cost input base; e.g., direct labor hours or direct labor dollars, which represents the total activity of a business unit may be used to allocate the G&A expense pool where it produces equitable results. A single element base may not produce equitable results where other measures of activity are also significant in relation to total activity. A single element base is inappropriate where it is an insignificant part of the total cost of some of the final cost objectives.

(e) Where, prior to the effective date of this Standard, a business unit's disclosed or established cost accounting practice was to use a cost of sales or sales base, that business unit may use the transition method set out in Appendix A hereof.

(f) Cost input shall include those expenses which by operation of this Standard are excluded from the G&A expense pool and are not part of a combined pool of G&A expenses and other expenses allocated using the same allocation base.

(g)(1) Allocations of the home office expenses of: (i) line management of particular segments or groups of segments, (ii) residual expenses, and (iii) directly allocated expenses related to the management and administration of the receiving segment as a whole, shall be included in the receiving segment's G&A expense pool.

(2) Any separate allocation of the expenses of home office centralized service functions, staff management of specific activities of segments, and central payments or accruals, which is received by a segment, shall be allocated to the segment cost objectives in proportion to the beneficial or causal relationship between the cost objectives and the expense if such allocation is significant in amount. Where a beneficial or causal relationship for the expense is not identifiable with segment cost objectives, the expense may be included in the G&A expense pool.

(h) Where a segment performs home office functions and also performs as an operating segment having a responsibility for final cost objectives, the expense of the home office functions shall be segregated. These expenses shall be allocated to all benefiting or causing segments, including the segment performing the home office functions, pursuant to disclosed or established accounting practices for the allocation of home office expenses to segments.

(i) For purposes of allocating the G&A expense pool, items produced or worked on for stock or product inventory shall be accounted for as final cost objectives in accordance with the following paragraphs:

(1) Where items are produced or worked on for stock or product inventory in a given cost accounting period, the cost input to such items in that period shall be included only once in the computation of the G&A expense allocation base and in the computation of the G&A expense allocation rate for that period and shall not be included in the computation of the base or rate for any other cost accounting period.

(2) A portion of the G&A expense pool shall be allocated to items produced or worked on for stock or product inventory in the cost accounting period or periods in which such items are produced at the rates determined for such periods except as provided in subparagraph (i)(3) of this subsection.

(3) Where the contractor does not include G&A expense in inventory as part of the cost of stock or product inventory items, the G&A rate of the cost accounting period in which such items are issued to final cost objectives may be used to determine the G&A expenses applicable to issues of stock or product inventory items.

(j) Where a particular final cost objective in relation to other final cost objectives receives significantly more or less benefit from G&A expense than would be reflected by the allocation of such expenses using a base determined pursuant to paragraph (d) of this subsection, the business unit shall account for this particular final cost objective by a special allocation from the G&A expense pool to the particular final cost objective commensurate with the benefits received. The amount of a special allocation to any such final cost objective shall be excluded from the G&A expense pool required by 9904.410-40(a), and the particular final cost objective's cost input data shall be excluded from the base used to allocate this pool.

9904.410-60 Illustrations.

(a) Business Unit A has been including the cost of scientific computer operations in its G&A expense pool. The scientific computer is used predominantly for research and development, rather than for the management and administration of the business unit as a whole. The costs of the scientific computer operation do not satisfy the Standard's definition of G&A expense; however, they may remain in the G&A expense pool unless they can be allocated to business unit cost objectives on a beneficial or causal relationship which is best measured by a base other than a cost input base representing the total activity of a business unit during a cost accounting period.

(b) Segment B performs a budgeting function, the cost of which is included in its G&A expense pool. This function includes the preparation of budgets for another segment. The cost of preparing the budgets for the other segment should be removed from B's G&A expense pool and transferred to the other segment.

(c)(1) Business Unit C has a personnel function which is divided into two parts: a vice president of personnel who establishes personnel policy and overall guidance, and a personnel department which handles hirings, testing, evaluations, etc.

The expense of the vice president is included in the G&A expense pool. The expense of the personnel department is allocated to the other indirect cost pools based on the beneficial or causal relationship between that expense and the indirect cost pools. This procedure is in compliance with the requirements of this Standard.

(2) Business Unit C has included selling costs as part of its G&A expense pool. Unit C wishes to continue to include selling costs in its G&A expense pool. Under the provisions of this Standard, Unit

C may continue to include selling costs in its G&A pool, and these costs will be allocated over a cost input base selected in accordance with the provisions of 9904.410-50(d).

(3) Business Unit C has included IR&D and B&P costs in its G&A expense pool. Unit C has used a cost of sales base to allocate its G&A expense pool. As of January 1, 1978 (assumed for purposes of this illustration), the date on which Unit C must first allocate its G&A expense pool in accordance with the requirements of this Standard, Unit C has among its final cost objectives several cost reimbursement contracts and fixed price contracts subject to the CAS clause (referred to as the preexisting contracts). If Unit C chooses to use the transition method in 9904.410-50(e):

(i) Unit C shall allocate IR&D and B&P costs during the transition period (from January 1, 1978, to and including the cost accounting period during which the preexisting contracts are completed), to the preexisting contracts as part of its G&A expense pool using a cost of sales base pursuant to 9904.410-50(e) and Appendix A to 9904.410.

(ii) During the transition period such costs, as part of the G&A expense pool, shall be allocated to new cost reimbursement contracts and new fixed price contracts subject to the CAS clause using a cost input base as required by 9904.410-50(d) and (e) and Appendix A to 9904.410.

(iii) Beginning with the cost accounting period after the transition period the IR&D and B&P costs, as part of the G&A expense pool, shall be allocated to all final cost objectives using a cost input base as required by 9904.410-50(d). If Unit C chooses not to use the transition method in 9904.410-50(e), the contractual provision requiring appropriate equitable adjustment of the prices of affected prime contracts and subcontracts will be implemented.

(4) Business Unit C has accounted for and allocated IR&D and B&P costs in a cost pool separate and apart from the G&A expense pool. Unit C may continue to account for these costs in a separate cost pool under the provision of this Standard. If Unit C is to use a total cost input base, these costs when accounted for and allocated in a cost pool separate and apart from the G&A expense pool will become part of the total cost input base used by Unit C to allocate the G&A expense pool.

(5) Business Unit C has included selling costs as part of its G&A expense pool. Unit C has used a cost of sales base to allocate the G&A expense pool. Unit C desires to continue to allocate selling costs using the costs of sales base. Under the provisions of this Standard, Unit C would account for selling costs as a cost pool separate and apart from the G&A expense pool, and continue to allocate these costs over a cost of sales base. If Unit C uses a total cost input base to allocate the G&A expense pool, the selling costs will become part of the total cost input base.

(d)(1) Business Unit D has accounted for selling costs in a cost pool separate and apart from its G&A expense pool and has allocated these costs using a cost of sales base. Under the provisions of this Standard, Unit D may continue to account for those costs in a separate pool and allocate them using a cost of sales base. Unit D has a total cost input base to allocate its G&A expense pool. The selling costs will become part of the cost input base used by Unit D to allocate the G&A expense pool.

(2) During a cost accounting period, Business Unit D buys \$2,000,000 of raw materials. At the end of that cost accounting period, \$500,000 of raw materials inventory have not been charged

out to contracts or other cost objectives. The \$500,000 of raw materials are not part of the total cost input base for the cost accounting period, because they have not been charged to the production of goods and services during that period. If all of the \$2,000,000 worth of raw material had been charged to cost objectives during the cost accounting period, the cost input base for the allocation of the G&A expense pool would include the entire \$2,000,000.

(3) Business Unit D manufactures a variety of testing devices. During a cost accounting period, Unit D acquires and uses a small building, constructs a small production facility using its own resources, and keeps for its own use one unit of a testing device that it manufactures and sells to its customers. The acquisition cost of the building is not part of the total cost input base; however, the depreciation taken on the building would be part of the total cost input base. The costs of construction of the small production facility are not part of the total cost input base. The requirements of 9904.404 provide that those G&A expenses which are identifiable with the constructed asset and are material in amount shall be capitalized as part of the cost of the production facility. If there are G&A expenses material in amount and identified with the constructed asset, these G&A expenses would be removed from the G&A expense pool prior to the allocation of this pool to final cost objectives. The cost of the testing device shall be part of the total cost input base per the requirements of 9904.404 which provides that the costs of constructed assets identical with the contractor's regular product shall include a full share of indirect cost.

(e)(1) Business Unit E produces Item Z for stock or product inventory. The business unit does not include G&A expense as part of the inventory cost of these items for costing or financial reporting purposes. A production run of these items occurred during Cost Accounting Period 1. A number of the units produced were not issued during Period 1 and are issued in Period 2. However, those units produced in Period 1 shall be included in the cost input of that period for calculating the G&A expense allocation base and shall not be included in the cost input of Period 2.

(2) Business Unit E should apply the G&A expense rate of Period 1 to those units of Item Z issued during Period 1 and may apply the rate of Period 2 to the units issued in Period 2.

(3) If the practice of Business Unit E is to include G&A expense as part of the cost of stock or product inventory, the inventory cost of all units of Item Z produced in Period 1 and remaining in inventory at the end of Period 1, should include G&A expense using the G&A rate of Period 1.

(f)(1) Business Unit F produced Item X for stock or product inventory. The business unit does not include G&A expense as part of the inventory cost of these items. A production run of these items was started, finished, and placed into inventory in a single cost accounting period. These items are issued during the next cost accounting period.

(2) The cost of items produced for stock or product inventory should be included in the G&A base in the same year they are produced. The cost of such items is not to be included in the G&A base on the basis of when they are issued to final cost objectives. Therefore, the time of issuance of these items from inventory to a final cost objective is irrelevant in computing the G&A base.

(g) The normal productive activity of Business Unit G includes the construction of base operating facilities for others. Unit G uses a total cost input base to allocate G&A expense to final cost objec-

tives. As part of a contract to construct an operating facility, Unit G agrees to acquire a large group of trucks and other mobile equipment to equip the base operating facility. Unit G does not usually supply such equipment. The cost of the equipment constitutes a significant part of the contract cost. A special G&A allocation to this contract shall be agreed to by the parties if they agree that in the circumstances the contract as a whole receives substantially less benefit from the G&A expense pool than that which would be represented by a cost allocation based on inclusion of the contract cost in the total cost input base.

(h)(1) The home office of Segment H separately allocates to benefiting or causing segments significant home office expenses of staff management functions relative to manufacturing, staff management functions relative to engineering, central payment of health insurance costs, and residual expenses. Segment H receives these expenses as separate allocations and maintains three indirect cost pools; i.e., G&A expense, manufacturing overhead, and engineering overhead; all home office expenses allocated to Segment H are included in Segment H's G&A expense pool.

(2) This accounting practice of Segment H does not comply with 9904.410-50(g)(2). Home office residual expenses should be in the G&A expense pool, and the expenses of the staff management functions relative to manufacturing and engineering should be included in the manufacturing overhead and engineering overhead pools, respectively. The health insurance costs should be allocated in proportion to the beneficial and causal relationship between these costs and Segment H's cost objectives.

9904.410-61 Interpretation. [Reserved]

9904.410-62 Exemption.

This Standard shall not apply to contracts and grants with state, local, and Federally recognized Indian tribal governments.

9904.410-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

Appendix A to Section 9904.410 Transition From a Cost of Sales or Sales Base to a Cost Input Base

A business unit may use the method described below for transition from the use of a cost of sales or sales base to a cost input base.

(1) Calculate the cost of sales or sales base in accordance with the cost accounting practice disclosed or established prior to the date established by 9904.410-80(b) of the original Cost Accounting Standard.

(2) Calculate the G&A expense allocation rate using the base determined in subparagraph (1) of this Appendix and use that rate to allocate from the G&A expense pool to the final cost objectives which were in existence prior to the date on which the business unit must first allocate costs in accordance with the requirements of this Cost Accounting Standard.

(3) Calculate a cost input base in compliance with 9904.410-50(d).

(4) Calculate the G&A expense rate using the base determined in subparagraph (3) of this Appendix and use that rate to allocate from the G&A expense pool to those final cost objectives which arise under contracts entered into on or after the date on which the business unit must first allocate costs in accordance with the requirements of this Cost Accounting Standard.

(5) The calculations set forth in subparagraphs (1)-(4) of this Appendix shall be performed for each cost accounting period during which final cost objectives described in (2) are being performed.

(6) The business unit shall establish an inventory suspense account. The amount of the inventory suspense account shall be equal to the beginning inventory of contracts subject to the CAS clause of the cost accounting period in which the business unit must first allocate costs in accordance with the requirements of this Cost Accounting Standard.

(7) In any cost accounting period, after the cost accounting periods described in subparagraph (5) of this Appendix, if the ending inventory of contracts subject to the CAS clause is less than the balance of the inventory suspense account, the business unit shall calculate two G&A expense allocation rates, one to allocate G&A expenses to contracts subject to the CAS clause and one applicable to other work.

(a) The G&A expense pool shall be divided in the proportion which the cost input of the G&A expense allocation base of the contracts subject to the CAS clause bears to the total of the cost input allocation base, selected in accordance with 9904.410-50(d), for the cost accounting period.

(b) The G&A expenses applicable to contracts subject to the CAS clause shall be reduced by an amount determined by multiplying the difference between the balance of the inventory suspense account and the ending inventory of contracts subject to the CAS clause by the cost of sales rate, as determined under subparagraph (1) of this Appendix, of the cost accounting period in which a business unit must first allocate costs in accordance with the requirements of this Cost Accounting Standard.

(8) In any cost accounting period in which such a reduction is made, the balance of the inventory suspense account shall be reduced to be equal to the ending inventory of contracts subject to the CAS clause of that cost accounting period.

The following illustrates how a business unit would use this transition method.

1. Business Unit R has been using a cost of sales base to allocate its G&A expense pool to final cost objectives. Unit R uses a calendar year as its cost accounting period. On October 1, 1976 (assumed for purposes of this illustration) Cost Accounting Standard 410 becomes effective. On October 2, 1976, Unit R receives a 3-year contract containing the Cost Accounting Standards clause. As a result, Unit R must comply with the requirements of the Standard in the cost accounting period beginning in January 1978. As of January 3, 1978, Business Unit R has the following contracts:

(1) Contract I - A 4-year contract awarded in January 1975.

(2) Contract II - A 3-year contract which was negotiated in March 1976, and was awarded on October 2, 1976.

(3) Contract III - A 4-year contract awarded on January 2, 1978.

If Business Unit R chooses to use the transition method provided in 9904.410-50(e), it will allocate the G&A expense pool to these contracts as follows:

(a) Contract I - Since Contract I was in existence prior to January 1, 1978, the G&A expense pool shall be allocated to it using a cost of sales base as provided in 9904.410-50(e).

(b) Contract II - Since this contract was in existence prior to January 1, 1978, the G&A expense pool shall be allocated to it using a cost of sales base as provided in 9904.410-50(e).

(c) Contract III - Since this contract was awarded after January 1, 1978, the G&A expense pool shall be allocated to this contract using a cost input base.

Having chosen to use 9904.410-50(e), Business Unit R will use the transition method of allocating the G&A expense pool to final cost objectives until all contracts awarded prior to January 1, 1978, are completed (1979 if the contracts are completed on schedule). Beginning with the cost accounting period subsequent to that time, 1980, Unit R will use a cost input base to allocate the G&A expense pool to all cost objectives. Unit R will also carry forward an inventory suspense account in accordance with the requirements of this Standard.

2.A. Business Unit N is first required to allocate its costs in accordance with the requirements of 9904.410 during the fiscal year beginning January 1, 1978. Unit N has used a cost of sales base to allocate its G&A expense pool.

During the years 1978, 1979, 1980, Business Unit N reported the following data:

	CONTRACTS PRIOR TO JANUARY 1, 1978			CONTRACTS PRIOR TO JANUARY 1, 1978			
	Total	Non-CAS work	CAS-fixed price work	CAS-cost contract	Non-CAS work	CAS-fixed price work	CAS-cost contracts
Year 1978:							
Beginning inventory	\$500	300	200	0	0	0	0
Cost input	+3,000	400	600	700	500	500	300
Total	3,500	7800	800	700	500	500	300
Cost of sales	-3,000	600	550	700	450	400	300
Ending inventory	500	100	250	0	50	100	0
Year 1979:	500	100	250	0	50	100	0
Beginning inventory							
Cost input	+3,000	400	600	700	500	500	300
Total	3,500	500	850	700	550	600	300
Cost of sales	-2,500	450	650	700	150	250	300
Ending inventory	1,000	50	200	0	400	350	0
Year 1980:	1,000	50	200	0	400	350	0
Beginning inventory							
Cost input	+3,000	400	600	700	500	500	300
Total	4,000	450	800	700	900	850	300
Cost of sales	-3,250	450	800	700	450	550	300
Ending inventory	750	0	0	0	450	300	0

NOTES: Operating data is in thousands of dollars. G&A expense \$375,00 in accordance with the requirements of this Standard.

Work existing prior to January 1, 1978, may include -

- (1) Government contracts which contain the CAS clause;
- (2) Government contracts which do not contain the CAS clause;
- (3) Contracts other than Government contracts or customer orders; and
- (4) Production not specifically identified with contracts or customer orders under production or work orders existing prior to the

date on which a business unit must first allocate its costs in compliance with this Standard and which are limited in time or quantity.

Production under standing or unlimited work orders, continuous flow processes and the like, not identified with contracts or customer orders are to be treated as final cost objectives awarded after the date on which a business unit must first allocate its costs in compliance with the requirements of this Standard.

Business Unit N may allocate the G&A expense pool as follows:

		(In Dollars)		
		Year 1978	Year 1979	Year 1980
1.	G&A expense pool	375	375	375
	Cost of sales rate	$375/3,000 = .125$	$375/2,500 = .150$	$375/3,250 = .115$
	Cost input	$375/3,000 = .125$	$375/3,000 = .125$	$375/3,000 = .125$
2.	G&A allocations:			
	Prior contracts:			
	Non-CAS work	$600 \times 0.125 = 75.00$	$450 \times 0.15 = 67.50$	$450 \times 0.115 = 51.75$
	CAS-fixed price work	$550 \times 0.125 = 68.75$	$650 \times 0.15 = 97.50$	$800 \times 0.115 = 92.00$
	CAS-cost contracts	$700 \times 0.125 = 87.50$	$700 \times 0.15 = 105.00$	$700 \times 0.115 = 80.50$
	After contracts:			
	Non-CAS work	$500 \times 0.125 = 62.50$	$500 \times 0.125 = 62.50$	$500 \times 0.125 = 62.50$
	CAS-fixed price work	$500 \times 0.125 = 62.50$	$500 \times 0.125 = 62.50$	$500 \times 0.125 = 62.50$
	CAS-cost contracts	$300 \times 0.125 = 37.50$	$300 \times 0.125 = 37.50$	$300 \times 0.125 = 37.50$
		393.75	432.50	386.80
3.	Inventory suspense account ¹	200		
	G&A rate applicable	.125		

¹ Beginning inventory of contracts subject to the CAS clause, January 1978.

2.B. In cost accounting period 1982, Business Unit N has an ending inventory of contracts subject to the CAS clause of \$100,000. This is the first cost accounting period after the transition in which the amount of the ending inventory is less than the amount of the inventory suspense account. During this cost accounting period, Business Unit N had G&A expenses of \$410,000 and cost input of \$3,500,000; \$1,500,000 applicable to contracts subject to the CAS clause and \$2,000,000 applicable to other work.

Business Unit N would compute its G&A expense allocation rate applicable to contracts subject to the CAS clause as follows:

(1)	Amount of inventory suspense account	\$200,000
	Amount of ending inventory	100,000
	Difference	100,000
	G&A rate applicable (see 2.A.above)	x0.125
	Adjustment to G&A expense applicable to contracts subject to the CAS clause	12,500
(2)	G&A expense pool	410,000
	G&A expenses applicable to contracts subject to the CAS clause (\$1,500,000/\$3,500,000 x \$410,000)	175,890
	G&A expenses applicable to other work	234,110
(3)	G&A expenses applicable to contracts subject to the CAS clause	175,890
	Adjustment to G&A expenses applicable to contracts subject to the CAS clause	-12,500
	G&A expenses allocable to contracts subject to the CAS clause	163,390
(4)	G&A expense allocation rate applicable to contracts subject to the CAS clause for cost accounting period 1982	$\$163,390/\$1,500,000 = 0.109$

The amount of the inventory suspense account would be reduced to \$100,000.

Subpart 9904.411—Cost Accounting Standard—Accounting for Acquisition Costs of Material

9904.411-10 [Reserved]

9904.411-20 Purpose.

(a) The purpose of this Cost Accounting Standard is to provide criteria for the accounting for acquisition costs of material. The Standard includes provisions on the use of inventory costing meth-

ods. Consistent application of this Standard will improve the measurement and assignment of costs to cost objectives.

(b) This Cost Accounting Standard does not cover accounting for the acquisition costs of tangible capital assets nor accountability for Government-furnished materials.

9904.411-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Allocate* means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Business unit* means any segment of an organization, or an entire business organization which is not divided into segments.

(3) *Category of material* means a particular kind of goods, comprised of identical or interchangeable units, acquired or produced by a contractor, which are intended to be sold, or consumed or used in the performance of either direct or indirect functions.

(4) *Cost objective* means a function, organizational subdivision, contract or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

(5) *Material inventory record* means any record used for the accumulation of actual or standard costs of a category of material recorded as an asset for subsequent cost allocation to one or more cost objectives.

(6) *Moving average cost* means an inventory costing method under which an average unit cost is computed after each acquisition by adding the cost of the newly acquired units to the cost of the units of inventory on hand and dividing this figure by the new total number of units.

(7) *Weighted average cost* means an inventory costing method under which a average unit cost is computed periodically by dividing the sum of the cost of beginning inventory plus the cost of acquisitions by the total number of units included in these two categories.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.411-40 Fundamental requirement.

(a) The contractor shall have, and consistently apply, written statements of accounting policies and practices for accumulating the costs of material and for allocating costs of material to cost objectives.

(b) The cost of units of a category of material may be allocated directly to a cost objective provided the cost objective was specifically identified at the time of purchase or production of the units.

(c) The cost of material which is used solely in performing indirect functions, or is not a significant element of production cost, whether or not incorporated in an end product, may be allocated to an indirect cost pool.

When significant, the cost of such indirect material not consumed in a cost accounting period shall be established as an asset at the end of the period.

(d) Except as provided in paragraphs (b) and (c) of this subsection, the cost of a category of material shall be accounted for in material inventory records.

(e) In allocating to cost objectives the costs of a category of material issued from company-owned material inventory, the costing method used shall be selected in accordance with the provisions of 9904.411-50, and shall be used in a manner which results in systematic and rational costing of issues of material to cost objectives. The same costing method shall, within the same business unit, be used for similar categories of materials.

9904.411-50 Techniques for application.

(a) Material cost shall be the acquisition cost of a category of material, whether or not a material inventory record is used. The purchase price of material shall be adjusted by extra charges incurred or discounts and credits earned. Such adjustments shall be charged or credited to the same cost objective as the purchase price of the material, except that where it is not practical to do so, the contractor's policy may provide for the consistent inclusion of such charges or credits in an appropriate indirect cost pool.

(b) One of the following inventory costing methods shall be used when issuing material from a company-owned inventory:

- (1) The first-in, first-out (FIFO) method.
- (2) The moving average cost method.
- (3) The weighted average cost method.
- (4) The standard cost method.
- (5) The last-in, first-out (LIFO) method.

(c) The method of computation used for any inventory costing method selected pursuant to the provisions of this Standard shall be consistently followed.

(d) Where the excess of the ending inventory over the beginning inventory of material of the type described in 9904.411-40(c) is estimated to be significant in relation to the total cost included in the indirect cost pool, the cost of such unconsumed material shall be established as an asset at the end of the period by reducing the indirect cost pool by a corresponding amount.

9904.411-60 Illustrations.

(a) Contractor "A" has one contract which requires two custom-ordered, high-value, airborne cameras. The contractor's established policy is to order such special items specifically identified to a contract as the need arises and to charge them directly to the contract. Another contract is received which requires three more of these cameras, which the contractor purchases at a unit cost which differs from the unit cost of the first two cameras ordered. When the purchase orders were placed, the contractor identified the specific contracts on which the cameras being purchased were to be used. Although these cameras are identical, the actual cost of each camera is charged to the contract for which it was acquired without establishing a material inventory record. This practice would not be a violation of this Standard.

(b)(1) A Government contract requires use of electronic tubes identified as "W." The contractor expects to receive other contracts requiring the use of tubes of the same type. In accordance with its written policy, the contractor establishes a material inventory record for electronic tube "W," and allocates the cost of units issued to the existing Government contract by the FIFO method. Such a practice would conform to the requirements of this Standard.

(2) The contractor is awarded several additional contracts which require an electronic tube which the contractor concludes is similar to the one described in paragraph (b)(1) of this subsection and which is identified as "Y." At the time a purchase order for these tubes is written, the contractor cannot identify the specific number of tubes to be used on each contract. Consequently, the contractor establishes an inventory record for these tubes and allocates their cost to the contracts on an average cost method. Because a FIFO method is used for a similar category of material within the same business unit, the use of an average cost method for "Y" would be a violation of this Standard.

(c) A contractor complies with the Cost Accounting Standard on standard costs (9904.407), and he uses a standard cost method for allocating the costs of essentially all categories of material. Also, it is the contractor's established practice to charge the cost of purchased parts which are incorporated in his end products, and which are not a significant element of production cost to an indirect cost pool. Such practices conform to this Standard.

(d) A contractor has one established inventory for type "R" transformers. The contractor allocates by the LIFO method the current costs of the individual units issued to Government contracts. Such a practice would conform to the requirements of this Standard.

(e) A contractor has established inventories for various categories of material which are used on Government contracts. During the year the contractor allocates the costs of the units of the various categories of material issued to contracts by the moving average cost method. The contractor uses the LIFO method for tax and financial reporting purposes and, at year end, applies a pooled LIFO inventory adjustment for all categories of material to Government contracts. This application of pooled costs to Government contracts would be a violation of this Standard because the lump sum adjustment to all of the various categories of material is, in effect, a non-current repricing of the material issues.

9904.411-61 Interpretation. [Reserved]

9904.411-62 Exemption.

None for this Standard.

9904.411-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

Subpart 9904.412—Cost Accounting Standard for Composition and Measurement of Pension Cost

9904.412-10 [Reserved]

9904.412-20 Purpose.

The purpose of this Standard is to provide guidance for determining and measuring the components of pension cost. The Standard establishes the basis on which pension costs shall be assigned to cost accounting periods. The provisions of this Cost Accounting Standard should enhance uniformity and consistency in accounting for pension costs and thereby increase the probability that those costs are properly allocated to cost objectives.

9904.412-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection requires otherwise.

(1) *Accrued benefit cost method* means an actuarial cost method under which units of benefits are assigned to each cost accounting period and are valued as they accrue; that is, based on the services performed by each employee in the period involved. The measure of normal cost under this method for each cost accounting period is the present value of the units of benefit deemed to be credited to employees for service in that period. The measure of the actuarial accrued liability at a plan's inception date is the present value of the units of benefit credited to employees for service prior to that date. (This method is also known as the Unit Credit cost method without salary projection.)

(2) *Actuarial accrued liability* means pension cost attributable, under the actuarial cost method in use, to years prior to the current period considered by a particular actuarial valuation. As of such date, the actuarial accrued liability represents the excess of the present value of future benefits and administrative expenses over the present value of future normal costs for all plan participants and beneficiaries. The excess of the actuarial accrued liability over the actuarial value of the assets of a pension plan is the Unfunded Actuarial Liability. The excess of the actuarial value of the assets of a pension plan over the actuarial accrued liability is an actuarial surplus and is treated as a negative unfunded actuarial liability.

(3) *Actuarial assumption* means an estimate of future conditions affecting pension cost; for example, mortality rate, employee turnover, compensation levels, earnings on pension plan assets, changes in values of pension plan assets.

(4) *Actuarial cost method* means a technique which uses actuarial assumptions to measure the present value of future pension benefits and pension plan administrative expenses, and which assigns the cost of such benefits and expenses to cost accounting periods. The actuarial cost method includes the asset valuation method used to determine the actuarial value of the assets of a pension plan.

(5) *Actuarial gain and loss* means the effect on pension cost resulting from differences between actuarial assumptions and actual experience.

(6) *Actuarial valuation* means the determination, as of a specified date, of the normal cost, actuarial accrued liability, actuarial value of the assets of a pension plan, and other relevant values for the pension plan.

(7) *Assignable cost credit* means the decrease in unfunded actuarial liability that results when the pension cost computed for a cost accounting period is less than zero.

(8) *Assignable cost deficit* means the increase in unfunded actuarial liability that results when the pension cost computed for a qualified defined-benefit pension plan exceeds the maximum tax-deductible amount for the cost accounting period determined in accordance with the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 *et seq.*, as amended.

(9) *Assignable cost limitation* means the excess, if any, of the actuarial accrued liability plus the current normal cost over the actuarial value of the assets of the pension plan.

(10) *Defined-benefit pension plan* means a pension plan in which the benefits to be paid or the basis for determining such ben-

efits are established in advance and the contributions are intended to provide the stated benefits.

(11) *Defined-contribution pension plan* means a pension plan in which the contributions are established in advance and the benefits are determined thereby.

(12) *Funded pension cost* means the portion of pension cost for a current or prior cost accounting period that has been paid to a funding agency.

(13) *Funding agency* means an organization or individual which provides facilities to receive and accumulate assets to be used either for the payment of benefits under a pension plan, or for the purchase of such benefits, provided such accumulated assets form a part of a pension plan established for the exclusive benefit of the plan participants and their beneficiaries. The fair market value of the assets held by the funding agency as of a specified date is the Funding Agency Balance as of that date.

(14) *Immediate-gain actuarial cost method* means any of the several cost methods under which actuarial gains and losses are included as part of the unfunded actuarial liability of the pension plan, rather than as part of the normal cost of the plan.

(15) *Market value of the assets* means the sum of the funding agency balance plus the accumulated value of any permitted unfunded accruals belonging to a pension plan. The Actuarial Value of the Assets means the value of cash, investments, permitted unfunded accruals, and other property belonging to a pension plan, as used by the actuary for the purpose of an actuarial valuation.

(16) *Multiemployer pension plan* means a plan to which more than one employer contributes and which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer.

(17) *Nonforfeitable* means a right to a pension benefit, either immediate or deferred, which arises from an employee's service, which is unconditional, and which is legally enforceable against the pension plan or the contractor. Rights to benefits that do not satisfy this definition are considered forfeitable. A right to a pension benefit is not forfeitable solely because it may be affected by the employee's or beneficiary's death, disability, or failure to achieve vesting requirements. Nor is a right considered forfeitable because it can be affected by the unilateral actions of the employee.

(18) *Normal cost* means the annual cost attributable, under the actuarial cost method in use, to current and future years as of a particular valuation date, excluding any payment in respect of an unfunded actuarial liability.

(19) *Pay-as-you-go cost method* means a method of recognizing pension cost only when benefits are paid to retired employees or their beneficiaries.

(20) *Pension plan* means a deferred compensation plan established and maintained by one or more employers to provide systematically for the payment of benefits to plan participants after their retirement, provided that the benefits are paid for life or are payable for life at the option of the employees. Additional benefits such as permanent and total disability and death payments, and survivorship payments to beneficiaries of deceased employees may be an integral part of a pension plan.

(21) *Pension plan participant* means any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit from a pension plan which covers employees of such

employer or members of such organization who have satisfied the plan's participation requirements, or whose beneficiaries are receiving or may be eligible to receive any such benefit. A participant whose employment status with the employer has not been terminated is an active participant of the employer's pension plan.

(22) *Permitted unfunded accrual* means the amount of pension cost for nonqualified defined-benefit pension plans that is not required to be funded under 9904.412-50(d)(2). The Accumulated Value of Permitted Unfunded Accruals means the value, as of the measurement date, of the permitted unfunded accruals adjusted for imputed earnings and for benefits paid by the contractor.

(23) *Prepayment credit* means the amount funded in excess of the pension cost assigned to a cost accounting period that is carried forward for future recognition. The Accumulated Value of Prepayment Credits means the value, as of the measurement date, of the prepayment credits adjusted for interest at the valuation rate and decreased for amounts used to fund pension costs or liabilities, whether assignable or not.

(24) *Projected benefit cost method* means either (i) any of the several actuarial cost methods which distribute the estimated total cost of all of the employees' prospective benefits over a period of years, usually their working careers, or (ii) a modification of the accrued benefit cost method that considers projected compensation levels.

(25) *Qualified pension plan* means a pension plan comprising a definite written program communicated to and for the exclusive benefit of employees which meets the criteria deemed essential by the Internal Revenue Service as set forth in the Internal Revenue Code for preferential tax treatment regarding contributions, investments, and distributions. Any other plan is a Nonqualified Pension Plan.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.412-40 Fundamental requirement.

(a) *Components of pension cost.* (1) For defined-benefit pension plans, except for plans accounted for under the pay-as-you-go cost method, the components of pension cost for a cost accounting period are (i) the normal cost of the period, (ii) a part of any unfunded actuarial liability, (iii) an interest equivalent on the unamortized portion of any unfunded actuarial liability, and (iv) an adjustment for any actuarial gains and losses.

(2) For defined-contribution pension plans, the pension cost for a cost accounting period is the net contribution required to be made for that period, after taking into account dividends and other credits, where applicable.

(3) For defined-benefit pension plans accounted for under the pay-as-you-go cost method, the components of pension cost for a cost accounting period are:

- (i) The net amount of periodic benefits paid for that period, and
- (ii) An amortization installment, including an interest equivalent on the unamortized settlement amount, attributable to amounts paid to irrevocably settle an obligation for periodic benefits due in current and future cost accounting periods.

(b) *Measurement of pension cost.* (1) For defined-benefit pension plans other than those accounted for under the pay-as-you-go cost method, the amount of pension cost of a cost accounting period

shall be determined by use of an immediate-gain actuarial cost method.

(2) Each actuarial assumption used to measure pension cost shall be separately identified and shall represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations. The validity of each assumption used shall be evaluated solely with respect to that assumption. Actuarial assumptions used in calculating the amount of an unfunded actuarial liability shall be the same as those used for other components of pension cost.

(c) *Assignment of pension cost.* Except costs assigned to future periods by 9904.412-50(c)(2) and (5), the amount of pension cost computed for a cost accounting period is assignable only to that period. For defined-benefit pension plans other than those accounted for under the pay-as-you-go cost method, the pension cost is assignable only if the sum of (1) the unamortized portions of assignable unfunded actuarial liability developed and amortized pursuant to 9904.412-50(a)(1), and (2) the unassignable portions of unfunded actuarial liability separately identified and maintained pursuant to 9904.412-50(a)(2) equals the total unfunded actuarial liability.

(d) *Allocation of pension cost.* Pension costs assigned to a cost accounting period are allocable to intermediate and final cost objectives only if they meet the requirements for allocation in 9904.412-50(d). Pension costs not meeting these requirements may not be reassigned to any future cost accounting period.

9904.412-50 Techniques for application.

(a) *Components of pension cost.* (1) The following portions of unfunded actuarial liability shall be included as a separately identified part of the pension cost of a cost accounting period and shall be included in equal annual installments. Each installment shall consist of an amortized portion of the unfunded actuarial liability plus an interest equivalent on the unamortized portion of such liability. The period of amortization shall be established as follows:

(i) If amortization of an unfunded actuarial liability has begun prior to the date this Standard first becomes applicable to a contractor, no change in the amortization period is required by this Standard.

(ii) If amortization of an unfunded actuarial liability has not begun prior to the date this Standard first becomes applicable to a contractor, the amortization period shall begin with the period in which the Standard becomes applicable and shall be no more than 30 years nor less than 10 years. However, if the plan was in existence as of January 1, 1974, the amortization period shall be no more than 40 years nor less than 10 years.

(iii) Each increase or decrease in unfunded actuarial liability resulting from the institution of new pension plans, from the adoption of improvements, or other changes to pension plans subsequent to the date this Standard first becomes applicable to a contractor shall be amortized over no more than 30 years nor less than 10 years.

(iv) If any assumptions are changed during an amortization period, the resulting increase or decrease in unfunded actuarial liability shall be separately amortized over no more than 30 years nor less than 10 years.

(v) Actuarial gains and losses shall be identified separately from unfunded actuarial liabilities that are being amortized pursuant to

the provisions of this Standard. The accounting treatment to be afforded to such gains and losses shall be in accordance with Cost Accounting Standard 9904.413.

(vi) Each increase or decrease in unfunded actuarial liability resulting from an assignable cost deficit or credit, respectively, shall be amortized over a period of 10 years.

(vii) Each increase or decrease in unfunded actuarial liability resulting from a change in actuarial cost method, including the asset valuation method, shall be amortized over a period of 10 to 30 years. This provision shall not affect the requirements of 9903.302 to adjust previously priced contracts.

(2) Except as provided in 9904.412-50(d)(2), any portion of unfunded actuarial liability attributable to either (i) pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions or (ii) pension costs assigned to a cost accounting period that were not funded in that period, shall be separately identified and eliminated from any unfunded actuarial liability being amortized pursuant to paragraph (a)(1) of this subsection. Such portions of unfunded actuarial liability shall be adjusted for interest at the valuation rate of interest. The contractor may elect to fund, and thereby reduce, such portions of unfunded actuarial liability and future interest adjustments thereon. Such funding shall not be recognized for purposes of 9904.412-50(d).

(3) A contractor shall establish and consistently follow a policy for selecting specific amortization periods for unfunded actuarial liabilities, if any, that are developed under the actuarial cost method in use. Such policy may give consideration to factors such as the size and nature of the unfunded actuarial liabilities. Except as provided in 9904.412-50(c)(2) or 9904.413-50(c)(12), once the amortization period for a portion of unfunded actuarial liability is selected, the amortization process shall continue to completion.

(4) Any amount funded in excess of the pension cost assigned to a cost accounting period shall be accounted for as a prepayment credit. The accumulated value of such prepayment credits shall be adjusted for interest at the valuation rate of interest until applied towards pension cost in a future accounting period. The accumulated value of prepayment credits shall be reduced for portions of the accumulated value of prepayment credits used to fund pension costs or to fund portions of unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2). The accumulated value of any prepayment credits shall be excluded from the actuarial value of the assets used to compute pension costs for purposes of this Standard and Cost Accounting Standard 9904.413.

(5) An excise tax assessed pursuant to a law or regulation because of excess, inadequate, or delayed funding of a pension plan is not a component of pension cost. Income taxes paid from the funding agency of a nonqualified defined-benefit pension plan on earnings or other asset appreciation of such funding agency shall be treated as an administrative expense of the fund and not as a reduction to the earnings assumption.

(6) For purposes of this Standard, defined-benefit pension plans funded exclusively by the purchase of individual or group permanent insurance or annuity contracts, and thereby exempted from ERISA's minimum funding requirements, shall be treated as defined-contribution pension plans. However, all other defined-benefit pension plans administered wholly or in part through insur-

ance company contracts shall be subject to the provisions of this Standard relative to defined-benefit pension plans.

(7) If a pension plan is supplemented by a separately-funded plan which provides retirement benefits to all of the participants in the basic plan, the two plans shall be considered as a single plan for purposes of this Standard. If the effect of the combined plans is to provide defined-benefits for the plan participants, the combined plans shall be treated as a defined-benefit plan for purposes of this Standard.

(8) A multiemployer pension plan established pursuant to the terms of a collective bargaining agreement shall be considered to be a defined-contribution pension plan for purposes of this Standard.

(9) A pension plan applicable to a Federally-funded Research and Development Center (FFRDC) that is part of a State pension plan shall be considered to be a defined-contribution pension plan for purposes of this Standard.

(b) *Measurement of pension cost.* (1) For defined-benefit pension plans other than those accounted for under the pay-as-you-go cost method, the amount of pension cost assignable to cost accounting periods shall be measured by an immediate-gain actuarial cost method.

(2) Where the pension benefit is a function of salaries and wages, the normal cost shall be computed using a projected benefit cost method. The normal cost for the projected benefit shall be expressed either as a percentage of payroll or as an annual accrual based on the service attribution of the benefit formula. Where the pension benefit is not a function of salaries and wages, the normal cost shall be based on employee service.

(3) For defined-benefit plans accounted for under the pay-as-you-go cost method, the amount of pension cost assignable to a cost accounting period shall be measured as the sum of:

(i) The net amount for any periodic benefits paid for that period, and

(ii) The level annual installment required to amortize over 15 years any amounts paid to irrevocably settle an obligation for periodic benefits due in current or future cost accounting periods.

(4) Actuarial assumptions shall reflect long-term trends so as to avoid distortions caused by short-term fluctuations.

(5) Pension cost shall be based on provisions of existing pension plans. This shall not preclude contractors from making salary projections for plans whose benefits are based on salaries and wages, or from considering improved benefits for plans which provide that such improved benefits must be made.

(6) If the evaluation of the validity of actuarial assumptions shows that any assumptions were not reasonable, the contractor shall:

(i) Identify the major causes for the resultant actuarial gains or losses, and

(ii) Provide information as to the basis and rationale used for retaining or revising such assumptions for use in the ensuing cost accounting period(s).

(c) *Assignment of pension cost.* (1) Amounts funded in excess of the pension cost computed for a cost accounting period pursuant to the provisions of this Standard shall be accounted for as a prepayment credit and carried forward to future accounting periods.

(2) For qualified defined-benefit pension plans, the pension cost computed for a cost accounting period is assigned to that period subject to the following adjustments, in order of application:

(i) Any amount of computed pension cost that is less than zero shall be assigned to future accounting periods as an assignable cost credit. The amount of pension cost assigned to the period shall be zero.

(ii) When the pension cost equals or exceeds the assignable cost limitation:

(A) The amount of computed pension cost, adjusted pursuant to paragraph (c)(2)(i) of this subsection, shall not exceed the assignable cost limitation,

(B) All amounts described in 9904.412-50(a)(1) and 9904.413-50(a), which are required to be amortized, shall be considered fully amortized, and

(C) Except for portions of unfunded actuarial liability separately identified and maintained in accordance with 9904.413-50(a)(2), any portion of unfunded actuarial liability, which occurs in the first cost accounting period after the pension cost has been limited by the assignable cost limitation, shall be considered an actuarial gain or loss for purposes of this Standard. Such actuarial gain or loss shall exclude any increase or decrease in unfunded actuarial liability resulting from a plan amendment, change in actuarial assumptions, or change in actuarial cost method effected after the pension cost has been limited by the assignable cost limitation.

(iii) Any amount of computed pension cost of a qualified pension plan, adjusted pursuant to paragraphs (c)(2)(i) and (ii) of this subsection that exceeds the sum of (A) the maximum tax-deductible amount, determined in accordance with ERISA, and (B) the accumulated value of prepayment credits shall be assigned to future accounting periods as an assignable cost deficit. The amount of pension cost assigned to the current period shall not exceed the sum of the maximum tax-deductible amount plus the accumulated value of prepayment credits.

(3) The cost of nonqualified defined-benefit pension plans shall be assigned to cost accounting periods in the same manner as qualified plans (with the exception of paragraph (c)(2)(iii) of this subsection) under the following conditions:

(i) The contractor, in disclosing or establishing his cost accounting practices, elects to have a plan so accounted for;

(ii) The plan is funded through the use of a funding agency; and,

(iii) The right to a pension benefit is nonforfeitable and is communicated to the participants.

(4) The costs of nonqualified defined-benefit pension plans that do not meet all of the requirements in 9904.412-50(c)(3) shall be assigned to cost accounting periods using the pay-as-you-go cost method.

(5) Any portion of pension cost computed for a cost accounting period that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of ERISA shall not be assigned to the current period. Rather, such excess shall be treated as an assignable cost deficit, except that it shall be assigned to future cost accounting periods using the same amortization period as used for ERISA purposes.

(d) *Allocation of pension costs.* The amount of pension cost assigned to a cost accounting period allocated to intermediate and

final cost objectives shall be limited according to the following criteria:

(1) Except for nonqualified defined-benefit plans, the costs of a pension plan assigned to a cost accounting period are allocable to the extent that they are funded.

(2) For nonqualified defined-benefit pension plans that meet the criteria set forth at 9904.412-50(c)(3), pension costs assigned to a cost accounting period are fully allocable if they are funded at a level at least equal to the percentage of the complement (i.e., 100% minus tax rate % = percentage of assigned cost to be funded) of the highest published Federal corporate income tax rate in effect on the first day of the cost accounting period. If the contractor is not subject to Federal income tax, the assigned costs are allocable to the extent such costs are funded. Funding at other levels and benefit payments of such plans are subject to the following:

(i) Funding at less than the foregoing levels shall result in proportional reductions of the amount of assigned cost that can be allocated within the cost accounting period.

(ii)(A) Payments to retirees or beneficiaries shall contain an amount drawn from sources other than the funding agency of the pension plan that is, at least, proportionately equal to the accumulated value of permitted unfunded accruals divided by an amount that is the market value of the assets of the pension plan excluding any accumulated value of prepayment credits.

(B) The amount of assigned cost of a cost accounting period that can be allocated shall be reduced to the extent that such payments are drawn in a higher ratio from the funding agency.

(iii) The permitted unfunded accruals shall be identified and accounted for year to year, adjusted for benefit payments directly paid by the contractor and for interest at the actual annual earnings rate on the funding agency balance.

(3) For nonqualified defined-benefit pension plans accounted for under the pay-as-you-go method, pension costs assigned to a cost accounting period are allocable in that period.

(4) Funding of pension cost shall be considered to have taken place within the cost accounting period if it is accomplished by the corporate tax filing date for such period including any permissible extensions thereto.

9904.412-60 Illustrations.

(a) *Components of pension cost.* (1) Contractor A has insured pension plans for each of two small groups of employees. One plan is exclusively funded through a group permanent life insurance contract and is exempt from the minimum funding requirements of ERISA. The other plan is funded through a deposit administration contract, which is a form of group deferred annuity contract that is not exempt from ERISA's minimum funding requirements. Both plans provide for defined benefits. Pursuant to 9904.412-50(a)(6), for purposes of this Standard the plan financed through a group permanent insurance contract shall be considered to be a defined-contribution pension plan; the net premium required to be paid for a cost accounting period (after deducting dividends and any credits) shall be the pension cost for that period. However, the deposit administration contract plan is subject to the provisions of this Standard that are applicable to defined-benefit plans.

(2) Contractor B provides pension benefits for certain hourly employees through a multiemployer defined-benefit plan. Under the collective bargaining agreement, the contractor pays six cents into the fund for each hour worked by the covered employees. Pursuant to 9904.412-50(a)(8), the plan shall be considered to be a defined-contribution pension plan. The payments required to be made for a cost accounting period shall constitute the assignable pension cost for that period.

(3) Contractor C provides pension benefits for certain employees through a defined-contribution pension plan. However, the contractor has a separate fund that is used to supplement pension benefits for all of the participants in the basic plan in order to provide a minimum monthly retirement income to each participant. Pursuant to 9904.412-50(a)(7), the two plans shall be considered as a single plan for purposes of this Standard. Because the effect of the supplemental plan is to provide defined-benefits for the plan's participants, the provisions of this Standard relative to defined-benefit pension plans shall be applicable to the combined plan.

(4) Contractor D provides supplemental benefits to key management employees through a nonqualified defined-benefit pension plan funded by a so-called "Rabbi Trust." The trust agreement provides that Federal income taxes levied on the earnings of the Rabbi trust may be paid from the trust. The contractor's actuarial cost method recognizes the administrative expenses of the plan and trust, such as broker and attorney fees, by adding the prior year's expenses to the current year's normal cost. The income taxes paid by the trust on trust earnings shall be accorded the same treatment as any other administrative expense in accordance with 9904.412-50(a)(5).

(5) (i) Contractor E has been using the entry age normal actuarial cost method to compute pension costs. The contractor has three years remaining under a firm fixed price contract subject to this Standard. The contract was priced using the unfunded actuarial liability, normal cost, and net amortization installments developed using the entry age normal method. The contract was priced as follows:

Entry Age Normal Values			
Cost Component	Year 1	Year 2	Year 3
Normal Cost	\$100,000	\$105,000	\$110,000
Amortization	<u>50,000</u>	<u>50,000</u>	<u>50,000</u>
Pension Cost	<u>\$150,000</u>	<u>\$155,000</u>	<u>\$160,000</u>

(ii) The contractor, after notifying the cognizant Federal official, switches to the projected unit credit actuarial cost method. The unfunded actuarial liability and normal cost decreased when re-determined under the projected unit credit method. Pursuant to 9904.412-50(a)(1)(vii), the contractor determines that an annual installment credit of \$20,000 will amortize the decrease in unfunded actuarial liability (UAL) over ten years. The following

pension costs are determined under the projected unit credit method:

Projected Unit Credit Values			
Cost Component	Year 1	Year 2	Year 3
Normal Cost	\$ 80,000	\$ 85,000	\$ 90,000
Amortization			
Prior Method	50,000	50,000	50,000
UAL Decease	(20,000)	(20,000)	(20,000)
Pension Cost	<u>\$110,000</u>	<u>\$115,000</u>	<u>\$120,000</u>

(iii) The change in cost method is a change in accounting method that decreased previously priced pension costs by \$40,000 per year. In accordance with 9903.302, Contractor E shall adjust the cost of the firm fixed-price contract for the remaining three years by \$120,000 (\$40,000 x 3 years).

(6) Contractor F has a defined-benefit pension plan for its employees. Prior to being subject to this Standard the contractor's policy was to compute and fund as annual pension cost normal cost plus only interest on the unfunded actuarial liability. Pursuant to 9904.412-40(a)(1), the components of pension cost for a cost accounting period must now include not only the normal cost for the period and interest on the unfunded actuarial liability, but also an amortized portion of the unfunded actuarial liability. The amortization of the liability and the interest equivalent on the unamortized portion of the liability must be computed in equal annual installments.

(b) *Measurement of pension cost.* (1) Contractor G has a pension plan whose costs are assigned to cost accounting periods by use of an actuarial cost method that does not separately identify actuarial gains and losses or the effect on pension cost resulting from changed actuarial assumptions. Contractor G's method is not an immediate-gain cost method and does not comply with the provisions of 9904.412-50(b)(1).

(2) For several years Contractor H has had an unfunded non-qualified pension plan which provides for payments of \$200 a month to employees after retirement. The contractor is currently making such payments to several retired employees and recognizes those payments as its pension cost. The contractor paid monthly annuity benefits totaling \$24,000 during the current year. During the prior year, Contractor H made lump sum payments to irrevocably settle the benefit liability of several participants with small benefits. The annual installment to amortize these lump sum payments over fifteen years at the valuation interest rate assumption is \$5,000. Since the plan does not meet the criteria set forth in 9904.412-50(c)(3)(ii), pension cost must be accounted for using the pay-as-you-go cost method. Pursuant to 9904.412-50(b)(3), the amount of assignable cost allocable to cost objectives of that period is \$29,000, which is the sum of the amount of benefits actually paid in that period (\$24,000) plus the second annual installment to amortize the prior year's lump sum settlements (\$5,000).

(3) Contractor I has two qualified defined-benefit pension plans that provide for fixed dollar payments to hourly employees. Under the first plan, the contractor's actuary believes that the contractor will be required to increase the level of benefits by specified per-

centages over the next several years. In calculating pension costs, the contractor may not assume future benefits greater than that currently required by the plan. With regard to the second plan, a collective bargaining agreement negotiated with the employees' labor union provides that pension benefits will increase by specified percentages over the next several years. Because the improved benefits are required to be made, the contractor can consider such increased benefits in computing pension costs for the current cost accounting period in accordance with 9904.412-50(b)(5).

(4) In addition to the facts of 9904.412-60(b)(3), assume that Contractor I was required to contribute at a higher level for ERISA purposes because the plan was underfunded. To compute pension costs that are closer to the funding requirements of ERISA, Contractor I decides to "fresh start" the unfunded actuarial liability being amortized pursuant to 9904.412-50(a)(1); i.e., treat the entire amount as a newly established portion of unfunded actuarial liability, which is amortized over 10 years in accordance with 9904.412-50(a)(1)(ii). Because the contractor has changed the periods for amortizing the unfunded actuarial liability established pursuant to 9904.412-50(a)(3), the contractor has made a change in accounting practice subject to the provisions of Cost Accounting Standard 9903.302.

(c) *Assignment of pension cost.* (1) Contractor J maintains a qualified defined-benefit pension plan. The actuarial value of the assets of \$18 million is subtracted from the actuarial accrued liability of \$20 million to determine the total unfunded actuarial liability of \$2 million. Pursuant to 9904.412-50(a)(1), Contractor J has identified and is amortizing twelve separate portions of unfunded actuarial liabilities. The sum of the unamortized balances for the twelve separately maintained portions of unfunded actuarial liability equals \$1.8 million. In accordance with 9904.412-50(a)(2), the contractor has separately identified, and eliminated from the computation of pension cost, \$200,000 attributable to a pension cost assigned to a prior period that was not funded. The sum of the twelve amortization bases maintained pursuant to 9904.412-50(a)(1) and the amount separately identified under 9904.412-50(a)(2) equals \$2 million (\$1,800,000 + 200,000). Because the sum of all identified portions of unfunded actuarial liability equals the total unfunded actuarial liability, the plan is in actuarial balance and Contractor J can assign pension cost to the current cost accounting period in accordance with 9904.412-40(c).

(2) Contractor K's pension cost computed for 1996, the current year, is \$1.5 million. This computed cost is based on the components of pension cost described in 9904.412-40(a) and 9904.412-50(a) and is measured in accordance with 9904.412-40(b) and 9904.412-50(b). The assignable cost limitation, which is defined at 9904.412-30(a)(9), is \$1.3 million. In accordance with the provisions of 9904.412-50(c)(2)(ii)(A), Contractor K's assignable pension cost for 1996 is limited to \$1.3 million. In addition, all amounts that were previously being amortized pursuant to 9904.412-50(a)(1) and 9904.413-50(a) are considered fully amortized in accordance with 9904.412-50(c)(2)(ii)(B). The following year, 1997, Contractor K computes an unfunded actuarial liability of \$4 million. Contractor K has not changed his actuarial assumptions nor amended the provisions of his pension plan. Contractor K has not had any pension costs disallowed or unfunded in prior periods. Contractor K must treat the entire \$4 million of unfunded actu-

arial liability as an actuarial loss to be amortized over fifteen years beginning in 1997 in accordance with 9904.412-50(c)(2)(ii)(C).

(3) Assume the same facts shown in illustration 9904.412-60(c)(2), except that in 1995, the prior year, Contractor K's assignable pension cost was \$800,000, but Contractor K only funded and allocated \$600,000. Pursuant to 9904.412-50(a)(2), the \$200,000 of unfunded assignable pension cost was separately identified and eliminated from other portions of unfunded actuarial liability. This portion of unfunded actuarial liability was adjusted for 8% interest, which is the interest assumption for 1995 and 1996, and was brought forward to 1996 in accordance with 9904.412-50(a)(2). Therefore, \$216,000 ($\$200,000 \times 1.08$) is excluded from the amount considered fully amortized in 1996. The next year, 1997, Contractor K must eliminate \$233,280 ($\$216,000 \times 1.08$) from the \$4 million so that only \$3,766,720 is treated as an actuarial loss in accordance with 9904.412-50(c)(2)(ii)(C).

(4) Assume, as in 9904.412-60(c)(2), the 1996 pension cost computed for Contractor K's qualified defined-benefit pension plan is \$1.5 million and the assignable cost limitation is \$1.7 million. However, because of the ERISA limitation on tax-deductible contributions, Contractor K cannot fund more than \$1 million without incurring an excise tax, which 9904.412-50(a)(5) does not permit to be a component of pension cost. In accordance with the provisions of 9904.412-50(c)(2)(iii), Contractor K's assignable pension cost for the period is limited to \$1 million. The \$500,000 (\$1.5 million - \$1 million) of pension cost not funded is reassigned to the next ten cost accounting periods beginning in 1997 as an assignable cost deficit in accordance with 9904.412-50(a)(1)(vi).

(5) Assume the same facts for Contractor K in 9904.412-60(c)(4), except that the accumulated value of prepayment credits equals \$700,000. Therefore, in addition to the \$1 million, Contractor K can apply \$500,000 of the accumulated value of prepayment credits towards the pension cost computed for the period. In accordance with the provisions of 9904.412-50(c)(2)(iii), Contractor K's assignable pension cost for the period is the full \$1.5 million (\$1 million + \$500,000) computed for the period. The \$200,000 of remaining accumulated value of prepayment credits (\$700,000 - \$500,000) is adjusted for interest at the valuation rate and carried forward until needed in future accounting periods in accordance with 9904.412-50(a)(4).

(6) Assume the same facts for Contractor K in 9904.412-60(c)(4), except that the 1996 assignable cost limitation is \$1.3 million. Pension cost of \$1.5 million is computed for the cost accounting period, but the assignable cost is limited to \$1.3 million in accordance with 9904.412-50(c)(2)(ii)(A). Pursuant to 9904.412-50(c)(2)(ii)(B), all existing amortization bases maintained in accordance with 9904.412-50(a)(1) are considered fully amortized. The assignable cost of \$1.3 million is then compared to the maximum tax-deductible amount of \$1 million. Pursuant to 9904.412-50(c)(2)(iii), Contractor K's assignable pension cost for the period is limited to \$1 million. The \$300,000 (\$1.3 million - \$1 million) excess of the assignable cost limitation over the tax-deductible maximum is assigned to future periods as an assignable cost deficit.

(7) Contractor L is currently amortizing a large decrease in unfunded actuarial liability over a period of ten years. A similarly large increase in unfunded actuarial liability is being amortized over 30 years. The absolute value of the resultant net amortization credit is greater than the normal cost so that the pension cost com-

puted for the period is a negative \$200,000. Contractor L first applies the provisions of 9904.412-50(c)(2)(i) and determines the assignable pension cost is \$0. The negative pension cost of \$200,000 is assigned to the next ten cost accounting periods as an assignable cost credit in accordance with 9904.412-50(a)(1)(vi). However, when Contractor L applies the provisions of 9904.412-50(c)(2)(ii), the assignable cost limitation is also \$0. Because the assignable cost of \$0 determined under 9904.412-50(c)(2)(i) is equal to the assignable cost limitation, the assignable cost credit of \$200,000 is considered fully amortized along with all other portions of unfunded actuarial liability being amortized pursuant to 9904.412-50(a)(1). Conversely, if the assignable cost limitation had been greater than zero, the assignable cost credit of \$200,000 would have carried-forward and amortized in future periods.

(8) Contractor M has a qualified defined-benefit pension plan which is funded through a funding agency. It computes \$1 million of pension cost for a cost accounting period. However, pursuant to a waiver granted under the provisions of ERISA, Contractor M is required to fund only \$800,000. Under the provisions of 9904.412-50(c)(5), the remaining \$200,000 shall be accounted for as an assignable cost deficit and assigned to the next five cost accounting periods in accordance with the terms of the waiver.

(9) Contractor N has a company-wide defined-benefit pension plan, wherein benefits are calculated on one consistently applied formula. That part of the formula defining benefits within ERISA limits is administered and reported as a qualified plan and funded through a funding agency. The remainder of the benefits are considered to be a supplemental or excess plan which, while it meets the criteria at 9904.412-50(c)(3)(iii) as to nonforfeitability and communication, is not funded. The costs of the qualified portion of the plan shall be comprised of those elements of costs delineated at 9904.412-40(a)(1), while the supplemental or excess portion of the plan shall be accounted for and assigned to cost accounting periods under the pay-as-you-go cost method provided at 9904.412-40(a)(3) and 9904.412-50(c)(4).

(10) Assuming the same facts as in 9904.412-60(c)(9), except that Contractor N funds its supplemental or excess plan using a so-called "Rabbi Trust" vehicle. Because the nonqualified plan is funded, the plan meets the criteria set forth at 9904.412-50(c)(3)(ii). Contractor N may account for the supplemental or excess plan in the same manner as its qualified plan, if it elects to do so pursuant to 9904.412-50(c)(3)(i).

(11) Assuming the same facts as in 9904.412-60(c)(10), except that under the nonqualified portion of the pension plan a former employee will forfeit his pension benefit if the employee goes to work for a competitor within three years of terminating employment. Since the right to a benefit cannot be affected by the unilateral action of the contractor, the right to a benefit is considered to be nonforfeitable for purposes of 9904.412-30(a)(17). The nonqualified plan still meets the criteria set forth at 9904.412-50(c)(3)(iii), and Contractor N may account for the supplemental or excess plan in the same manner as its qualified plan, if it elects to do so.

(12) Assume the same facts as in 9904.412-60(c)(11), except that Contractor N, while maintaining a "Rabbi Trust" funding vehicle elects to have the plan accounted for under the pay-as-you-go cost method so as to have greater latitude in annual funding decisions. It may so elect pursuant to 9904.412-50(c)(3)(i).

(13) The assignable pension cost for Contractor O's qualified defined-benefit plan is \$600,000. For the same period Contractor O contributes \$700,000, which is the minimum funding requirement under ERISA. In addition, there exists \$75,000 of unfunded actuarial liability that has been separately identified pursuant to 9904.412-50(a)(2). Contractor O may use \$75,000 of the contribution in excess of the assignable pension cost to fund this separately identified unfunded actuarial liability, if he so chooses. The effect of the funding is to eliminate the unassignable \$75,000 portion of unfunded actuarial liability that had been separately identified and thereby eliminated from the computation of pension costs. Contractor O shall then account for the remaining \$25,000 of excess contribution as a prepayment credit in accordance with 9904.412-50(a)(4).

(d) *Allocation of pension cost.* (1) Assume the same set of facts for Contractor M in 9904.412-60(c)(8) except there was no ERISA waiver; i.e., only \$800,000 was funded against \$1 million of assigned pension cost for the period. Under the provisions of 9904.412-50(d)(1), only \$800,000 may be allocated to Contractor M's intermediate and final cost objectives. The remaining \$200,000 of assigned cost, which has not been funded, shall be separately identified and maintained in accordance with 9904.412-50(a)(2) so that it will not be reassigned to any future accounting periods.

(2) Contractor P has a nonqualified defined-benefit pension plan which covers benefits in excess of the ERISA limits. Contractor P has elected to account for this plan in the same manner as its qualified plan and, therefore, has established a "Rabbi Trust" as the funding agency. For the current cost accounting period, the contractor computes and assigns \$100,000 as pension cost. The contractor funds \$65,000, which is equivalent to a funding level equal to the complement of the highest published Federal corporate income tax rate of 35%. Under the provisions of 9904.412-50(d)(2), the entire \$100,000 is allocable to cost objectives of the period.

(3) Assume the set of facts in 9904.412-60(d)(2), except that Contractor P's contribution to the Trust is \$59,800. In that event, the provisions of 9904.412-50(d)(2)(i) would limit the amount of assigned cost allocable within the cost accounting period to the percentage of cost funded (i.e., $\$59,800/\$65,000 = 92\%$). This results in allocable cost of \$92,000 (92% of \$100,000) for the cost accounting period. Under the provisions of 9904.412-40(c) and 9904.412-50(d)(2)(i), respectively, the unallocable \$8,000 may not be assigned to any future cost accounting period. In addition, in accordance with 9904.412-50(a)(2), the \$8,000 must be separately identified and no amount of interest on such separately identified \$8,000 shall be a component of pension cost in any future cost accounting period.

(4) Again, assume the set of facts in 9904.412-60(d)(2) except that, Contractor P's contribution to the Trust is \$105,000 based on a valuation interest assumption of 8%. Under the provisions of 9904.412-50(d)(2) the entire \$100,000 is allocable to cost objectives of the period. In accordance with the provisions of 9904.412-50(c)(1) Contractor P has funded \$5,000 ($\$105,000 - \$100,000$) in excess of the assigned pension cost for the period. The \$5,000 shall be accounted for as a prepayment credit. Pursuant to 9904.412-50(a)(4), the \$5,000 shall be adjusted for interest at the 8% valuation rate of interest and excluded from the actuarial value of assets used to compute the next year's pension cost computations. The accumulated value of prepayment credits of \$5,400 ($5,000 \times 1.08$)

may be used to fund the next year's assigned pension cost, if needed.

(5) Contractor Q maintains a nonqualified defined-benefit pension plan which satisfies the requirements of 9904.412-50(c)(3). As of the valuation date, the reported funding agency balance is \$3.4 million excluding any accumulated value of prepayment credits. When the adjusted funding agency balance is added to the accumulated value of permitted unfunded accruals of \$1.6 million, the market value of assets equals \$5.0 million ($\$3.4 \text{ million} + \1.6 million) in accordance with 9904.412-30(a)(13). During the plan year, retirees receive monthly benefits totaling \$350,000. Pursuant to 9904.412-50(d)(2)(ii)(A), at least 32% ($\$1.6 \text{ million} \text{ divided by } \5 million) of these benefit payments shall be made from sources other than the funding agency. Contractor Q, therefore, draws \$238,000 from the funding agency assets and pays the remaining \$112,000 using general corporate funds.

(6) Assume the same facts as 9904.412-60(d)(5), except that by the time Contractor Q receives its actuarial valuation it has paid retirement benefits equaling \$288,000 from funding agency assets. The contractor has made deposits to the funding agency equal to the tax complement of the \$500,000 assignable pension cost for the period. Pursuant to 9904.412-50(d)(2)(ii)(B), the assignable \$500,000 shall be reduced by the \$50,000 ($\$288,000 - \$238,000$) of benefits paid from the funding agency in excess of the permitted \$238,000, unless the contractor makes a deposit to replace the \$50,000 inadvertently drawn from the funding agency. If this corrective action is not taken within the time permitted by 9904.412-50(d)(4), Contractor Q shall allocate only \$450,000 ($\$500,000 - \$50,000$) to final cost objectives. Furthermore, the \$50,000, which was thereby attributed to benefit payments instead of funding, must be separately identified and maintained in accordance with 9904.412-50(a)(2).

(7) Contractor R has a nonqualified defined-benefit plan that meets the criteria of 9904.412-50(c)(3). For 1996, the funding agency balance was \$1,250,000 and the accumulated value of permitted unfunded accruals was \$600,000. During 1996 the earnings and appreciation on the assets of the funding agency equaled \$125,000, benefit payments to participants totaled \$300,000, and administrative expenses were \$60,000. All transactions occurred on the first day of the period. In accordance with 9904.412-50(d)(2)(ii)(A), \$20,000 of benefits were paid from the funding agency and \$100,000 were paid directly from corporate assets. Pension cost of \$400,000 was assigned to 1996. Based on the current corporate tax rate of 35%, \$260,000 ($\$400,000 \times (1-35\%)$) was deposited into the funding agency at the beginning of 1996. For 1997 the funding agency balance is \$1,375,000 ($\$1,250,000 + \$260,000 + \$125,000 - \$200,000 - \$60,000$). The actual annual earnings rate of the funding agency was 10% for 1996. Pursuant to 9904.412-50(d)(2)(iii), the accumulated value of permitted unfunded accruals is updated from 1996 to 1997 by: (i) adding \$140,000 ($35\% \times \$400,000$), which is the unfunded portion of the assigned cost; (ii) subtracting the \$100,000 of benefits paid directly by the contractor; and (iii) increasing the value of the assets by \$64,000 for imputed earnings at 10% ($10\% \times (\$600,000 + \$140,000 - \$100,000)$). The accumulated value of permitted unfunded accruals for 1997 is \$704,000 ($\$600,000 + \$140,000 - \$100,000 + \$64,000$).

9904.412-61 Interpretation. [Reserved]

9904.412-62 Exemption.

None for this Standard.

9904.412-63 Effective date.

(a) This Standard is effective as of March 30, 1995.

(b) This Standard shall be followed by each contractor on or after the start of its next cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow the Standard in 9904.412 in effect prior to March 30, 1995, until this Standard, effective March 30, 1995, becomes applicable following receipt of a contract or subcontract to which this Standard applies.

9904.412-64 Transition method.

To be acceptable, any method of transition from compliance with Standard 9904.412 in effect prior to March 30, 1995, to compliance with the Standard effective March 30, 1995, must follow the equitable principle that costs, which have been previously provided for, shall not be redundantly provided for under revised methods. Conversely, costs that have not previously been provided for must be provided for under the revised method. This transition subsection is not intended to qualify for purposes of assignment or allocation, pension costs which have previously been disallowed for reasons other than ERISA tax-deductibility limitations. The sum of all portions of unfunded actuarial liability identified pursuant to Standard 9904.412, effective March 30, 1995, including such portions of unfunded actuarial liability determined for transition purposes, is subject to the provisions of 9904.412-40(c) on requirements for assignment. The method, or methods, employed to achieve an equitable transition shall be consistent with the provisions of Standard 9904.412, effective March 30, 1995, and shall be approved by the contracting officer. Examples and illustrations of such transition methods include, but are not limited to, the following:

(a) *Reassignment of certain prior unfunded accruals.* (1) Any portion of pension cost for a qualified defined-benefit pension plan, assigned to a cost accounting period prior to March 30, 1995, which was not funded because such cost exceeded the maximum tax-deductible amount, determined in accordance with ERISA, shall be assigned to subsequent accounting periods, including an adjustment for interest, as an assignable cost deficit. However, such costs shall be assigned to periods on or after March 30, 1995, only to the extent that such costs have not previously been allocated as cost or price to contracts subject to this Standard.

(2) Alternatively, the transition method described in paragraph (d) of this subsection may be applied separately to costs subject to paragraph (a)(1) of this subsection.

(b) *Reassignment of certain prior unallocated credits.*

(1) Any portion of pension cost for a defined-benefit pension plan, assigned to a cost accounting period prior to March 30, 1995, which was not allocated as a cost or price credit to contracts subject to this Standard because such cost was less than zero, shall be assigned to subsequent accounting periods, including an adjustment for interest, as an assignable cost credit.

(2) Alternatively, the transition method described in paragraph (d) of this subsection may be applied separately to costs subject to paragraph (b)(1) of this subsection.

(c) *Accounting for certain prior allocated unfunded accruals.* Any portion of unfunded pension cost for a nonqualified defined-benefit pension plan, assigned to a cost accounting period prior to March 30, 1995, that was allocated as cost or price to contracts subject to this Standard, shall be recognized in subsequent accounting periods, including adjustments for imputed interest and benefit payments, as an accumulated value of permitted unfunded accruals.

(d) *"Fresh start" alternative transition method.* The transition methods of paragraphs (a)(1), (b)(1), and (c) of this subsection may be implemented using the so-called "fresh start" method whereby a portion of the unfunded actuarial liability of a defined-benefit pension plan, which occurs in the first cost accounting period after March 30, 1995, shall be treated in the same manner as an actuarial gain or loss. Such portion of unfunded actuarial liability shall exclude any portion of unfunded actuarial liability that must continue to be separately identified and maintained in accordance with 9904.412-50(a)(2), including interest adjustments. If the contracting officer already has approved a different amortization period for the fresh start amortization, then such amortization period shall continue.

(e) *Change to pay-as-you-go method.* A change in accounting method subject to 9903.302 will have occurred whenever costs of a nonqualified defined-benefit pension plan have been accounted for on an accrual basis prior to March 30, 1995, and the contractor must change to the pay-as-you-go cost method because the plan does not meet the requirement of 9904.412-50(c)(3), either by election or otherwise. In such case, any portion of unfunded pension cost, assigned to a cost accounting period prior to March 30, 1995, that was allocated as cost or price to contracts subject to this Standard, shall be assigned to future accounting periods, including adjustments for imputed interest and benefit payments, as an accumulated value of permitted unfunded accruals. Costs computed under the pay-as-you-go cost method shall be charged against such accumulated value of permitted unfunded accruals before such costs may be allocated to contracts.

(f) *Actuarial assumptions.* The actuarial assumptions used to calculate assignable cost deficits, assignable cost credits, or accumulated values of permitted unfunded accruals for transition purposes shall be consistent with the long term assumptions used for valuation purposes for such prior periods unless the contracting officer has previously approved the use of other reasonable assumptions.

(g) *Transition illustrations.* Unless otherwise noted, paragraphs (g)(1) through (9) of this subsection address pension costs and transition amounts determined for the first cost accounting period beginning on or after the date this revised Standard becomes applicable to a contractor. For purposes of these illustrations an interest assumption of 7% is presumed to be in effect for all periods.

(1) For the cost accounting period immediately preceding the date this revised Standard becomes applicable to a contractor, Contractor S computed and assigned pension cost of \$1 million for a qualified defined-benefit pension plan. The contractor made a contribution equal to the maximum tax-deductible amount of \$800,000 for the period leaving \$200,000 of assigned cost unfunded for the period. Except for this \$200,000, no other assigned pension costs have ever been unfunded or otherwise disallowed. Using the transition method of paragraph (a)(1) of this subsection, the contractor shall establish an assignable cost deficit equal to \$214,000

(\$200,000 x 1.07), which is the prior unfunded assigned cost plus interest. If this assignable cost deficit amount, plus all other portions of unfunded actuarial liability identified in accordance with 9904.412-50(a)(1) and (2), equal the total unfunded actuarial liability, pension cost may be assigned to the current period.

(2) Assume that Contractor S in 9904.412-64(g)(1) priced the entire \$1 million into firm fixed-price contracts. In this case, no assignable cost deficit amount may be established. In addition, the \$214,000 (\$200,000 x 1.07) shall be separately identified and maintained in accordance with 9904.412-50(a)(2). If all portions of unfunded actuarial liability identified in accordance with 9904.412-50(a)(1) and (2), equal the total unfunded actuarial liability, pension cost may be assigned to the period.

(3) Assume the same facts as in 9904.412-64(g)(1), except Contractor S only funded and allocated \$500,000. The \$300,000 of assigned cost that was not funded, but could have been funded without exceeding the tax-deductible maximum, may not be recognized as an assignable cost deficit. Instead, the \$300,000 must be separately identified and maintained in accordance with 9904.412-50(a)(2). If the \$321,000 (\$300,000 x 1.07) plus the \$214,000 already identified as an assignable cost deficit plus all other portions of unfunded actuarial liability identified in accordance with 9904.412-50(a)(1) and (2), equal the total unfunded actuarial liability, pension cost may be assigned to the period.

(4) Assume that, for Contractor S in 9904.412-64(g)(3), the only portion of unfunded actuarial liability that must be identified under 9904.412-50(a)(2) is the \$321,000. If Contractor S chooses to use the "fresh start" transition method, the \$321,000 of unfunded assigned cost must be subtracted from the total unfunded actuarial liability in accordance with 9904.412-63(d). The net amount of unfunded actuarial liability shall then be amortized over a period of fifteen years as an actuarial loss in accordance with 9904.412-50(a)(1)(v) and Cost Accounting Standard 9904.413.

(5) For the cost accounting period immediately preceding the date this revised Standard becomes applicable to a contractor, Contractor T computed and assigned pension cost of negative \$400,000 for a qualified defined-benefit plan. Because the contractor could not withdraw assets from the trust fund, the contracting officer agreed that instead of allocating a current period credit to contracts, the negative costs would be carried forward, with interest, and offset against future pension costs allocated to the contract. Using the transition method of paragraph (b)(1) of this subsection, the contractor shall establish an assignable cost credit equal to \$428,000 (\$400,000 x 1.07). If this assignable cost credit amount, plus all other portions of unfunded actuarial liability identified in accordance with 9904.412-50(a)(1) and (2), equals the total unfunded actuarial liability, pension cost may be assigned to the period.

(6) Assume that in 9904.412-64(g)(5), following guidance issued by the contracting agency the contracting officer had deemed the cost for the prior period to be \$0. In order to satisfy the requirements of 9904.412-40(c) and assign pension cost to the current period, Contractor S must account for the prior period negative accruals that have not been specifically identified. Following the transition method of paragraph (b)(1) of this subsection, the contractor shall identify \$428,000 as an assignable cost credit.

(7) Assume the facts of 9904.412-64(g)(5), except Contractor S uses the "fresh start" transition method. In addition, for the current period the plan is overfunded since the actuarial value of the assets

is greater than the actuarial accrued liability. In this case, an actuarial gain equal to the negative unfunded actuarial liability; i.e., actuarial surplus, is recognized since there are no portions of unfunded actuarial liability that must be identified under 9904.412-50(a)(2).

(8) Since March 28, 1989 Contractor U has computed, assigned, and allocated pension costs for a nonqualified defined-benefit plan on an accrual basis. The value of these past accruals, increased for imputed interest at 7% and decreased for benefits paid by the contractor, is equal to \$2 million as of the beginning of the current period. Contractor U elects to establish a "Rabbi trust" and the plan meets the other criteria at 9904.412-50(c)(3). Using the transition method of paragraph (c) of this subsection, Contractor U shall recognize the \$2 million as the accumulated value of permitted unfunded accruals, which will then be included in the market value and actuarial value of the assets. Because the accumulated value of permitted unfunded accruals is exactly equal to the current period market value of the assets, 100% of benefits for the current period must be paid from sources other than the funding agency in accordance with 9904.412-50(d)(2)(ii).

(9) Assume that Contractor U in 9904.412-64(g)(8) establishes a funding agency, but elects to use the pay-as-you-go method for current and future pension costs. Furthermore, plan participants receive \$500,000 in benefits on the last day of the current period. Using the transition method of paragraph (e) of this subsection to ensure prior costs are not redundantly provided for, the contractor shall establish assets; i.e., an accumulated value of permitted unfunded accruals, of \$2 million. Since these assets are sufficient to provide for the current benefit payments, no pension costs can be allocated in this period. Furthermore, previously priced contracts subject to this Standard shall be adjusted in accordance with 9903.302. The accumulated value of permitted unfunded accruals shall be carried forward to the next period by adding \$140,000 (7% x \$2 million) of imputed interest, and subtracting the \$500,000 of benefit payments made by the contractor. The accumulated value of permitted unfunded accruals for the next period equals \$1,640,000 (\$2 million + \$140,000 - \$500,000).

Subpart 9904.413—Adjustment and Allocation of Pension Cost

9904.413-10 [Reserved]

9904.413-20 Purpose.

A purpose of this Standard is to provide guidance for adjusting pension cost by measuring actuarial gains and losses and assigning such gains and losses to cost accounting periods. The Standard also provides the bases on which pension cost shall be allocated to segments of an organization. The provisions of this Cost Accounting Standard should enhance uniformity and consistency in accounting for pension costs.

9904.413-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this chapter 99 shall have the meaning ascribed to them in those definitions unless paragraph (b) of this subsection requires otherwise.

(1) *Accrued benefit cost method* means an actuarial cost method under which units of benefits are assigned to each cost accounting period and are valued as they accrue; that is, based on the services performed by each employee in the period involved. The measure of normal cost under this method for each cost accounting period is

the present value of the units of benefit deemed to be credited to employees for service in that period. The measure of the actuarial accrued liability at a plan's inception date is the present value of the units of benefit credited to employees for service prior to that date. (This method is also known as the Unit Credit cost method without salary projection.)

(2) *Actuarial accrued liability* means pension cost attributable, under the actuarial cost method in use, to years prior to the current period considered by a particular actuarial valuation. As of such date, the actuarial accrued liability represents the excess of the present value of future benefits and administrative expenses over the present value of future normal costs for all plan participants and beneficiaries. The excess of the actuarial accrued liability over the actuarial value of the assets of a pension plan is the Unfunded Actuarial Liability. The excess of the actuarial value of the assets of a pension plan over the actuarial accrued liability is an actuarial surplus and is treated as a negative unfunded actuarial liability.

(3) *Actuarial assumption* means an estimate of future conditions affecting pension cost; for example, mortality rate, employee turnover, compensation levels, earnings on pension plan assets, changes in values of pension plan assets.

(4) *Actuarial cost method* means a technique which uses actuarial assumptions to measure the present value of future pension benefits and pension plan administrative expenses, and which assigns the cost of such benefits and expenses to cost accounting periods. The actuarial cost method includes the asset valuation method used to determine the actuarial value of the assets of a pension plan.

(5) *Actuarial gain and loss* means the effect on pension cost resulting from differences between actuarial assumptions and actual experience.

(6) *Actuarial valuation* means the determination, as of a specified date, of the normal cost, actuarial accrued liability, actuarial value of the assets of a pension plan, and other relevant values for the pension plan.

(7) *Curtailment of benefits* means an event; *e.g.*, a plan amendment, in which the pension plan is frozen and no further material benefits accrue. Future service may be the basis for vesting of non-vested benefits existing at the time of the curtailment. The plan may hold assets, pay benefits already accrued, and receive additional contributions for unfunded benefits. Employees may or may not continue working for the contractor.

(8) *Funding agency* means an organization or individual which provides facilities to receive and accumulate assets to be used either for the payment of benefits under a pension plan, or for the purchase of such benefits, provided such accumulated assets form a part of a pension plan established for the exclusive benefit of the plan participants and their beneficiaries. The fair market value of the assets held by the funding agency as of a specified date is the Funding Agency Balance as of that date.

(9) *Immediate-gain actuarial cost method* means any of the several cost methods under which actuarial gains and losses are included as part of the unfunded actuarial liability of the pension plan, rather than as part of the normal cost of the plan.

(10) *Market value of the assets* means the sum of the funding agency balance plus the accumulated value of any permitted unfunded accruals belonging to a pension plan. The Actuarial Value of the Assets means the value of cash, investments, permitted

unfunded accruals, and other property belonging to a pension plan, as used by the actuary for the purpose of an actuarial valuation.

(11) *Normal cost* means the annual cost attributable, under the actuarial cost method in use, to current and future years as of a particular valuation date, excluding any payment in respect of an unfunded actuarial liability.

(12) *Pension plan* means a deferred compensation plan established and maintained by one or more employers to provide systematically for the payment of benefits to plan participants after their retirement, provided that the benefits are paid for life or are payable for life at the option of the employees. Additional benefits such as permanent and total disability and death payments, and survivorship payments to beneficiaries of deceased employees may be an integral part of a pension plan.

(13) *Pension plan participant* means any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit from a pension plan which covers employees of such employer or members of such organization who have satisfied the plan's participation requirements, or whose beneficiaries are receiving or may be eligible to receive any such benefit. A participant whose employment status with the employer has not been terminated is an active participant of the employer's pension plan.

(14) *Pension plan termination* means an event; *i.e.*, plan amendment, in which either the pension plan ceases to exist and all benefits are settled by purchase of annuities or other means, or the trusteeship of the plan is assumed by the Pension Benefit Guarantee Corporation or other conservator. The plan may or may not be replaced by another plan.

(15) *Permitted unfunded accruals* means the amount of pension cost for nonqualified defined-benefit pension plans that is not required to be funded under 9904.412-50(d)(2). The Accumulated Value of Permitted Unfunded Accruals means the value, as of the measurement date, of the permitted unfunded accruals adjusted for imputed earnings and for benefits paid by the contractor.

(16) *Prepayment credit* means the amount funded in excess of the pension cost assigned to a cost accounting period that is carried forward for future recognition. The Accumulated Value of Prepayment Credits means the value, as of the measurement date, of the prepayment credits adjusted for interest at the valuation rate and decreased for amounts used to fund pension costs or liabilities, whether assignable or not.

(17) *Projected benefit cost method* means either (i) any of the several actuarial cost methods which distribute the estimated total cost of all of the employees' prospective benefits over a period of years, usually their working careers, or (ii) a modification of the accrued benefit cost method that considers projected compensation levels.

(18) *Qualified pension plan* means a pension plan comprising a definite written program communicated to and for the exclusive benefit of employees which meets the criteria deemed essential by the Internal Revenue Service as set forth in the Internal Revenue Code for preferential tax treatment regarding contributions, investments, and distributions. Any other plan is a nonqualified pension plan.

(19) *Segment* means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility

for profit and/or producing a product or service. The term includes Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the organization has less than a majority ownership, but over which it exercises control.

(20) *Segment closing* means that a segment has (i) been sold or ownership has been otherwise transferred, (ii) discontinued operations, or (iii) discontinued doing or actively seeking Government business under contracts subject to this Standard.

(21) *Termination of employment gain or loss* means an actuarial gain or loss resulting from the difference between the assumed and actual rates at which plan participants separate from employment for reasons other than retirement, disability, or death.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.413-40 Fundamental requirement.

(a) *Assignment of actuarial gains and losses.* Actuarial gains and losses shall be calculated annually and shall be assigned to the cost accounting period for which the actuarial valuation is made and subsequent periods.

(b) *Valuation of the assets of a pension plan.* The actuarial value of the assets of a pension plan shall be determined under an asset valuation method which takes into account unrealized appreciation and depreciation of the market value of the assets of the pension plan, including the accumulated value of permitted unfunded accruals, and shall be used in measuring the components of pension costs.

(c) *Allocation of pension cost to segments.* Contractors shall allocate pension costs to each segment having participants in a pension plan. A separate calculation of pension costs for a segment is required when the conditions set forth in 9904.413-50(c)(2) or (3) are present. When these conditions are not present, allocations may be made by calculating a composite pension cost for two or more segments and allocating this cost to these segments by means of an allocation base. When pension costs are separately computed for a segment or segments, the provisions of Cost Accounting Standard 9904.412 regarding the assignable cost limitation shall be based on the assets and liabilities for the segment or segments for purposes of such computations. In addition, the amount of pension cost assignable to a segment or segments shall not exceed the maximum tax-deductible amount computed for the plan as a whole and apportioned among the segment(s).

9904.413-50 Techniques for application.

(a) *Assignment of actuarial gains and losses.* (1) In accordance with the provisions of Cost Accounting Standard 9904.412, actuarial gains and losses shall be identified separately from other unfunded actuarial liabilities.

(2) Actuarial gains and losses determined under a pension plan whose costs are measured by an immediate-gain actuarial cost method shall be amortized over a 15 year period in equal annual installments, beginning with the date as of which the actuarial valuation is made. The installment for a cost accounting period shall consist of an element for amortization of the gain or loss plus an element for interest on the unamortized balance at the beginning of the period. If the actuarial gain or loss determined for a cost

accounting period is not material, the entire gain or loss may be included as a component of the current or ensuing year's pension cost.

(3) Pension plan terminations and curtailments of benefits shall be subject to adjustment in accordance with 9904.413-50(c)(12).

(b) *Valuation of the assets of a pension plan.* (1) The actuarial value of the assets of a pension plan shall be used:

(i) In measuring actuarial gains and losses, and

(ii) For purposes of measuring other components of pension cost.

(2) The actuarial value of the assets of a pension plan may be determined by the use of any recognized asset valuation method which provides equivalent recognition of appreciation and depreciation of the market value of the assets of the pension plan. However, the actuarial value of the assets produced by the method used shall fall within a corridor from 80 to 120 percent of the market value of the assets, determined as of the valuation date. If the method produces a value that falls outside the corridor, the actuarial value of the assets shall be adjusted to equal the nearest boundary of the corridor.

(3) The method selected for valuing pension plan assets shall be consistently applied from year to year within each plan.

(4) The provisions of paragraphs (b)(1) through (3) of this subsection are not applicable to plans that are treated as defined-contribution plans in accordance with 9904.412- 50(a)(6).

(5) The market and actuarial values of the assets of a pension plan shall not be adjusted for any fee, reserve charge, or other investment charge for withdrawals from or termination of an investment contract, trust agreement, or other funding arrangement, unless such fee is determined in an arm's length transaction, and actually incurred and paid.

(c) *Allocation of pension cost to segments.* (1) For contractors who compute a composite pension cost covering plan participants in two or more segments, the base to be used for allocating such costs shall be representative of the factors on which the pension benefits are based. For example, a base consisting of salaries and wages shall be used for pension costs that are calculated as a percentage of salaries and wages; a base consisting of the number of participants shall be used for pension costs that are calculated as an amount per participant. If pension costs are separately calculated for one or more segments, the contractor shall make a distribution among the segments for the maximum tax-deductible amount and the contribution to the funding agency as follows:

(i) When apportioning the maximum tax-deductible amount, which is determined for a qualified defined-benefit pension plan as a whole pursuant to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 *et seq.*, as amended, to segments, the contractor shall use a base that considers the otherwise assignable pension costs or the funding levels of the individual segments.

(ii) When apportioning amounts deposited to a funding agency to segments, contractors shall use a base that is representative of the assignable pension costs, determined in accordance with 9904.412-50(c) for the individual segments. However, for qualified defined-benefit pension plans, the contractor may first apportion amounts funded to the segment or segments subject to this Standard.

(2) Separate pension cost for a segment shall be calculated whenever any of the following conditions exist for that segment,

provided that such condition(s) materially affect the amount of pension cost allocated to the segment:

(i) There is a material termination of employment gain or loss attributable to the segment,

(ii) The level of benefits, eligibility for benefits, or age distribution is materially different for the segment than for the average of all segments, or

(iii) The appropriate actuarial assumptions are, in the aggregate, materially different for the segment than for the average of all segments. Calculations of termination of employment gains and losses shall give consideration to factors such as unexpected early retirements, benefits becoming fully vested, and reinstatements or transfers without loss of benefits. An amount may be estimated for future reemployments.

(3) Pension cost shall also be separately calculated for a segment under circumstances where—

(i) The pension plan for that segment becomes merged with that of another segment, or the pension plan is divided into two or more pension plans, and in either case,

(ii) The ratios of market value of the assets to actuarial accrued liabilities for each of the merged or separated plans are materially different from one another after applying the benefits in effect after the pension plan merger or pension plan division.

(4) For a segment whose pension costs are required to be calculated separately pursuant to paragraphs (c)(2) or (3) of this subsection, such calculations shall be prospective only; pension costs need not be redetermined for prior years.

(5) For a segment whose pension costs are either required to be calculated separately pursuant to paragraph (c)(2) or (c)(3) of this subsection or calculated separately at the election of the contractor, there shall be an initial allocation of a share in the undivided market value of the assets of the pension plan to that segment, as follows:

(i) If the necessary data are readily determinable, the funding agency balance to be allocated to the segment shall be the amount contributed by, or on behalf of, the segment, increased by income received on such assets, and decreased by benefits and expenses paid from such assets. Likewise, the accumulated value of permitted unfunded accruals to be allocated to the segment shall be the amount of permitted unfunded accruals assigned to the segment, increased by interest imputed to such assets, and decreased by benefits paid from sources other than the funding agency; or

(ii) If the data specified in paragraph (c)(5)(i) of this subsection are not readily determinable for certain prior periods, the market value of the assets of the pension plan shall be allocated to the segment as of the earliest date such data are available. Such allocation shall be based on the ratio of the actuarial accrued liability of the segment to the plan as a whole, determined in a manner consistent with the immediate gain actuarial cost method or methods used to compute pension cost. Such assets shall be brought forward as described in paragraph (c)(7) of this subsection.

(iii) The actuarial value of the assets of the pension plan shall be allocated to the segment in the same proportion as the market value of the assets.

(6) If, prior to the time a contractor is required to use this Standard, it has been calculating pension cost separately for individual segments, the amount of assets previously allocated to those segments need not be changed.

(7) After the initial allocation of assets, the contractor shall maintain a record of the portion of subsequent contributions, permitted unfunded accruals, income, benefit payments, and expenses attributable to the segment and paid from the assets of the pension plan. Income and expenses shall include a portion of any investment gains and losses attributable to the assets of the pension plan. Income and expenses of the pension plan assets shall be allocated to the segment in the same proportion that the average value of assets allocated to the segment bears to the average value of total pension plan assets for the period for which income and expenses are being allocated.

(8) If plan participants transfer among segments, contractors need not transfer assets or actuarial accrued liabilities unless a transfer is sufficiently large to distort the segment's ratio of pension plan assets to actuarial accrued liabilities determined using the accrued benefit cost method. If assets and liabilities are transferred, the amount of assets transferred shall be equal to the actuarial accrued liabilities, determined using the accrued benefit cost method, transferred.

(9) Contractors who separately calculate the pension cost of one or more segments may calculate such cost either for all pension plan participants assignable to the segment(s) or for only the active participants of the segment(s). If costs are calculated only for active participants, a separate segment shall be created for all of the inactive participants of the pension plan and the cost thereof shall be calculated. When a contractor makes such an election, assets shall be allocated to the segment for inactive participants in accordance with paragraphs (c)(5), (6), and (7) of this subsection. When an employee of a segment becomes inactive, assets shall be transferred from that segment to the segment established to accumulate the assets and actuarial liabilities for the inactive plan participants. The amount of assets transferred shall be equal to the actuarial accrued liabilities, determined under the accrued benefit cost method, for these inactive plan participants. If inactive participants become active, assets and liabilities shall similarly be transferred to the segments to which the participants are assigned. Such transfers need be made only as of the last day of a cost accounting period. The total annual pension cost for a segment having active employees shall be the amount calculated for the segment plus an allocated portion of the pension cost calculated for the inactive participants. Such an allocation shall be on the same basis as that set forth in paragraph (c)(1) of this subsection.

(10) Where pension cost is separately calculated for one or more segments, the actuarial cost method used for a plan shall be the same for all segments. Unless a separate calculation of pension cost for a segment is made because of a condition set forth in paragraph (c)(2)(iii) of this subsection, the same actuarial assumptions may be used for all segments covered by a plan.

(11) If a pension plan has participants in the home office of a company, the home office shall be treated as a segment for purposes of allocating the cost of the pension plan. Pension cost allocated to a home office shall be a part of the costs to be allocated in accordance with the appropriate requirements of Cost Accounting Standard 9904.403.

(12) If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the actuarial accrued liability for the segment and the market value of the assets allocated to the segment,

irrespective of whether or not the pension plan is terminated. The difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs.

(i) The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs. If there is a pension plan termination, the actuarial accrued liability shall be measured as the amount paid to irrevocably settle all benefit obligations or paid to the Pension Benefit Guarantee Corporation.

(ii) In computing the market value of assets for the segment, if the contractor has not already allocated assets to the segment, such an allocation shall be made in accordance with the requirements of paragraphs (c)(5)(i) and (ii) of this subsection. The market value of the assets shall be reduced by the accumulated value of prepayment credits, if any. Conversely, the market value of the assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).

(iii) The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.

(iv) Pension plan improvements adopted within 60 months of the date of the event which increase the actuarial accrued liability shall be recognized on a prorata basis using the number of months the date of adoption preceded the event date. Plan improvements mandated by law or collective bargaining agreement are not subject to this phase-in.

(v) If a segment is closed due to a sale or other transfer of ownership to a successor in interest in the contracts of the segment and all of the pension plan assets and actuarial accrued liabilities pertaining to the closed segment are transferred to the successor segment, then no adjustment amount pursuant to this paragraph (c)(12) is required. If only some of the pension plan assets and actuarial accrued liabilities of the closed segment are transferred, then the adjustment amount required under this paragraph (c)(12) shall be determined based on the pension plan assets and actuarial accrued liabilities remaining with the contractor. In either case, the effect of the transferred assets and liabilities is carried forward and recognized in the accounting for pension cost at the successor contractor.

(vi) The Government's share of the adjustment amount determined for a segment shall be the product of the adjustment amount and a fraction. The adjustment amount shall be reduced for any excise tax imposed upon assets withdrawn from the funding agency of a qualified pension plan. The numerator of such fraction shall be the sum of the pension plan costs allocated to all contracts and sub-contracts (including Foreign Military Sales) subject to this Standard during a period of years representative of the Government's participation in the pension plan. The denominator of such fraction shall be the total pension costs assigned to cost accounting periods during those same years. This amount shall represent an adjustment of contract prices or cost allowance as appropriate. The adjustment

may be recognized by modifying a single contract, several but not all contracts, or all contracts, or by use of any other suitable technique.

(vii) The full amount of the Government's share of an adjustment is allocable, without limit, as a credit or charge during the cost accounting period in which the event occurred and contract prices/costs will be adjusted accordingly. However, if the contractor continues to perform Government contracts, the contracting parties may negotiate an amortization schedule, including interest adjustments. Any amortization agreement shall consider the magnitude of the adjustment credit or charge, and the size and nature of the continuing contracts.

9904.413-60 Illustrations.

(a) *Assignment of actuarial gains and losses.* Contractor A has a defined-benefit pension plan whose costs are measured under an immediate-gain actuarial cost method. The contractor makes actuarial valuations every other year. In the past, at each valuation date, the contractor has calculated the actuarial gains and losses that have occurred since the previous valuation date and has merged such gains and losses with the unfunded actuarial liabilities that are being amortized. Pursuant to 9904.413-40(a), the contractor must make an actuarial valuation annually. Any actuarial gains or losses measured must be separately amortized over a 15-year period beginning with the period for which the actuarial valuation is made in accordance with 9904.413-50(a)(1) and (2).

(b) *Valuation of the assets of a pension plan.* (1) Contractor B has a qualified defined-benefit pension plan, the assets of which are invested in equity securities, debt securities, and real property. The contractor, whose cost accounting period is the calendar year, has an annual actuarial valuation of the pension plan assets in June of each year; the effective date of the valuation is the beginning of that year. The contractor's method for valuing the assets of the pension plan is as follows: debt securities expected to be held to maturity are valued on an amortized basis running from initial cost at purchase to par value at maturity; land and buildings are valued at cost less depreciation taken to date; all equity securities and debt securities not expected to be held to maturity are valued on the basis of a five-year moving average of market values. In making an actuarial valuation, the contractor must compare the values reached under the asset valuation method used with the market value of all the assets as required by 9904.413-40(b). In this case, the assets are valued as of January 1 of that year. The contractor established the following values as of the valuation date.

	Asset Valuation Method	Market
Cash	\$100,000	\$100,000
Equity securities	6,000,000	7,800,000
Debt securities expected to be held to maturity	550,000	600,000
Other debt securities	600,000	750,000
Land and buildings, net of depreciation	400,000	750,000
Total	\$7,650,000	\$10,000,000

(2) Section 9904.413-50(b)(2) requires that the actuarial value of the assets of the pension plan fall within a corridor from 80 to 120 percent of market. The corridor for the plan's assets as of January 1 is from \$12 million to \$8 million. Because the asset value reached by the contractor, \$7,650,000, falls outside that corridor, the value reached must be adjusted to equal the nearest boundary of the corridor: \$8 million. In subsequent years the contractor must continue to use the same method for valuing assets in accordance with 9904.413-50(b)(3). If the value produced falls inside the corridor, such value shall be used in measuring pension costs.

(c) *Allocation of pension costs to segments.* (1) Contractor C has a defined-benefit pension plan covering employees at five segments. Pension cost is computed by use of an immediate-gain actuarial cost method. One segment (X) is devoted primarily to performing work for the Government. During the current cost accounting period, Segment X had a large and unforeseeable reduction of employees because of a contract termination at the convenience of the Government and because the contractor did not receive an anticipated follow-on contract to one that was completed during the period. The segment does continue to perform work under several other Government contracts. As a consequence of this termination of employment gain, a separate calculation of the pension cost for Segment X would result in materially different allocation of costs to the segment than would a composite calculation and allocation by means of a base. Accordingly, pursuant to 9904.413-50(c)(2), the contractor must calculate a separate pension cost for Segment X. In doing so, the entire termination of employment gain must be assigned to Segment X and amortized over fifteen years. If the actuarial assumptions for Segment X continue to be substantially the same as for the other segments, the termination of employment gain may be separately amortized and allocated only to Segment X; all other Segment X computations may be included as part of the composite calculation. After the termination of employment gain is amortized, the contractor is no longer required to separately calculate the costs for Segment X unless subsequent events require each separate calculation.

(2) Contractor D has a defined-benefit pension plan covering employees at ten segments, all of which have some contracts subject to this Standard. The contractor's calculation of normal cost is based on a percentage of payroll for all employees covered by the plan. One of the segments (Segment Y) is entirely devoted to Government work. The contractor's policy is to place junior employees in this segment. The salary scale assumption for employees of the segment is so different from that of the other segments that the pension cost for Segment Y would be materially different if computed separately. Pursuant to 9904.413-50(c)(2)(iii), the contractor must compute the pension cost for Segment Y as if it were a separate pension plan. Therefore, the contractor must allocate a portion of the market value of pension plan's assets to Segment Y in accordance with 9904.413-50(c)(5). Memorandum records may be used in making the allocation. However, because the necessary records only exist for the last five years, 9904.413-50(c)(5)(ii) permits an initial allocation to be made as of the earliest date such records are available. The initial allocation must be made on the basis of the immediate gain actuarial cost method or methods used to calculate prior years' pension cost for the plan. Once the assets have been allocated, they shall be brought forward to the current period as described in 9904.413-50(c)(7). A portion of the undivided actuarial

value of assets shall then be allocated to the segment based on the segment's proportion of the market value of assets in accordance with 9904.413-50(c)(5)(iii). In future cost accounting periods, the contractor shall make separate pension cost calculations for Segment Y based on the appropriate salary scale assumption. Because the factors comprising pension cost for the other nine segments are relatively equal, the contractor may compute pension cost for these nine segments by using composite factors. As required by 9904.413-50(c)(1), the base to be used for allocating such costs shall be representative of the factors on which the pension benefits are based.

(3) Contractor E has a defined-benefit pension plan which covers employees at twelve segments. The contractor uses composite actuarial assumptions to develop a pension cost for all segments. Three of these segments primarily perform Government work; the work at the other nine segments is primarily commercial. Employee turnover at the segments performing commercial work is relatively stable. However, employment experience at the Government segments has been very volatile; there have been large fluctuations in employment levels and the contractor assumes that this pattern of employment will continue to occur. It is evident that separate termination of employment assumptions for the Government segments and the commercial segments will result in materially different pension costs for the Government segments. Therefore, the cost for these segments must be separately calculated, using the appropriate termination of employment assumptions for these segments in accordance with 9904.413-50(c)(2)(iii).

(4) Contractor F has a defined-benefit pension plan covering employees at 25 segments. Twelve of these segments primarily perform Government work; the remaining segments perform primarily commercial work. The contractor's records show that the termination of employment experience and projections for the twelve segments are so different from that of the average of all of the segments that separate pension cost calculations are required for these segments pursuant to 9904.413-50(c)(2). However, because the termination of employment experience and projections are about the same for all twelve segments, Contractor F may calculate a composite pension cost for the twelve segments and allocate the cost to these segments by use of an appropriate allocation base in accordance with 9904.413-50(c)(1).

(5) After this Standard becomes applicable to Contractor G, it acquires Contractor H and makes it Segment H. Prior to the merger, each contractor had its own defined-benefit pension plan. Under the terms of the merger, Contractor H's pension plan and plan assets were merged with those of Contractor G. The actuarial assumptions, current salary scale, and other plan characteristics are about the same for Segment H and Contractor G's other segments. However, based on the same benefits at the time of the merger, the plan of Contractor H had a disproportionately larger unfunded actuarial liability than did Contractor G's plan. Any combining of the assets and actuarial liabilities of both plans would result in materially different pension cost allocation to Contractor G's segments than if pension cost were computed for Segment H on the basis that it had a separate pension plan. Accordingly, pursuant to 9904.413-50(c)(3), Contractor G must allocate to Segment H a portion of the assets of the combined plan. The amount to be allocated shall be the market value of Segment H's pension plan assets at the date of the merger determined in accordance with 9904.413-50(c)(5), and shall be

adjusted for subsequent receipts and expenditures applicable to the segment in accordance with 9904.413-50(c)(7). Pursuant to 9904.413-40(b)(1) and 9904.413-50(c)(5)(iii), Contractor G must use these amounts of assets as the basis for determining the actuarial value of assets used for calculating the annual pension cost applicable to Segment H.

(6) Contractor I has a defined-benefit pension plan covering employees at seven segments. The contractor has been making a composite pension cost calculation for all of the segments. However, the contractor determines that, pursuant to this Standard, separate pension costs must be calculated for one of the segments. In accordance with 9904.413-50(c)(9), the contractor elects to allocate pension plan assets only for the active participants of that segment. The contractor must then create a segment to accumulate the assets and actuarial accrued liabilities for the plan's inactive participants. When active participants of a segment become inactive, the contractor must transfer assets to the segment for inactive participants equal to the actuarial accrued liabilities for the participants that become inactive.

(7) Contractor J has a defined-benefit pension plan covering employees at ten segments. The contractor makes a composite pension cost calculation for all segments. The contractor's records show that the termination of employment experience for one segment, which is performing primarily Government work, has been significantly different from the average termination of employment experience of the other segments. Moreover, the contractor assumes that such different experience will continue. Because of this fact, and because the application of a different termination of employment assumption would result in significantly different costs being charged the Government, the contractor must develop separate pension cost for that segment. In accordance with 9904.413-50(c)(2)(iii), the amount of pension cost must be based on an acceptable termination of employment assumption for that segment; however, as provided in 9904.413-50(c)(10), all other assumptions for that segment may be the same as those for the remaining segments.

(8) Contractor K has a five-year contract to operate a Government-owned facility. The employees of that facility are covered by the contractor's overall qualified defined-benefit pension plan which covers salaried and hourly employees at other locations. At the conclusion of the five-year period, the Government decides not to renew the contract. Although some employees are hired by the successor contractor, because Contractor K no longer operates the facility, it meets the 9904.413-30(a)(20)(iii) definition of a segment closing. Contractor K must compute the actuarial accrued liability for the pension plan for that facility using the accrued benefit cost method as of the date the contract expired in accordance with 9904.413-50(c)(12)(i). Because many of Contractor K's employees are terminated from the pension plan, the Internal Revenue Service considers it to be a partial plan termination, and thus requires that the terminated employees become fully vested in their accrued benefits to the extent such benefits are funded. Taking this mandated benefit improvement into consideration in accordance with 9904.413-50(c)(12)(iv), the actuary calculates the actuarial accrued liability to be \$12.5 million. The contractor must then determine the market value of the pension plan assets allocable to the facility, in accordance with 9904.413-50(c)(5), as of the date agreed to by the contracting parties pursuant to 9904.413-50(c)(12)(iii), the date the

contract expired. In making this determination, the contractor is able to do a full historical reconstruction of the market value of the assets allocated to the segment. In this case, the market value of the segment's assets amounted to \$13.8 million. Thus, for this facility the value of pension plan assets exceeded the actuarial accrued liability by \$1.3 million. Pursuant to 9904.413-50(c)(12)(vi), this amount indicates the extent to which the Government over-contributed to the pension plan for the segment and, accordingly, is the amount of the adjustment due to the Government.

(9) Contractor L operated a segment over the last five years during which 80% of its work was performed under Government CAS-covered contracts. The Government work was equally divided each year between fixed-price and cost-type contracts. The employees of the facility are covered by a funded nonqualified defined-benefit pension plan accounted for in accordance with 9904.412-50(c)(3). For each of the last five years the highest Federal corporate income tax rate has been 30%. Pension costs of \$1 million per year were computed using a projected benefit cost method. Contractor L funded at the complement of the tax rate (\$700,000 per year). The pension plan assets held by the funding agency earned 8% each year. At the end of the five-year period, the funding agency balance; i.e., the market value of invested assets, was \$4.4 million. As of that date, the accumulated value of permitted unfunded accruals; i.e., the current value of the \$300,000 not funded each year, is \$1.9 million. As defined by 9904.413-30(a)(20)(i), a segment closing occurs when Contractor L sells the segment at the end of the fifth year. Thus, for this segment, the market value of the assets of the pension plan determined in accordance with 9904.413-30(a)(10) is \$6.3 million, which is, the sum of the funding account balance (\$4.4 million) and the accumulated value of permitted unfunded accruals (\$1.9 million). Pursuant to 9904.413-50(c)(12)(i), the contractor uses the accrued benefit cost method to calculate an actuarial accrued liability of \$5 million as of that date. There is no transfer of plan assets or liabilities to the buyer. The difference between the market value of the assets and the actuarial accrued liability for the segment is \$1.3 million (\$6.3 million - \$5 million). Pursuant to 9904.413-50(c)(12)(vi), the adjustment due the Government for its 80% share of previously-determined pension costs for CAS-covered contracts is \$1.04 million (80% times \$1.3 million). Because contractor L has no other Government contracts the \$1.04 million is a credit due to the Government.

(10) Assume the same facts as in 9904.413-60(c)(9), except that Contractor L continues to perform substantial Government contract work through other segments. After considering the amount of the adjustment and the current level of contracts, the contracting officer and the contractor establish an amortization schedule so that the \$1.04 million is recognized as credits against ongoing contracts in five level annual installments, including an interest adjustment based on the interest assumption used to compute pension costs for the continuing contracts. This amortization schedule satisfies the requirements of 9904.413-50(c)(12)(vii).

(11) Assume the same facts as in 9904.413-60(c)(9). As part of the transfer of ownership, Contractor L also transfers all pension liabilities and assets of the segment to the buyer. Pursuant to 9904.413-50(c)(12)(v), the segment closing adjustment amount for the current period is transferred to the buyer and is subsumed in the future pension cost accounting of the buyer. If the transferred liabilities and assets of the segment are merged into the buyer's pension

plan which has a different ratio of market value of pension plan assets to actuarial accrued liabilities, then pension costs must be separately computed in accordance with 9904.413-50(c)(3).

(12) Contractor M sells its only government segment. Through a contract notation, the buyer assumes responsibility for performance of the segment's government contracts. Just prior to the sale, the actuarial accrued liability under the actuarial cost method in use is \$18 million and the market value of assets allocated to the segment is \$22 million. In accordance with the sales agreement, Contractor M is required to transfer \$20 million of assets to the new plan. In determining the segment closing adjustment under 9904.413-50(c)(12) the actuarial accrued liability and the market value of assets are reduced by the amounts transferred to the buyer by the sale. The adjustment amount, which is the difference between the remaining assets (\$2 million) and the remaining actuarial liability (\$0), is \$2 million.

(13) Contractor N has three segments that perform primarily government work and has been separately calculating pension costs for each segment. As part of a corporate reorganization, the contractor closes the production facility for Segment A and transfers all of that segment's contracts and employees to Segments B and C, the two remaining government segments. The pension assets from Segment A are allocated to the remaining segments based on the actuarial accrued liability of the transferred employees. Because Segment A has discontinued operations, a segment closing has occurred pursuant to 9904.413-30(a)(20)(ii). However, because all pension assets and liabilities have been transferred to other segments or to successors in interest of the contracts of Segment A, an immediate period adjustment is not required pursuant to 9904.413-50(c)(12)(v).

(14) Contractor O does not renew its government contract and decides to not seek additional government contracts for the affected segment. The contractor reduces the work force of the segment that had been dedicated to the government contract and converts the segment's operations to purely commercial work. In accordance with 9904.413-30(a)(20)(iii), the segment has closed. Immediately prior to the end of the contract the market value of the segment's assets was \$20 million and the actuarial accrued liability determined under the actuarial cost method in use was \$22 million. An actuarial accrued liability of \$16 million is determined using the accrued benefit cost method as required by 9904.413-50(c)(12)(i). The segment closing adjustment is \$4 million (\$20 million - \$16 million).

(15) Contractor P terminated its underfunded defined-benefit pension plan for hourly employees. The market value of the assets for the pension plan is \$100 million. Although the actuarial accrued liability exceeds the \$100 million of assets, the termination liability for benefits guaranteed by the Pension Benefit Guarantee Corporation (PBGC) is only \$85 million. Therefore, the \$15 million of assets in excess of the liability for guaranteed benefits are allocated to plan participants in accordance with PBGC regulations. The PBGC does not impose an assessment for unfunded guaranteed benefits against the contractor. The adjustment amount determined under 9904.413-50(c)(12) is zero.

(16) Assume the same facts as 9904.413-60(c)(15), except that the termination liability for benefits guaranteed by the Pension Benefit Guarantee Corporation (PBGC) is \$120 million. The PBGC imposes a \$20 million (\$120 million - \$100 Million) assessment

against Contractor P for the unfunded guaranteed benefits. The contractor then determines the Government's share of the pension plan termination adjustment charge of \$20 million in accordance with 9904.413-50(c)(12)(vi). In accordance with 9904.413-50(c)(12)(vii), the cognizant Federal official may negotiate an amortization schedule based on the contractor's schedule of payments to the PBGC.

(17) Assume the same facts as in 9904.413-60(c)(16), except that pursuant to 9904.412-50(a)(2) Contractor P has an unassignable portion of unfunded actuarial liability for prior unfunded pension costs which equals \$8 million. The \$8 million represents the value of assets that would have been available had all assignable costs been funded and, therefore, must be added to the assets used to determine the pension plan termination adjustment in accordance with 9904.413-50(c)(12)(ii). In this case, the adjustment charge is determined to be \$12 million (\$20 million - \$8 million).

(18) Contractor Q terminates its qualified defined-benefit pension plan without establishing a replacement plan. At termination, the market value of assets are \$85 million. All obligations for benefits are irrevocably transferred to an insurance company by the purchase of annuity contracts at a cost of \$55 million, which thereby determines the actuarial liability in accordance with 9904.413-50(c)(12)(i). The contractor receives a reversion of \$30 million (\$85 million - \$55 million). The adjustment is equal to the reversion amount, which is the excess of the market value of assets over the actuarial liability. However, ERISA imposes a 50% excise tax of \$15 million (50% of \$30 million) on the reversion amount. In accordance with 9904.413-50(c)(12)(vi), the \$30 million adjustment amount is reduced by the \$15 million excise tax. Pursuant to 9904.413-50(c)(12)(vi), a share of the \$15 million net adjustment (\$30 million - \$15 million) shall be allocated, without limitation, as a credit to CAS-covered contracts.

(19) Assume that, in addition to the facts of 9904.413-60(c)(18), Contractor Q has an accumulated value of prepayment credits of \$10 million. Contractor Q has \$3 million of unfunded actuarial liability separately identified and maintained pursuant to 9904.412-50(a)(2). The assets used to determine the adjustment amount equal \$78 million. This amount is determined as the market value of assets (\$85 million) minus the accumulated value of prepayment credits (\$10 million) plus the portion of unfunded actuarial liability maintained pursuant to 9904.412-50(a)(2) (\$3 million). Therefore, the difference between the assets and the actuarial liability is \$23 million (\$78 million - \$55 million). In accordance with 9904.413-50(c)(12)(vi), the \$23 million adjustment is reduced by the \$15 million excise tax to equal \$8 million. The contracting officer determines that the pension cost data of the most recent eight years reasonably reflects the government's participation in the pension plan. The sum of costs allocated to fixed-price and cost-type contracts subject to this Standard over the eight-year period is \$21 million. The sum of costs assigned to cost accounting periods during the last eight years equals \$42 million. Therefore, the government's share of the net adjustment is 50% (\$21 million divided by \$42 million) of the \$8 million and equals \$4 million.

(20) Contractor R maintains a qualified defined-benefit pension plan. Contractor R amends the pension plan to eliminate the earning of any future benefits; however the participants do continue to earn vesting service. Pursuant to 9904.413-30(a)(7), a curtailment of benefits has occurred. An actuarial accrued liability of \$78 million

is determined under the accrued benefit cost method using the interest assumption used for the last four actuarial valuations. The market value of assets, determined in accordance with 9904.413-50(c)(12)(ii), is \$90 million. Contractor R shall determine the Government's share of the adjustment in accordance with 9904.413-50(c)(12)(vi). The contractor then shall allocate that share of the \$12 million adjustment (\$90 million - \$78 million) determined under 9904.413-50(c)(12) to CAS-covered contracts. The full amount of adjustment shall be made without limitation in the current cost accounting period unless arrangements to amortize the adjustment are permitted and negotiated pursuant to 9904.413-50(c)(12)(vii).

(21) Contractor S amends its qualified defined-benefit pension plan to "freeze" all accrued benefits at their current level. Although not required by law, the amendment also provides that all accrued benefits are fully vested. Contractor S must determine the adjustment for the curtailment of benefits. Fifteen months prior to the date of the plan amendment freezing benefits, Contractor S voluntarily amended the plan to increase benefits. This voluntary amendment resulted in an overall increase of over 10%. All actuarial accrued liabilities are computed using the accrued benefit cost method. The actuarial accrued liability for all accrued benefits is \$1.8 million. The actuarial accrued liability for vested benefits immediately prior to the current plan amendment is \$1.6 million. The actuarial accrued liability determined for vested benefits based on the plan provisions before the voluntary amendment is \$1.4 million. The \$1.4 million actuarial liability is based on benefit provisions that have been in effect for six years and is fully recognized. However, the \$200,000 increase in liability due to the voluntary benefit improvement adopted 15 months ago must be phased-in on a prorata basis over 60 months. Therefore, only 25% (15 months divided by 60 months) of the \$200,000 increase, or \$50,000, can be included in the curtailment liability. The current amendment voluntarily increasing vesting was just adopted and, therefore, none of the associated increase in actuarial accrued liability can be included. Accordingly, in accordance with 9904.413-50(c)(12)(iv), Contractor S determines the adjustment for the curtailment of benefits using an actuarial accrued liability of \$1.45 million (\$1.4 million plus \$50,000).

(22) Contractor T has maintained separate qualified defined-benefit plans for Segments A and B and has separately computed pension costs for each segment. Both segments perform work under contracts subject to this Standard. On the first day of the current cost accounting period, Contractor T merges the two pension plans so that segments A and B are now covered by a single pension plan. Because the ratio of assets to liabilities for each plan is materially different from that of the merged plan, the contractor continues the separate computation of pension costs for each segment pursuant to 9904.413-50(c)(3). After considering the assignable cost limitations for each segment, Contractor T determines the potentially assignable pension cost is \$12,000 for Segment A and \$24,000 for Segment B. The maximum tax-deductible amount for the merged plan is \$30,000, which is \$6,000 less than the sum of the otherwise assignable costs for the segments (\$36,000). To determine the portion of the total maximum tax-deductible amount applicable to each segment on a reasonable basis, the contractor prorates the \$30,000 by the pension cost determined for each segment after considering the assignable cost limitations for each segment. Therefore, in

accordance with 9904.413-50(c)(1)(i), the assignable pension cost is \$10,000 for Segment A (\$30,000 times \$12,000 divided by \$36,000) and \$20,000 for Segment B (\$30,000 times \$24,000 divided by \$36,000). Contractor T funds the full \$30,000 and allocates the assignable pension cost for each segment to final cost objectives.

(23) Assume the same facts as in 9904.413-60(c)(22), except that the tax-deductible maximum is \$40,000 and the ERISA minimum funding requirement is \$18,000. Since funding of the accrued pension cost is not constrained by tax-deductibility, Contractor T determines the assignable pension cost to be \$12,000 for Segment A and \$24,000 for Segment B. If the contractor funds \$36,000, the full assigned pension cost of each segment can be allocated to final cost objectives. However, because the contractor funds only the ERISA minimum of \$18,000, the contractor must apportion the \$18,000 contribution to each segment on a basis that reflects the assignable pension cost of each segment in accordance with 9904.413-50(c)(1)(ii). To measure the funding level of each segment, Contractor T uses an ERISA minimum funding requirement separately determined for each segment, as if the segment were a separate plan. On this basis, the allocable pension cost is determined to be \$8,000 for Segment A and \$10,000 for Segment B. In accordance with 9904.412-50(a)(2), Contractor T must separately identify, and eliminate from future cost computations, \$4,000 (\$12,000-\$8,000) for Segment A and \$14,000 (\$24,000-\$10,000) for Segment B.

(24) Assume the same facts as in 9904.413-60(c)(23), except that Segment B performs only commercial work. As permitted by 9904.413-50(c)(1)(ii), the contractor first applies \$12,000 of the contribution amount to Segment A, which is performing work under Government contracts, for purposes of 9904.412-50(d)(1). The remaining \$6,000 is applied to Segment B. The full assigned pension cost of \$12,000 for Segment A is funded and such amount is allocable to CAS-covered contracts. Pursuant to 9904.412-50(a)(2), the contractor separately identifies, and eliminates from future pension costs, the \$18,000 (\$24,000-\$6,000) of unfunded assigned cost for Segment B.

(25) Contractor U has a qualified defined-benefit pension plan covering employees at two segments that perform work on contracts subject to this Standard. The ratio of the actuarial value of assets to actuarial accrued liabilities is significantly different between the two segments. Therefore, Contractor U is required to compute pension cost separately for each segment. The actuarial value of assets allocated to Segment A exceeds the actuarial accrued liability by \$50,000. Segment B has an unfunded actuarial liability of \$20,000. Thus, the pension plan as a whole has an actuarial surplus of \$30,000. Pension cost of \$5,000 is computed for Segment B and is less than Segment B's assignable cost limitation of \$9,000. The tax-deductible maximum is \$0 for the plan as whole and, therefore, \$0 for each segment. Contractor U will deem all existing amortization bases maintained for Segment A to be fully amortized in accordance with 9904.412-50(c)(2)(ii). For Segment B, the amortization of existing portions of unfunded actuarial liability continues unabated.

Furthermore, pursuant to 9904.412-50(c)(2)(iii), the contractor establishes an additional amortization base for Segment B for the assignable cost deficit of \$5,000.

9904.413-61 Interpretation. [Reserved]

9904.413-62 Exemption.

None for this Standard.

9904.413-63 Effective date.

(a) This Standard is effective as of March 30, 1995.

(b) This Standard shall be followed by each contractor on or after the start of its next cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow Standard 9904.413 in effect prior to March 30, 1995, until this Standard, effective March 30, 1995, becomes applicable following receipt of a contract or subcontract to which this revised Standard applies.

9904.413-64 Transition method.

(a) To be acceptable, any method of transition from compliance with Standard 9904.413 in effect prior to March 30, 1995, to compliance with Standard 9904.413 in effect as of March 30, 1995, must follow the equitable principle that costs, which have been previously provided for, shall not be redundantly provided for under revised methods. Conversely, costs that have not previously been provided for must be provided for under the revised method. This transition subsection is not intended to qualify for purposes of assignment or allocation, pension costs which have previously been disallowed for reasons other than ERISA funding limitations.

(b) The sum of all portions of unfunded actuarial liability identified pursuant to Standard 9904.413, effective March 30, 1995, including such portions of unfunded actuarial liability determined for transition purposes, is subject to the requirements for assignment of 9904.412-40(c).

(c) Furthermore, this Standard, effective March 30, 1995, clarifies, but is not intended to create, rights of the contracting parties, and specifies techniques for determining adjustments pursuant to 9904.413-50(c)(12). These rights and techniques should be used to resolve outstanding issues that will affect pension costs of contracts subject to this Standard.

(d) The method, or methods, employed to achieve an equitable transition shall be consistent with the provisions of this Standard and shall be approved by the contracting officer.

(e) All adjustments shall be prospective only. However, costs/prices of prior and existing contracts not subject to price adjustment may be considered in determining the appropriate transition method or adjustment amount for the computation of costs/prices of contracts subject to this Standard.

Subpart 9904.414—Cost Accounting Standard—Cost of Money as an Element of the Cost of Facilities Capital**9904.414-10 [Reserved]****9904.414-20 Purpose.**

The purpose of this Cost Accounting Standard is to establish criteria for the measurement and allocation of the cost of capital committed to facilities as an element of contract cost. Consistent application of these criteria will improve cost measurement by providing for allocation of cost of contractor investment in facilities capital to negotiated contracts.

9904.414-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Business unit* means any segment of an organization, or an entire business organization, which is not divided into segments.

(2) *Cost of capital committed to facilities* means an imputed cost determined by applying a cost of money rate to facilities capital.

(3) *Facilities capital* means the net book value of tangible capital assets and of those intangible capital assets that are subject to amortization.

(4) *Intangible capital asset* means an asset that has no physical substance, has more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the benefits it yields.

(5) *Tangible capital asset* means an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the services it yields.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.414-40 Fundamental requirement.

(a) A contractor's facilities capital shall be measured and allocated in accordance with the criteria set forth in this Standard. The allocated amount shall be used as a base to which a cost of money rate is applied.

(b) The cost of money rate shall be based on rates determined by the Secretary of the Treasury, pursuant to Public Law 92-41 (85 Stat. 97).

(c) The cost of capital committed to facilities shall be separately computed for each contract using facilities capital cost of money factors computed for each cost accounting period.

9904.414-50 Techniques for application.

(a) The investment base used in computing the cost of money for facilities capital shall be computed from accounting data used for contract cost purposes. The form and instructions stipulated in this Standard shall be used to make the computation.

(b) The cost of money rate for any cost accounting period shall be the arithmetic mean of the interest rates specified by the Secretary of the Treasury pursuant to Public Law 92-41 (85 Stat. 97). Where the cost of money must be determined on a prospective basis, the cost of money rate shall be based on the most recent available rate published by the Secretary of the Treasury.

(c)(1) A facilities capital cost of money factor shall be determined for each indirect cost pool to which a significant amount of facilities capital has been allocated and which is used to allocate indirect costs to final cost objectives.

(2) The facilities capital cost of money factor for an indirect cost pool shall be determined in accordance with Form CASB CMF, and its instructions which are set forth in Appendix A to 9904.414. One form will serve for all the indirect cost pools of a business unit.

(3) For each CAS-covered contract, the applicable cost of capital committed to facilities for a given cost accounting period is the sum of the products obtained by multiplying the amount of allocation base units (such as direct labor hours, or dollars of total cost

input) identified with the contract for the cost accounting period by the facilities capital cost of money factor for the corresponding indirect cost pool. In the case of process cost accounting systems, the contracting parties may agree to substitute an appropriate statistical measure for the allocation base units identified with the contract.

9904.414-60 Illustrations.

The use of Form CASB CMF and other computations anticipated for this Cost Accounting Standard are illustrated in the Appendix to 9904.414

9904.414-61 Interpretation. [Reserved]

9904.414-62 Exemption.

(a) For contractors who are not subject to full CAS-coverage as of the date of publication of this Part 99 as a final rule, this Standard

shall apply only to those fully-covered contracts with subsequent dates of award and pricing certification.

(b) This Standard shall not apply where compensation for the use of tangible capital assets is based on use rates or allowances provided for by other appropriate Federal procurement regulations such as those governing:

- (1) Educational institutions,
- (2) State, local, and Federally recognized Indian tribal governments, or
- (3) Construction equipment rates (see 48 CFR 31.105(d)).

9904.414-63 Effective date.

This Standard is effective as of April 17, 1992.

Appendix to Section 9904.414—Instructions for Form CASB CMF

Form CASB-CMF							
APPENDIX A							
FACILITIES CAPITAL							
COST OF MONEY FACTORS COMPUTATION							
CONTRACTOR:		ADDRESS:					
BUSINESS UNIT:							
COST ACCOUNTING PERIOD:	1. APPLICABLE COST OF MONEY RATE _____ %	2. ACCUMULATION & DIRECT DISTRIBUTION OF N.B.V.	3. ALLOCATION OF UNDISTRIBUTED	4. TOTAL NET BOOK VALUE	5. COST OF MONEY FOR THE COST ACCOUNTING PERIOD	6. ALLOCATION BASE FOR THE PERIOD	7. FACILITIES CAPITAL COST OF MONEY FACTORS
			BASIS OF ALLOCATION	COLUMNS 2 + 3	COLUMNS 1 x 4	IN UNIT(S) OF MEASURE	COLUMNS 5 + 6
BUSINESS UNIT FACILITIES CAPITAL	RECORDED						
	LEASED PROPERTY						
	CORPORATE OR GROUP TOTAL						
	UNDISTRIBUTED						
	DISTRIBUTED						
OVERHEAD POOLS							
G & A EXPENSE POOLS							
TOTAL						//////////	

Purpose

The purpose of this form is to (a) accumulate total facilities capital net book values allocated to each business unit for the contractor cost accounting period, and (b) convert those values to facilities capital cost of money factors applicable to each overhead or G&A expense allocation base employed within a business unit.

Basis

All data pertain to the cost accounting period for which the contractor prepares overhead and G&A expense allocations. The cost of money computations should be compatible with those allocation procedures. More specifically, facilities capital values used should be the same values that are used to generate depreciation or amortization that is allowed for Federal Government contract costing purposes; land which is integral to the regular operation of the business unit shall be included.

Applicable Cost of Money Rate (Col. 1)

Enter here the rate as computed in accordance with 9904.414-50(b)

Accumulation and Direct Distribution of Net Book Value (Col. 2)

Recorded, Leased Property, Corporate.

The net book value of facilities capital items in this column shall represent the average balances outstanding during the cost accounting period. This applies both to items that are subject to periodic depreciation or amortization and also to such items as land that are not subject to periodic write-offs. Unless there is a major fluctuation, it will be adequate to ascertain the net book value of these assets at the beginning and end of each cost accounting period, and to compute an average of those two sets of figures.

"Recorded" facilities are the facilities capital items owned by the contractor, carried on the books of the business unit, and used in its regular business activity. "Leased property" is the capitalized value of leases for which constructive costs of ownership are allowed in lieu of rental costs under Government procurement regulations. Corporate or group facilities are the business unit's allocable share of corporate-owned and leased facilities. The net book value of items of facilities capital which are held or controlled by the home office shall be allocated to the business unit on a basis consistent with the home office expense allocation.

Distributed and Undistributed.

All facilities capital items that are identified in the contractor's records as solely applicable to an organizational unit corresponding to a specific overhead, G&A or other indirect cost pool which is used to allocate indirect costs to final cost objectives, are listed against the applicable pools and are classified as "distributed."

"Undistributed" is the remainder of the business unit's facilities capital. The sum of "distributed" and "undistributed" must also correspond to the amount shown on the "total" line.

Allocation of Distributed.

List in the narrative column all the overhead and G&A expense pools to which "distributed" facilities capital items have been allocated. Enter the corresponding amounts in (Col. 2). The sum of all the amounts shown against specific overhead and G&A expense pools must correspond to the amount shown in the "distributed" line.

Allocation of Undistributed (Col. 3)

Business unit "undistributed" facilities are allocated to overhead and the G&A expense pools on any reasonable basis that approximates the actual absorption of depreciation or amortization of such facilities. For instance, the basis of allocation of undistributed assets in each business unit between; e.g., engineering overhead pool and the manufacturing overhead pool, should be related to the manner in which the expenses generated by these assets are allocated between the two overhead pools. Detailed analysis of this allocation is not required where essentially the same results can be obtained by other means. Where the cost accounting system for purposes of Government contract costing uses more than one "charging rate" for allocating indirect costs accumulated in a single cost pool, one representative base may be substituted for the multiplicity of bases used in the allocation process. The net book value of service center facilities capital items appropriately allocated should be included in this column. The sum of the entries in Column 3 is equal to the entry in the undistributed line, Column 2.

A supporting work sheet of this allocation should be prepared if there is more than one service center or other similar "intermediate" cost objective involved in the reallocation process.

Alternative Allocation Process—As an alternative to the above allocation process all the undistributed assets for one or more service centers or similar intermediate cost objectives may be allocated to the G&A expense pool. Consequently, the cost of money for these undistributed assets will be distributed to the final cost objectives on the same basis that is used to allocate G&A expense. This procedure may be adopted for any cost accounting period only when the contracting parties agree (a) that the depreciation or amortization generated by these undistributed assets is immaterial, or (b) that the results of this alternative procedure are not likely to differ materially from those which would be obtained under the "regular" allocation process described previously.

Total Net Book Value (Col. 4)

The sum of Columns 2 and 3. The total of this column should agree with the business unit's total shown in Column 2.

Cost of Money for the Cost Accounting Period (Col. 5)

Multiply the amounts in Column 4 by the percentage rate in Column 1.

Allocation Base for the Period (Col. 6)

Show here the total units of measure used to allocate overhead and G&A expense pools (e.g., direct labor dollars, machine hours, total cost input, etc.). Include service centers that make charges to final cost objectives. Each base unit-of-measure must be compatible with the bases used for applying overhead in the Federal Government contract cost computation. The total base unit of measure used for allocation in this column refers to all work done in an organizational unit associated with the indirect cost pool and not to Government work alone.

Facilities Capital Cost of Money Factors (Col. 7)

The quotients or cost of money for the cost accounting period (Col. 5) separately divided by the corresponding overhead or G&A expense allocation bases (Col. 6). Carry each computation to five decimal places. This factor represents the cost of money applicable to facilities capital allocated to each unit of measure of the overhead or G&A expense allocation base.

The Appendix to Section 9904.414—Example—ABC Corporation

ABC Corporation has a home office that controls three operating divisions (Business Units A, B & C). The home office includes an administrative computer center whose costs are allocated separately to the business units. The separate allocation conforms to the requirements specified in the Cost Accounting Standard No. 403. Tables I through VI deal with home office expense allocations to business units.

The A Division is a business unit as defined by the CASB, and it uses one engineering and one manufacturing overhead pool to accumulate costs for charging overhead to final cost objectives. In addition, the indirect cost allocation process also uses two "service centers" with their own indirect cost pools: occupancy and technical computer center.

The costs accumulated in the occupancy pool are allocated among manufacturing overhead, engineering overhead, and the technical computer center on the basis of floor space occupied. The

costs accumulated in the technical computer center cost pool are allocated to users on the basis of a CPU hourly rate. Some of these allocations are made to engineering or manufacturing overhead while others are allocated direct to final cost objectives.

At the business unit level, all the indirect expense incurred is regarded either as an engineering or manufacturing expense. Thus the sole item that enters into the business unit G&A expense pool is the allocation received by the A Division from the home office.

Operating results for the A Division are given in Table VII. Facilities capital items for the division are given in Table IX.

The example is based on a single set of illustrative contract cost data given in Table VIII. Since two methods, the "regular" and the "alternative" method, are potentially available for computing cost of money on facilities capital items two sets of different results can be considered.

Throughout the example, where appropriate, cross references have been made to the text of the relevant parts of the Standard.

VARIATION I-TOTAL COST INPUT ALLOCATION BASE EXCLUDES COST OF MONEY

TABLE I—Net book value of home office facilities capital

	Dec. 31, 1974	Dec. 31, 1975
Administrative computer center facilities capital	\$550,000	\$450,000
Other home office facilities capital	420,000	380,000
Total	970,000	830,000

The assets in the above table generate allowable depreciation or amortization, as explained in Instructions for Form CASB CMF (Basis). Thus they should be included in the asset base for cost of money computation.

TABLE II—Home office facilities capital annual average balances

Administrative computer center facilities capital	\$500,000
Other home office facilities capital	<u>400,000</u>
Total	900,000

The above averages are based on data in Table I computed in accordance with the criteria in Instructions for Form CASB CMF (Recorded, Leased Property, Corporate).
 $\$970,000 + \$830,000 = \$1,800,000 \div 2 = \$900,000$

TABLE III—Home office depreciation and amortization for 1975

Administrative computer center facilities capital	\$100,000
Other home office facilities capital	<u>40,000</u>
Total	140,000

TABLE IV—Allocation of ABC home office expenses to divisions (business units)

	Total expense	Allocation of business units		
		A	B	C
Administrative computer center	\$1,800,000	\$900,000	\$900,000	.....
Other home office	4,800,000	2,400,000	1,200,000	1,200,000
Total	6,600,000	3,300,000	2,100,000	1,200,000

The above allocation is carried out in accordance with CAS 403. The expense allocated to individual business units above includes depreciation and amortization as reflected in Table V.

TABLE V—Depreciation and amortization component of ABC home office expense

	Total depreciation and amortization expense	Allocation of business units		
		A	B	C
Administrative computer center	\$100,000	\$50,000	\$50,000	.....
Other home office	40,000	20,000	10,000	10,000
Total	140,000	70,000	60,000	10,000

TABLE VI—Allocation of home office facilities capital to business units
(a) Depreciation and amortization allocation in Table V converted to percentages

	Total depreciation and amortization (in percent)	Allocation of business units (in percent)		
		A	B	C
Administrative computer center	100	50	50	.....
Other home office	100	50	25	25

(b) Application of percentages in (a) to average net book values in Table II, in accordance with criteria in Instructions for Form CASB CMF (Recorded, Leased Property, Corporate).

	Total net book value	Allocation of business units		
		A	B	C
Administrative computer center facilities capital	\$500,000	\$250,000	\$250,000	.....
Other home office facilities capital	400,000	200,000	100,000	\$100,000
Total	900,000	450,000	350,000	\$100,000

TABLE VII "A" Division 1975 operating results

	Total cost input and other work G. & A.	Fixed Price CAS-covered contract	Cost reimbursement CAS-covered contracts	Commercial and other work
Direct material:				
Purchased parts	\$2,000,000	\$ 100,000	\$ 100,000	\$1,800,000
Subcontract items.....	21,530,000	11,750,000	7,205,000	2,575,000
Total.....	23,530,000	11,850,000	7,305,000	4,375,000
Direct labor and overhead:				
Engineering labor.....	2,000,000	1,500,000	500,000	.....
Engineering overhead (80 pct of direct engineering labor)	1,600,000	1,200,000	400,000	.....
Manufacturing labor	3,000,000	1,200,000	200,000	1,600,000
Manufacturing overhead (200 pct of direct management labor)	6,000,000	2,400,000	400,000	3,200,000
Other direct charges:				
Technical computer center direct charge 2,280 h at \$250/h	570,000	200,000	370,000	.....
Total cost input (excluding cost of money).....	36,700,000	18,350,000	9,175,000	9,175,000
G. & A. (8.99 pct of cost input)	3,300,000	1,650,000	825,000	825,000
Total	40,000,000	20,000,000	10,000,000	10,000,000

TABLE VIII—Cost data for the contract

Purchased parts	\$ 85,000
Subcontract items.....	990,000
Technical computer time 280 h at \$250/h.....	70,000
Engineering labor.....	330,000
Engineering overhead at 80 pct	264,000
Manufacturing labor	1,210,000
Manufacturing overhead at 200 pct.....	2,420,000
Total cost input (excluding cost of money)	<u>5,369,000</u>
G. & A. at 8.99 pct.....	<u>483,000</u>
Total cost input and G. & A. (excluding cost of money)	<u>5,852,000</u>

TABLE IX—Division A facilities capital

Average net book values are computed in accordance with Instructions to Form CASB CMF. Average figures only are given, the underlying beginning and ending balances for 1975 have not been reproduced.

Name of indirect cost pool the asset is associated with	Average net book value	Annual depreciation
Engineering overhead	\$ 320,000	\$ 40,000
Manufacturing overhead	4,500,000	900,000
Technical computer center	450,000	90,000
Occupancy	3,000,000	200,000
Facilities capital recorded by division A (see Form CASB CMF instructions for description of recorded)	8,270,000	1,230,000
Allocated from home office, table VI	450,000	.....
Total division A	8,720,000	.....

TABLE X—Allocation of undistributed facilities capital

(a) *Occupancy Pool Assets.* Total occupancy pool expenses are assumed to be \$1,000,000 of which \$200,000 is depreciation per Table IX. Allocation of the \$3,000,000 net book value of assets per Table IX is performed on the basis of floor space utilization.

Indirect cost pool	Occupancy expense and depreciation allocation	Percent of total floor space utilized	Asset Allocation
Engineering	\$ 200,000	20	\$ 600,000
Manufacturing	750,000	75	2,250,000
Technical computer	50,000	5	150,000
Total	1,000,000	100	3,000,000

(b) *Technical Computer Center Assets.* Total technical computer center expenses for the year are assumed to be \$770,000 including \$90,000 depreciation per Table IX and \$50,000 charge from the occupancy pool per paragraph (a) of this table. A charging rate of \$250 per hour is computed assuming a total of 3,080 chargeable CPU hours per annum. The net book value of assets amounting to \$600,000 (\$450,000 per Table IX plus the \$150,000 allocated per (a) above) is allocated on the basis of CPU hours utilized.

Overhead pool or cost objective	Hours charged	Amount charged	Percent	Asset Allocation
Fixed price contracts, table VII.....	800	\$ 200,000	26	\$ 156,000
Cost reimbursement contracts, Table VII	1,480	370,000	48	288,000
Engineering overhead pool	800	200,000	26	156,000
Total	3,080	770,000	100	600,000

(c) *Summary of Undistributed Facilities Capital Allocation.* Undistributed (per Table IX).

Technical computer center	\$ 450,000
Occupancy.....	3,000,000
Total.....	<u>3,450,000</u>

Distribution per paragraph (a) or (b) of this table of balances to overhead pools that result in charges direct to final cost objectives.

Overhead pool	(a)	(b)	Total
Engineering.....	\$ 600,000	\$ 156,000	\$ 756,000
Manufacturing.....	2,250,000	.....	2,250,000
Technical computer center (direct charge to contracts).....	.....	444,000	444,000
Total	2,850,000	600,000	3,450,000

TABLE XII FACILITIES CAPITAL COST OF MONEY FACTORS COMPUTATION ("Alternative" Method - Cost of Money Excluded from Total Cost Input)									
CONTRACTOR: ABC Corp.		ADDRESS:							
BUSINESS UNIT: A Division									
COST ACCOUNTING PERIOD: Y.E. 12/31/75		1. APPLICABLE COST OF MONEY RATE: 8%		2. ACCUMULATION & DIRECT DISTRIBUTION OF N.B.V.		3. ALLOCATION OF UNDISTRIBUTED		4. TOTAL NET BOOK VALUE	
BUSINESS UNIT FACILITIES CAPITAL	RECORDED	Table IX	8,270,000	BASIS OF ALLOCATION	COLUMNS 1 x 4	COLUMNS 2 + 3	COLUMNS 1 x 4	IN UNIT(S) OF MEASURE	FACILITIES CAPITAL COST OF MONEY FACTORS
	LEASED PROPERTY			All to G&A Expense Pool				Table VII	COLUMNS 5 + 6
CORPORATE OR GROUP TOTAL	UNDISTRIBUTED		450,000						
	DISTRIBUTED		8,720,000						
OVERHEAD POOLS	Engineering	Table IX	320,000			320,000	25,600	\$ 2,000,000	.0128
	Manufacturing	Table IX	4,500,000			4,500,000	360,000	\$ 3,000,000	.12
G & A EXPENSE POOLS	G & A Expense	Table VI	450,000	3,450,000	3,900,000	312,000		\$36,700,000	.00850
	TOTAL		5,270,000	3,450,000	8,720,000	697,600			//////////

**TABLE XIII—Summary of cost of money computation on facilities capital
(cost of money excluded from total cost input)**

Allocation base	Allocated to contract, table VIII	Computation using regular facilities, capital cost of money factor, table XI	Amount	Computation using alternative facilities capital, cost of money factor, table XI	Amount
Engineering labor.....	\$330,000	0.04304	\$14,203	0.0128	\$4,244
Manufacturing labor.....	\$1,210,000	.18	217,800	.12	145,200
Technical computer time.....	1 280	15.57895	4,362	.....	.....
Cost input.....	\$5,369,000	.00098	5,261	.00850	45,636
Total cost of money on facilities capital.....	.....	.....	241,626	.....	195,060

1 Hours.

VARIATION II-TOTAL COST INPUT ALLOCATION BASE INCLUDES COST OF MONEY

TABLE XIV—Recomputation of "A" division total cost input to reflect inclusion of cost of money

(a) Regular method:		
Total cost input per table VII		\$36,700,000
Cost of money applicable to facilities capital identified with overhead pools per subtotal in column 5, table XV		<u>661,600</u>
Total cost input including cost of money.....		37,361,600
(b) Alternative method:		
Total cost input per table VII		36,700,000
Cost of money applicable to facilities capital identified with overhead pools per subtotal in column 5, table XVI.....		<u>385,600</u>
Total cost input including cost of money.....		37,085,900

FORM CASB-CMF

<p align="center">TABLE XV FACILITIES CAPITAL COST OF MONEY FACTORS COMPUTATION ("Regular" Method - Cost of Money Included in Total Cost Input)</p>						
<p>CONTRACTOR: ABC Corp.</p>		<p>ADDRESS:</p>				
<p>BUSINESS UNIT: A Division</p>						
<p>COST ACCOUNTING PERIOD: Y.B. 12/31/75</p>		<p>1. APPLICABLE COST OF MONEY RATE <u>8</u> %</p>	<p>2. ACCUMULATION & DIRECT DISTRIBUTION OF N.B.V.</p>	<p>3. ALLOCATION OF UNDISTRIBUTED</p>	<p>4. TOTAL NET BOOK VALUE</p>	<p>5. COST OF MONEY FOR THE COST ACCOUNTING PERIOD</p>
<p>BUSINESS UNIT FACILITIES CAPITAL</p>	<p>RECORDED</p>	<p>Table IX</p>	<p>8,270,000</p>	<p>BASIS OF ALLOCATION</p>	<p>COLUMNS 2 + 3</p>	<p>COLUMNS 1 x 4</p>
	<p>LEASED PROPERTY</p>					
	<p>CORPORATE OR GROUP TOTAL</p>	<p>Table VI</p>	<p>450,000</p>	<p>Worksheet Table X</p>	<p>Table VII & Table XIV</p>	<p>COLUMNS 5 + 6</p>
	<p>UNDISTRIBUTED</p>		<p>8,720,000</p>			
	<p>DISTRIBUTED</p>		<p>3,450,000</p>			
			<p>5,270,000</p>			
<p>OVERHEAD POOLS</p>	<p>Engineering</p>	<p>Table IX</p>	<p>320,000</p>	<p>756,000</p>	<p>1,076,000</p>	<p>86,080</p>
	<p>Manufacturing</p>	<p>Table IX</p>	<p>4,500,000</p>	<p>2,250,000</p>	<p>6,750,000</p>	<p>540,000</p>
	<p>Technical Computer</p>			<p>444,000</p>	<p>444,000</p>	<p>35,520</p>
	<p>Subtotal: Cost of Money to be included in Total Cost Input</p>					<p>661,600</p>
<p>G & A EXPENSE POOLS</p>	<p>G & A Expense</p>	<p>Table VI</p>	<p>450,000</p>		<p>450,000</p>	<p>36,000</p>
<p>TOTAL</p>			<p>5,270,000</p>	<p>3,450,000</p>	<p>8,720,000</p>	<p>697,600</p>
						<p>04304</p>
						<p>.18</p>
						<p>15.57895</p>
						<p>00096</p>
						<p>//////////</p>

**TABLE XVII—Summary of cost of money computation on facilities capital
(cost of money included in total cost input – regular method)**

Allocation base	Allocated to contract, table VIII	Computation using regular facilities, capital cost of money factor, table XV	Amount
Engineering labor.....	\$ 330,000	0.04304	\$14,203
Manufacturing labor.....	1,210,000	.18	217,800
Technical computer time.....	1 280	15.57895	4,362
Cost of money related to overheads.....	.....	.....	236,365
Cost of money above to be included in cost input.....	\$ 236,365	.....	.....
Cost input, table VIII.....	\$5,369,000	.....	.....
Cost input including cost of money.....	\$5,605,365	.00096	5,381
Total cost of money on facilities capital.....	.....	.....	\$241,674

1 Hours.

**TABLE XVIII—Summary of cost of money computation on facilities capital
(cost of money included in total cost input – alternative method)**

Allocation base	Allocated to contract, table VIII	Computation using alternative facilities, capital cost of money factor, table XVI	Amount
Engineering labor.....	\$330,000	0.0128	\$4,224
Manufacturing labor.....	1,210,000	.12	145,200
Cost of money related to overheads.....	.....	.....	149,424
Cost of money above to be included in cost input.....	\$ 149,424	.....	.....
Cost input, table VIII.....	5,369,000	.....	.....
Cost input including cost of money.....	5,518,424	.00841	\$46,410
Total cost of money on facilities capital.....	\$5,518,424	.....	\$195,834

Subpart 9904.415—Accounting for the Cost of Deferred Compensation

9904.415-10 [Reserved]

9904.415-20 Purpose.

(a) The purpose of this Standard is to provide criteria for the measurement of the cost of deferred compensation and the assignment of such cost to cost accounting periods. The application of these criteria should increase the probability that the cost of deferred compensation is allocated to cost objectives in a uniform and consistent manner.

(b) This Standard is applicable to the cost of all deferred compensation except for compensated personal absence and pension plan costs which are covered in other Cost Accounting Standards.

9904.415-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Deferred compensation* means an award made by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one more cost accounting periods prior to the date of the receipt of compensation by the employee. This definition shall not include the amount of year end accruals for salaries, wages, or bonuses that are to be paid within a reasonable period of time after the end of a cost accounting period.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.415-40 Fundamental requirement.

(a) The cost of deferred compensation shall be assigned to the cost accounting period in which the contractor incurs an obligation to compensate the employee. In the event no obligation is incurred prior to payment, the cost of deferred compensation shall be the amount paid and shall be assigned to the cost accounting period in which the payment is made.

(b) The measurement of the amount of the cost of deferred compensation shall be the present value of the future benefits to be paid by the contractor.

(c) The cost of each award of deferred compensation shall be considered separately for purposes of measurement and assignment of such costs to cost accounting periods. However, if the cost of deferred compensation for the employees covered by a deferred compensation plan can be measured with reasonable accuracy on a group basis, separate computations for each employee are not required.

9904.415-50 Techniques for application.

(a) The contractor shall be deemed to have incurred an obligation for the cost of deferred compensation when all of the following conditions have been met. However, for awards which require that the employee perform future service in order to receive the benefits, the obligation is deemed to have been incurred as the future service is performed for that part of the award attributable to such future service:

(1) There is a requirement to make the future payment(s) which the contractor cannot unilaterally avoid.

(2) The deferred compensation award is to be satisfied by a future payment of money, other assets, or shares of stock of the contractor.

(3) The amount of the future payment can be measured with reasonable accuracy.

(4) The recipient of the award is known.

(5) If the terms of the award require that certain events must occur before an employee is entitled to receive the benefits, there is a reasonable probability that such events will occur.

(6) For stock options, there must be a reasonable probability that the options ultimately will be exercised.

(b) If any of the conditions in 9904.415-50(a) is not met, the cost of deferred compensation shall be assignable only to the cost accounting period or periods in which the compensation is paid to the employee.

(c) If the cost of deferred compensation can be estimated with reasonable accuracy on a group basis, including consideration of probable forfeitures, such estimate may be used as the basis for measuring and assigning the present value of future benefits.

(d) The following provisions are applicable for plans that meet the conditions of 9904.415-50(a) and the compensation is to be paid in money.

(1) If the deferred compensation award provides that the amount to be paid shall include the principal of the award plus interest at a rate fixed at the date of award, such interest shall be included in the computation of the amount of the future benefit. If no interest is included in the award, the amount of the future benefit is the amount of the award.

(2) If the deferred compensation award provides for payment of principal plus interest at a rate not fixed at the time of award but based on a specified index which is determinable in each applicable cost accounting period; e.g., a published corporate bond rate, such interest shall be included in the computation of the amount of future benefit. The interest rate to be used shall be the rate in effect at the close of the period in which the cost of deferred compensation is assignable. Since that interest rate is likely to vary from the actual rates in future periods, adjustments shall be made in any such future period in which the variation in rates materially affects the cost of deferred compensation.

(3) If the deferred compensation award provides for payment of principal plus interest at a rate not based on a specified index, or not determinable in each applicable year, the—

(i) Cost of deferred compensation for the principal of the award shall be measured by the present value of the future benefits of the principal, and shall be assigned to the cost accounting period in which the employer incurs an obligation to compensate the employee; and

(ii) Interest on such awards shall be assigned to the cost accounting period(s) in which the payment of the deferred compensation is made.

(4) If the terms of the award require that the employee perform future service in order to receive benefits, the cost of the deferred compensation shall be appropriately assigned to the periods of current and future service based on the facts and circumstances of the award. The cost of deferred compensation for each cost accounting period shall be the present value of the future benefits of the

deferred compensation calculated as of the end of each such period to which such cost is assigned.

(5) In computing the present value of the future benefits, the discount rate shall be equal to the interest rate as determined by the Secretary of the Treasury pursuant to Public Law 92-41, 85 Stat. 97, at the time the cost is assignable.

(6) If the award is made under a plan which requires irrevocable funding for payment to the employee in a future cost accounting period together with all interest earned thereon, the amount assignable to the period of award shall be the amount irrevocably funded.

(7) In computing the assignable cost for a cost accounting period, any forfeitures which reduce the employer's obligation for payment of deferred compensation shall be a reduction of contract costs in the period in which the forfeiture occurred. The amount of the reduction for a forfeiture shall be the amount of the award that was assigned to a prior period, plus interest compounded annually, using the same Treasury rate that was used as the discount rate at the time the cost was assigned. For irrevocably funded plans, pursuant to 9904.415-50(d)(6), the amount of the reduction for a forfeiture shall be the amount initially funded plus or minus a pro-rata share of the gains and losses of the fund.

(8) If the cost of deferred compensation for group plans measured in accordance with 9904.415-50(c) is determined to be greater than the amounts initially assigned because the forfeiture was overestimated, the additional cost shall be assignable to the cost accounting period in which such cost is ascertainable.

(e) The following provisions are applicable for plans that meet the conditions of 9904.415-50(a) and the compensation is received by the employee in other than money. The measurements set forth herein constitute the present value of future benefits for awards made in other than money and, therefore, shall be deemed to be a reasonable measure of the amount of the future payment:

(1) If the award is made in the stock of the contractor, the cost of deferred compensation for such awards shall be based on the market value of the stock on the measurement date; i.e., the first date the number of shares awarded is known. Market value is the current or prevailing price of the security as indicated by market quotations. If such values are unavailable or not appropriate (thin market, volatile price movements, etc.) an acceptable alternative is the fair value of the stock.

(2) If an award is made in the form of options to employees to purchase stock of the contractor, the cost of deferred compensation of such award shall be the amount by which the market value of the stock exceeds the option price multiplied by the number of shares awarded on the measurement date; i.e., the first date on which both the option price and the number of shares is known. If the option price on the measurement date is equal to or greater than the market value of the stock, no cost shall be deemed to have been incurred for contract costing purposes.

(3) If the terms of an award of stock or stock option require that the employee perform future service in order to receive the stock or to exercise the option, the cost of the deferred compensation shall be appropriately assigned to the periods of current and future service based on the facts and circumstances of the award. The cost to be assigned shall be the value of the stock or stock option at the measurement date as prescribed in 9904.415-50(e)(1) or (e)(2).

(4) If an award is made in the form of an asset other than cash, the cost of deferred compensation for such award shall be based on

the market value of the asset at the time the award is made. If a market value is not available, the fair value of the asset shall be used.

(5) If the terms of an award, made in the form of an asset other than cash, require that the employee perform future service in order to receive the asset, the cost of the deferred compensation shall be appropriately assigned to the periods of current and future service based on the facts and circumstances of the award. The cost to be assigned shall be the value of the asset at the time of award as prescribed in 9904.415-50(e)(4).

(6) In computing the assignable cost for a cost accounting period, any forfeitures which reduce the employer's obligation for payment of deferred compensation shall be a reduction of contract costs in the period in which the forfeiture occurred. The amount of the reduction shall be equal to the amount of the award that was assigned to a prior period, plus interest compounded annually, using the Treasury rate (see 9904.415-50(d)(5)) that was in effect at the time the cost was assigned. If the recipient of the award of stock options voluntarily fails to exercise such options, such failure shall not constitute a forfeiture under provisions of this Standard.

(7) Stock option awards or any other form of stock purchase plans containing all of the following characteristics shall be considered noncompensatory and not covered by this Standard:

(i) Substantially all full-time employees meeting limited employment qualifications may participate.

(ii) Stock is offered equally to eligible employees or based on a uniform percentage of salary or wages.

(iii) An option or a purchase right must be exercisable within a reasonable period.

(iv) The discount from the market price of the stock is no greater than would be reasonable in an offer of stock to stockholders or others.

9904.415-60 Illustrations.

(a) Contractor A has a deferred compensation plan in which all cash awards are increased each year by an interest factor equivalent to the long-term borrowing rate of the contractor prevailing during each such year. The interest factor based on a variable of 9904.415-50(d)(2). Consequently, the cost of deferred compensation for Contractor A shall be measured by the present value of the future benefits and shall be assigned to the cost accounting period in which the contractor initially incurs an obligation to compensate the employee. If the long-term borrowing rate for Contractor A was 9 percent at the close of the period to which the cost of deferred compensation was assignable, then that rate should be used to calculate the future benefit. Any adjustment in the cost of deferred compensation which results from a material change in the 9 percent rate in future applicable periods shall be made in each such future period or periods (see 9904.415-50(d)(2)).

(b) Contractor B made a deferred compensation award of \$10,000 to an employee on December 31, 1976, for services performed in 1976 to be paid in equal annual payments of \$2,000 starting at December 31, 1981. The terms of the award do not provide for an interest factor to be included in the payment; consequently, according to provisions of 9904.415-50(d)(1), interest may not be included in the computation of the future benefit. The assignable cost for 1976 is computed as follows, assuming that the interest rate determined by the Secretary of the Treasury pursuant to Public Law

92-41, 85 Stat. 97, at the time of the award is 8 percent and the conditions set forth in 9904.415-50(a) are met.

Year	Amount of future payment x Discount rate 8-pct present value factor = Present value
1981.....	\$2,000 x .6805 = \$1,361
1982.....	2,000 x .6301 = 1,260
1983.....	2,000 x .5834 = 1,167
1984.....	2,000 x .5402 = 1,080
1985.....	<u>2,000 x .5002 = 1,000</u>
Assignable Cost for 1976	\$5,868

(c) Contractor C awarded stock options for 1,000 shares of the contractor to key employees on December 31, 1976, under a deferred compensation plan requiring 2 years of additional service before the awards can be exercised. The facts and circumstances of the awards indicate that the deferred compensation applies only to the periods of future service. The market price of the stock was \$26 per share, the option price was \$22, and the interest rate established by the Secretary of the Treasury in effect at the time of award was 8 percent.

(1) In accordance with 9904.415-50(e)(2), the cost of the stock options is the amount by which the current value of the stock exceeds the option price multiplied by the number of shares awarded on the measurement date. Thus, the total cost of the stock options is 1,000 shares multiplied by the difference of the option price and the market price (\$26 - 22) or \$4,000.

(2) Under provisions of 9904.415-50(e)(3), the cost for stock options is assigned to each future cost accounting period in which employee service is required and is computed as follows:

Year of required service:	Assignable Cost (Note 1)
1977	\$2,000
1978	<u>2,000</u>
Total amount of award.	\$4,000

Note 1 - Note that this illustration assumes that the facts and circumstances of the award indicate that the award relates equally to each period of future service. Thus, the assignable cost was allocated on a pro-rata basis.

(d)(1) Contractor D has a deferred compensation plan that specifies that an employee receiving a cash award must remain with the company for 3 calendar years after the award in order to qualify and receive the award and the facts and circumstances indicate that the deferred compensation applies only to the periods of future service. In accordance with 9904.415-5-(d)(4), the cost of deferred compensation is assignable to the periods of future service. Thus, the amount of cost of deferred compensation to be assigned by Contractor D for each of the 3 years shall be the present value of the future benefits of the deferred compensation award calculated as of the end of each such period to which such cost is assigned.

(2) Under this plan, Contractor D made an award to an employee of \$3,000 to be paid at the end of the third year. The assignable cost for each of the 3 years is computed as follows:

Year (Note 1)	Amount of future payment	Present value factor (Note 2) Treasury rate (Note 3)	Assignable cost for each year
1	\$1,000	x 0.8573 (8 pct for 2 yr) =	\$857.30
2	1,000	x 0.9302 (7.5 pct for 1 yr) =	930.20
3	1,000	x 1.000 (8 pct for 0 yr) =	1,000.00

NOTE 1 - Note that in accordance with the facts and circumstances of the award no deferred compensation is assignable to the period in which the award is made and that the award relates equally to each period of future service.

NOTE 2 - Note that since the costs are measured at the end of each year of required service, the present value factors are based on the number of years from the year of assignment to the date of payment.

NOTE 3 - Note that the prevailing Treasury rate changed from year 1 to year 2.

(e)(1) Contractor E has a deferred compensation plan that specifies that an employee receiving a cash award must remain with the company for 2 calendar years after the award in order to qualify and receive the award. Contractor E made an award of \$6,000 at the end of 1976 to an employee to be paid at the end of 1978.

(2) According to provisions of 9904.415-50(d)(7), the amount of the forfeiture shall be the amount of the cost that was assigned to a prior period, plus interest compounded annually, from the year the cost was assigned to the year of forfeiture, using the same Treasury rate (see 9904.415-50(d)(5)) that was used as the discount rate at the time the cost was assigned. The IRS rate in effect at the date of award was 8 percent.

9904.415-61 Interpretation. [Reserved]

9904.415-62 Exemption.

None for this Standard.

9904.415-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

9904.416 Accounting for insurance costs.

9904.416-10 [Reserved]

9904.416-20 Purpose.

The purpose of this standard is to provide criteria for the measurement of insurance costs, the assignment of such costs to cost accounting periods, and their allocation to cost objectives. The application of these criteria should increase the probability that insurance costs are allocated to cost objectives in a uniform and consistent manner.

However, the employee voluntarily terminated his employment before the end of 1977. The facts and circumstances of the award indicate that \$2,000 of the award represents compensation for services rendered in the period of award (1976). The remaining portion of the award represents compensation for services to be rendered in future periods. The assignable cost for 1976, which was the only period to which costs were assigned before termination, was the present value of \$2,000, the amount of the award attributable to the services of that period. Thus, the cost assigned for 1976 was:

Amount of future payment x Discount rate present value factor for

2 yr at 8 pct = Assignable cost $\$2,000 \times 0.8573 = \$1,714.60$

(3) The amount of the forfeiture is computed as follows:

Assignable cost x Discount rate future value for 1 yr at 8 pct = Forfeiture $\$1,714.60 \times 1.08 = \$1,851.77$

9904.416-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Actual cash value* means the cost of replacing damaged property with other property of like kind and quality in the physical condition of the property immediately prior to the damage.

(2) *Insurance administration expenses* means the contractor's costs of administering an insurance program, e.g., the costs of operating an insurance or risk-management department, processing claims, actuarial fees, and service fee paid to insurance companies, trustees, or technical consultants.

(3) *Projected average loss* means the estimated long-term average loss per period for periods of comparable exposure to risk of loss.

(4) *Self-insurance* means the assumption or retention of the risk or loss by the contractor, whether voluntarily or involuntarily. Self-insurance includes the deductible portion of purchased insurance.

(5) *Self-insurance charge* means a cost which represents the projected average loss under a self-insurance plan.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.416-40 Fundamental requirement.

(a) The amount of insurance cost to be assigned to a cost accounting period is the projected average loss for that period plus insurance administration expenses in that period.

(b) The allocation of insurance costs to cost objectives shall be based on the beneficial or causal relationship between the insurance costs and the benefiting or causing cost objectives.

9904.416-50 Techniques for application.

(a) *Measurement of projected average loss.* (1) For exposure to risk of loss which is covered by the purchase of insurance or by payments to a trustee fund, the premium or payment, adjusted in accordance with the following criteria, shall represent the projected average loss:

(i) The premium cost applicable to a given policy term shall be assigned pro rata among the cost accounting periods covered by the policy term, except as provided in subdivisions (a)(1)(ii) through (vi) of this subsection. A refund, dividend or additional assessment shall become an adjustment to the pro rata premium costs for the earliest cost accounting period in which the refund or dividend is actually or constructively received or in which the additional assessment is payable.

(ii) Where insurance is purchased specifically for, and directly allocated to, a single final cost objective, the premium need not be prorated among cost accounting periods.

(iii) Any part of a premium or payment to an insurer or trustee, or any part of a dividend or premium refund retained by an insurer or trustee which would be includable as a deposit in published financial statements prepared in accordance with generally accepted accounting principles shall be accounted for as a deposit for the purpose of determining insurance costs.

(iv) Any part of a premium or payment to an insurer or to a trustee, or any part of a dividend or premium refund retained by an insurer, for inclusion in a reserve or fund established and maintained on behalf of the insured or the policyholder or trustor, shall be accounted for as a deposit unless the following conditions are met:

(A) The objectives of the reserve or fund are clearly stated in writing.

(B) Measurement of the amount required for the reserve or fund is actuarially determined and is consistent with the objectives of the reserve or fund.

(C) Payments and additions to the reserve or fund are made in a systematic and consistent manner.

(D) If payments to accomplish the stated objectives of the reserve or fund are made from a source other than the reserve or fund, the payments into the reserve or fund are reduced accordingly.

(v) If an objective of an insurance program is to prefund insurance coverage on retired persons, then, in addition to the requirements imposed by subdivision (a)(1)(iv) of this subsection, the:

(A) Payments must be made to an insurer or trustee to establish and maintain a fund or reserve for that purpose;

(B) Policyholder or trustor must have no right of recapture of the reserve or fund so long as any active or retired participant in the program remains alive, unless the interests of such remaining participants are satisfied through adequate reinsurance or otherwise; and

(C) Amount added to the reserve or fund in any cost accounting period must not be greater than an amount which would be required to apportion the cost of the insurance coverage fairly over the working lives of the active employees in the plan. If a contractor establishes a terminal-funded plan for retired persons or converts from a

pay-as-you-go plan to a terminal-funded plan, the actuarial present value of benefits applicable to employees already retired shall be amortized over a period of 15 years.

(vi) The contractor may adopt and consistently follow a practice of determining insurance costs based on the estimated premium and assessments net of estimated refunds and dividends. If this practice is adopted, then any difference between an estimated and actual refund, dividend, or assessment shall become an adjustment to the pro rata net premium costs for the earliest cost accounting period in which the refund or dividend is actually or constructively received or in which the additional assessment is payable.

(2) For exposure to risk of loss which is not covered by the purchase of insurance or by payments to a trustee fund, the contractor shall follow a program of self-insurance accounting according to the following criteria:

(i) Except as provided in subdivisions (a)(2)(ii) and (iii) of this subsection, actual losses shall not become a part of insurance costs. Instead, the contractor shall make a self-insurance charge for each period for each type of self-insured risk which shall represent the projected average loss for that period. If insurance could be purchased against the self-insured risk, the cost of such insurance may be used as an estimate of the projected average loss; if this method is used, the self-insurance charge plus insurance administration expenses may be equal to, but shall not exceed, the cost of comparable purchased insurance plus the associated insurance administration expenses. However, the contractor's actual loss experience shall be evaluated regularly, and self-insurance charges for subsequent periods shall reflect such experience in the same manner as would purchased insurance. If insurance could not be purchased against the self-insured risk, the amount of the self-insurance charge for each period shall be based on the contractor's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

(ii) Where it is probable that the actual amount of losses which will occur in a cost accounting period will not differ significantly from the projected average loss for that period, the actual amount of losses in that period may be considered to represent the projected average loss for that period in lieu of a self-insurance charge.

(iii) Under self-insurance programs for retired persons, only actual losses shall be considered to represent the projected average loss unless a reserve or fund is established in accordance with 9904.416-50(a)(1)(v).

(iv) The self-insurance charge shall be determined in a manner which will give appropriate recognition to any indemnification agreement which exists between the contracting parties.

(3) In measuring actual losses under subparagraph (a)(2) of this subsection:

- (i) The amount of a loss shall be measured by:
 - (A) the actual cash value of property destroyed,
 - (B) amounts paid or accrued to repair damage,
 - (C) amounts paid or accrued to estates and beneficiaries, and
 - (D) amounts paid or accrued to compensate claimants, including subrogation.

Where the amount of a loss which is represented by a liability to a third party is uncertain, the estimate of the loss shall be the amount which would be includable as an accrued liability in financial statements prepared in accordance with generally accepted accounting principles.

(ii) If a loss has been incurred and the amount of the liability to a claimant is fixed or reasonably certain, but actual payment of the liability will not take place for more than 1 year after the loss is incurred, the amount of the loss to be recognized currently shall be the present value of the future payments, determined by using a discount rate equal to the interest rate as determined by the Secretary of the Treasury pursuant to Public Law 92-41, 85 Stat. 97, in effect at the time the loss is recognized. Alternatively, where settlement will consist of a series of payments over an indefinite time period, as in workmen's compensation, the contractor may follow a consistent policy of recognizing only the actual amounts paid in the period of payment.

(4) The contractor may elect to recognize immaterial amounts of self-insured losses or insurance administration expenses as part of other expense categories rather than as "insurance costs."

(b) *Allocation of insurance costs.* (1) Where actual losses are recognized as an estimate of the projected average loss, in accordance with 9904.416-50(a)(2), or where actual loss experience is determined for the purpose of developing self-insurance charges by segment, a loss which is incurred in a given segment shall be identified with that segment. However, if the contractor's home office is, in effect, a reinsurer of its segments against catastrophic losses, a portion of such catastrophic losses shall be allocated to, or identified with, the home office.

(2) Insurance costs shall be allocated on the basis of the factors used to determine the premium, assessment, refund, dividend, or self-insurance charge, except that insurance costs incurred by a segment or allocated to a segment from a home office may be combined with costs of other indirect cost pools if the resultant allocation to each final cost objective is substantially the same as it would have been if separately allocated under this provision.

(3) Insurance administration expenses which are material in relation to total insurance costs shall be allocated on the same basis as the related premium costs or self-insurance charge.

(c) *Records.* The contractor shall maintain such records as may be necessary to substantiate the amounts of premiums, refunds, dividends, losses, and self-insurance charges, paid or accrued, and the measurement and allocation of insurance costs. Memorandum records may be used to reflect any material differences between insurance costs as determined in accordance with this standard and as includable in financial statements prepared in accordance with generally accepted accounting principles.

9904.416-60 Illustrations.

(a) Contractor A pays a company-wide property and casualty insurance premium for the policy term July 1, 1980, to July 1, 1983, and includes the entire amount as cost in its cost accounting period which ended December 31, 1980. This is a violation of 9904.416-50(a)(1)(i) in that only one-sixth of the policy term fell within the cost accounting period which ended December 31, 1980, and therefore only one-sixth of the premium should have been included in cost in that cost accounting period.

(b) Contractor B has a retrospectively rated worker's compensation insurance program. The policy term corresponds with the contractor's cost accounting period. Premium refunds are normally received and applied in the following cost accounting period. The contractor's practice is to include the entire gross premium in insurance cost in the cost accounting period in which it is paid and to credit the refund against insurance cost in the cost accounting

period in which it is received. This practice conforms with 9904.416-50(a)(1)(i). The contractor could also, under the provisions of 9904.416-50(a)(1)(vi), have followed a consistent practice of estimating such refunds in advance and including the estimated net premium in insurance cost.

(c) Contractor C establishes a self-insured program of life insurance for active and retired persons. The contractor pays death benefits directly to the beneficiaries of deceased employees and includes such payments in insurance costs at the time of payment. This practice complies with 9904.416-50(a)(2)(iii) which requires that only the actual losses be recognized unless a trustee reserve or fund is established in accordance with 9904.416-50(a)(1)(v).

(d) Instead of paying death benefits directly, contractor D purchases annual group term life insurance on active and retired persons and charges the premiums to insurance costs (with proper recognition for refunds and dividends). Contractor D's retired persons wish to be protected against possible discontinuance of the program. Contractor D, therefore, establishes a trustee fund. As each employee retires, contractor D deposits in the fund an amount which is equal to the premium on a paid-up policy for that employee, and he advises the trustee that the fund is to be used to continue to pay premiums on retired persons in the event the program is discontinued. The contractor also continues to purchase group term insurance on both active employees and retired persons and charges both the premiums and the deposits to insurance costs. This practice does not comply with 9904.416-50(a)(1)(iv)(D) which requires that if payments to accomplish the stated objectives of the reserve or funds are made from a source other than the reserve or fund, the payments into the fund shall be reduced accordingly.

NOTE: In this instance the contractor could comply with the standard by paying from the fund that portion of the group term premium which represented the retired persons or by reducing the deposits to the fund by an equivalent amount in accordance with 9904.416-50(a)(1)(iv)(D). This practice would also comply with the requirement of 9904.416-50(a)(1)(v)(C) that the amount added to the fund not be greater than an amount which would be required to fairly allocate the cost over the working lives of the active employees in the plan.

(e) Contractor E wishes to provide assurance of his life insurance program continuance to both active and retired employees. He establishes a trustee fund in accordance with 9904.416-50(a)(1)(iv) and (v) and thereafter pays into the fund each year for each active employee an actuarially determined amount which will accumulate to the equivalent of the premium on a paid-up life insurance policy at retirement. He charges the annual payments to insurance costs. Benefits are paid directly from the fund (or the fund is used to pay the annual premiums on group term life insurance for all employees). This practice also complies with the requirement of 9904.416-50(a)(1)(v)(C) that the amount added to the fund not be greater than an amount which would be required to fairly allocate the cost over the working lives of the active employees in the plan.

(f) Contractor F has a fire insurance policy which provides that the first \$50,000 of any fire loss will be borne by the contractor. Because the risk of loss is dispersed among many physical units of property and the average potential loss per unit is relatively low, the actual losses in any period may be expected not to differ significantly from the projected average loss. Therefore, the contractor

intends to let the actual losses represent the projected average loss for this exposure to risk. Property with an actual cash value of \$80,000 is destroyed in a fire. The contractor charges the \$50,000 of the loss not covered by the policy to insurance costs for contract costing purposes. The practice complies with the requirement of 9904.416-50(a)(2). However, had the contractor's plan been to make a self-insurance charge for such losses, then any difference between the self-insurance charge and actual losses in that cost accounting period would not have been allocable as an insurance cost.

(g) Contractor G is preparing to enter into a Government contract to produce explosive devices. The contractor is unable to purchase adequate insurance protection and must act as a self-insurer. There is a significant possibility of a major loss, against which the Government will not undertake to indemnify the contractor. The contractor, therefore, intends to make a self-insurance charge for this exposure to risk. The contractor may, in accordance with 9904.416-50(a)(2)(i), use data obtained from other contractors or any other reasonable method of estimating the projected average loss in order to determine the self-insurance charge.

(h) Contractor H purchases liability insurance for all of its motor vehicles in a single, company-wide policy which contains a \$50,000 deductible provision. However, the company's management policy provides that when a loss is incurred in a segment, only the first \$5,000 of the loss will be charged to the segment; the balance of the loss will be absorbed at the home-office level and reallocated among all segments. Because the risk of loss is dispersed among many physical units and the maximum potential loss per occurrence is limited, the actual losses in any cost accounting period may be expected not to differ significantly from the projected average loss. Therefore, the contractor intends to let the actual losses represent the projected average loss for this exposure to risk. An analysis of the loss experience shows that many past losses exceeded \$5,000. Contractor H's practice of allocating the loss in excess of \$5,000 to the home office is a violation of 9904.416-50(b)(1). The limit of \$5,000 cannot realistically be considered a measure of a "catastrophic" loss when losses frequently exceed this amount, and the use of a limit this low would obscure segment loss experience.

9904.416-61 Interpretation. [Reserved]

9904.416-62 Exemption.

None for this Standard.

9904.416-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

Subpart 9904.417—Cost of Money as an Element of the Cost of Capital Assets Under Construction

9904.417-10 [Reserved]

9904.417-20 Purpose.

The purpose of this Cost Accounting Standard is to establish criteria for the measurement of the cost of money attributable to capital assets under construction, fabrication, or development as an element of the cost of those assets. Consistent application of these criteria will improve cost measurement by providing for recognition of cost of contractor investment in assets under construction, and will provide greater uniformity in accounting for asset acquisition costs.

9904.417-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Intangible capital asset* means an asset that has no physical substance, has more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the benefits it yields.

(2) *Tangible capital asset* means an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the services it yields.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.417-40 Fundamental requirement.

The cost of money applicable to the investment in tangible and intangible capital assets being constructed, fabricated, or developed for a contractor's own use shall be included in the capitalized acquisition cost of such assets.

9904.417-50 Techniques for application.

(a) The cost of money for an asset shall be calculated as follows:

(1) The cost of money rate used shall be based on interest rates determined by the Secretary of the Treasury pursuant to Public Law 92-41 (85 Stat. 97).

(2) A representative investment amount shall be determined each cost accounting period for each capital asset being constructed, fabricated, or developed giving appropriate consideration to the rate at which costs of construction are incurred.

(3) Other methods for calculating the cost of money to be capitalized, such as the method used for financial accounting and reporting, may be used, provided the resulting amount does not differ materially from the amount calculated by use of paragraphs (a)(1) and (2) of this subsection.

(b) If substantially all the activities necessary to get the asset ready for its intended use are discontinued, cost of money shall not be capitalized for the period of discontinuance. However, if such discontinuance arises out of causes beyond the control and without the fault or negligence of the contractor, cessation of cost of money capitalization is not required.

9904.417-60 Illustrations.

(a) A contractor decided to build a major addition to his plant using both his own labor and outside subcontractors. It took 13 months to complete the building. The first 10 months of the construction period were in one cost accounting period. At the end of the cost accounting period the total charges, including cost of money computed in accordance with 9904.414, accumulated in the construction-in-progress account for this project amounted to

\$750,000. However, most of these construction costs were incurred towards the end of the cost accounting period. In developing a method for determining a representative investment amount, appropriate consideration must be given to the rate at which costs have been incurred in accordance with 9904.417-50(a)(2). Therefore, the contractor averaged the 10 month-end balances and determined that the average investment in the project was \$245,000. Two cost of money rates were in effect during the 10-month period; their time-weighted average was determined to be 8.6 percent. Application of the 8.6 percent rate for ten-twelfths of a year to the representative balance of \$245,000 resulted in the determination that \$17,558 should be added to the construction-in-progress account in recognition of the cost of money related to this project in its first cost accounting period. The project was completed with the addition of \$750,000 of additional costs during the first 3 months of the subsequent cost accounting period. The contractor considered the 3 month-end balances (which included the \$17,558 capitalized cost of money described in the preceding paragraph) and determined that the representative balance was \$1,234,000. The cost of money rate in effect during this 3-month period was 7.75 percent. Applying the rate of 7.75 percent for one-fourth of a year to the balance of \$1,234,000 resulted in a determination that \$23,909 should be added to the construction-in-progress account in recognition of the cost of money while under construction in the second cost accounting period. The capitalized project was put into service at the recognized cost of acquisition of \$1,541,467 which consists of the "regular" costs of \$1,500,000 plus \$17,558 and \$23,909 cost of money. This practice is in accordance with 9904.417-50(a) and other applicable provisions of the Standard.

NOTE: An alternative technique would be to make separate calculations, using an appropriate investment amount and cost of money rate, for each month. The sum of the monthly cost of money amounts could be entered in the construction-in-progress account once each cost accounting period.

(b) A contractor built a major addition with identical basic data to those described in 9904.417-60(a) except that the costs were incurred at a fairly uniform rate throughout the period. Because of the pattern of cost incurrence, the contractor used beginning and ending balances of the cost accounting period to find the representative amounts. For the first cost accounting period the representative investment amount was the average of the beginning and ending balances (zero and \$750,000), or \$375,000. Application of the average interest rate of 8.6 percent for ten-twelfths of a year resulted in the determination that \$26,875 should be added to the construction-in-progress account in recognition of the cost of money related to this project in its first cost accounting period. During the subsequent 3 months the contractor used the representative balance of \$1,151,875, derived by averaging the beginning balance of \$776,875 (\$750,000 "regular" cost plus the \$26,875 imputed cost from the prior period) and the balance at the end, \$1,526,875. Applying the 7.75 percent cost of money rate to this balance for a 3-month period resulted in a determination that \$22,317 should be added to the construction-in-progress account in recognition of the cost of money while under construction in the second cost accounting period. The capitalized project was put into service at the recognized cost of acquisition of \$1,549,192 which consists of the "regular" costs of \$1,500,000 plus \$26,875 and \$22,317 imputed

cost of money. This practice is in accordance with 9904.417-50(a) and other applicable provisions of the Standard.

NOTE: If this contractor, acting in accordance with established Standards for financial accounting, allocated a portion of its paid interest expense to this construction project and the resultant acquisition cost for financial reporting purposes was not materially different from \$1,549,192, the contractor could, in accordance with 9904.417-50(a)(iii), use the same acquisition cost for contract costing purposes.

9904.417-61 Interpretation. [Reserved]

9904.417-62 Exemption.

None for this Standard.

9904.417-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's next full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

Subpart 9904.418—Allocation of Direct and Indirect Costs

9904.418-10 [Reserved]

9904.418-20 Purpose.

The purpose of this Cost Accounting Standard is to provide for consistent determination of direct and indirect costs; to provide criteria for the accumulation of indirect costs, including service center and overhead costs, in indirect cost pools; and, to provide guidance relating to the selection of allocation measures based on the beneficial or causal relationship between an indirect cost pool and cost objectives.

Consistent application of these criteria and guidance will improve classification of costs as direct and indirect and the allocation of indirect costs.

9904.418-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Allocate* means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Direct cost* means any cost which is identified specifically with a particular final cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.

(3) *Indirect cost* means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

(4) *Indirect cost pool* means a grouping of incurred costs identified with two or more cost objectives but not identified specifically with any final cost objective.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.418-40 Fundamental requirements.

(a) A business unit shall have a written statement of accounting policies and practices for classifying costs as direct or indirect which shall be consistently applied.

(b) Indirect costs shall be accumulated in indirect cost pools which are homogeneous.

(c) Pooled costs shall be allocated to cost objectives in reasonable proportion to the beneficial or causal relationship of the pooled costs to cost objectives as follows:

(1) If a material amount of the costs included in a cost pool are costs of management or supervision of activities involving direct labor or direct material costs, resource consumption cannot be specifically identified with cost objectives. In that circumstance, a base shall be used which is representative of the activity being managed or supervised.

(2) If the cost pool does not contain a material amount of the costs of management or supervision of activities involving direct labor or direct material costs, resource consumption can be specifically identified with cost objectives. The pooled cost shall be allocated based on the specific identifiability of resource consumption with cost objectives by means of one of the following allocation bases:

- (i) A resource consumption measure,
- (ii) An output measure, or
- (iii) A surrogate that is representative of resources consumed.

The base shall be selected in accordance with the criteria set out in 9904.418-50(e).

(d) To the extent that any cost allocations are required by the provisions of other Cost Accounting Standards, such allocations are not subject to the provisions of this Standard.

(e) This Standard does not cover accounting for the costs of special facilities where such costs are accounted for in separate indirect cost pools.

9904.418-50 Techniques for application.

(a) *Determination of direct cost and indirect cost.* (1) The business unit's written policy classifying costs as direct or indirect shall be in conformity with the requirements of this Standard.

(2) In accounting for direct costs a business unit shall use actual costs, except that—

- (i) Standard costs for material and labor may be used as provided in 9904.407; or
- (ii) An average cost or pre-established rate for labor may be used provided that

(A) The functions performed are not materially disparate and employees involved are interchangeable with respect to the functions performed, or

(B) The functions performed are materially disparate but the employees involved either all work in a single production unit yielding homogeneous outputs, or perform their respective functions as an integral team. Whenever average cost or preestablished rates for labor are used, the variances, if material, shall be disposed of at least annually by allocation to cost objectives in proportion to the costs previously allocated to these cost objectives.

(3) Labor or material costs identified specifically with one of the particular cost objectives listed in paragraph (d)(3) of this subsection shall be accounted for as direct labor or direct material costs.

(b) *Homogeneous indirect cost pools.* (1) An indirect cost pool is homogeneous if each significant activity whose costs are included therein has the same or a similar beneficial or causal relationship to cost objectives as the other activities whose costs are included in the cost pool. It is also homogeneous if the allocation of the costs of the activities included in the cost pool result in an allocation to cost objectives which is not materially different from the allocation that would result if the costs of the activities were allocated separately.

(2) An indirect cost pool is not homogeneous if the costs of all significant activities in the cost pool do not have the same or a similar beneficial or causal relationship to cost objectives and, if the costs were allocated separately, the resulting allocation would be materially different. The determination of materiality shall be made using the criteria provided in 9903.305.

(3) A homogeneous indirect cost pool shall include all indirect costs identified with the activity to which the pool relates.

(c) *Change in Allocation Base.* No change in an existing indirect cost pool allocation base is required if the allocation resulting from the existing base does not differ materially from the allocation that results from the use of the base determined to be most appropriate in accordance with the criteria set forth in paragraphs (d) and (e) of this subsection. The determination of materiality shall be made using the criteria provided in Subpart 9903.305.

(d) Allocation measures for an indirect cost pool which includes a material amount of the costs of management or supervision of activities involving direct labor or direct material costs. (1) The costs of the management or supervision of activities involving direct labor or direct material costs do not have a direct and definitive relationship to the benefiting cost objectives and cannot be allocated on measures of a specific beneficial or causal relationship. In that circumstance, the base selected to measure the allocation of the pooled costs to cost objectives shall be a base representative of the activity being managed or supervised.

(2) The base used to represent the activity being managed or supervised shall be determined by the application of the criteria below. All significant elements of the selected base shall be included.

(i) A direct labor hour base or direct labor cost base shall be used, whichever in the aggregate is more likely to vary in proportion to the costs included in the cost pool being allocated, except that:

(ii) A machine-hour base is appropriate if the costs in the cost pool are comprised predominantly of facility-related costs, such as depreciation, maintenance, and utilities; or

(iii) A units-of-production base is appropriate if there is common production of comparable units; or

(iv) A material cost base is appropriate if the activity being managed or supervised is a material-related activity.

(3) Indirect cost pools which include material amounts of the costs of management or supervision of activities involving direct labor or direct material costs shall be allocated to:

(i) Final cost objectives;

(ii) Goods produced for stock or product inventory;

(iii) Independent research and development and bid and proposal projects;

(iv) Cost centers used to accumulate costs identified with a process cost system (i.e., process cost centers);

(v) Goods or services produced or acquired for other segments of the contractor and for other cost objectives of a business unit; and

(vi) Self-construction, fabrication, betterment, improvement, or installation of tangible capital assets.

(e) Allocation measures for indirect cost pools that do not include material amounts of the costs of management or supervision of activities involving direct labor or direct material costs. Homogeneous indirect cost pools of this type have a direct and definitive relationship between the activities in the pool and benefiting cost objectives. The pooled costs shall be allocated using an appropriate measure of resource consumption. This determination shall be made in accordance with the following criteria taking into consideration the individual circumstances:

(1) The best representation of the beneficial or causal relationship between an indirect cost pool and the benefiting cost objectives is a measure of resource consumption of the activities of the indirect cost pool.

(2)(i) If consumption measures are unavailable or impractical to ascertain, the next best representation of the beneficial or causal relationship for allocation is a measure of the output of the activities of the indirect cost pool. Thus, the output is substituted for a direct measure of the consumption of resources.

(ii) The use of the basic unit of output will not reflect the proportional consumption of resources in circumstances in which the level of resource consumption varies among the units of output produced. Where a material difference will result, either the output measure shall be modified or more than one output measure shall be used to reflect the resources consumed to perform the activity.

(3) If neither resources consumed nor output of the activities can be measured practically, a surrogate that varies in proportion to the services received shall be used to measure the resources consumed. Generally, such surrogates measure the activity of the cost objectives receiving the service.

(4) Allocation of indirect cost pools which benefit one another may be accomplished by use of:

(i) The cross-allocation (reciprocal) method,

(ii) The sequential method, or

(iii) Another method the results of which approximate those achieved by either of the methods in subdivisions (e)(4)(i) or (e)(4)(ii) of this subsection.

(5) Where the activities represented by an indirect cost pool provide services to two or more cost objectives simultaneously, the cost of such services shall be prorated between or among the cost objectives in reasonable proportion to the beneficial or causal relationship between the services and the cost objectives.

(f) Special allocation. Where a particular cost objective in relation to other cost objectives receives significantly more or less benefit from an indirect cost pool than would be reflected by the allocation of such costs using a base determined pursuant to paragraphs (d) and (e) of this subsection, the Government and contractor may agree to a special allocation from that indirect cost pool to the particular cost objective commensurate with the benefits

received. The amount of a special allocation to any such cost objective made pursuant to such an agreement shall be excluded from the indirect cost pool and the particular cost objective's allocation base data shall be excluded from the base used to allocate the pool.

(g) Use of preestablished rates for indirect costs. (1) Preestablished rates, based on either forecasted actual or standard cost, may be used in allocating an indirect cost pool.

(2) Preestablished rates shall reflect the costs and activities anticipated for the cost accounting period except as provided in paragraph (g)(3) of this subsection. Such preestablished rates shall be reviewed at least annually, and revised as necessary to reflect the anticipated conditions.

(3) The contracting parties may agree on preestablished rates which are not based on costs and activities anticipated for a cost accounting period. The contractor shall have and consistently apply written policies for the establishment of these rates.

(4) Under paragraphs (g)(2) and (3) of this subsection where variances of a cost accounting period are material, these variances shall be disposed of by allocating them to cost objectives in proportion to the costs previously allocated to these cost objectives by use of the preestablished rates.

(5) If preestablished rates are revised during a cost accounting period and if the variances accumulated to the time of the revision are significant, the costs allocated to that time shall be adjusted to the amounts which would have been allocated using the revised preestablished rates.

9904.418-60 Illustrations.

(a) Business Unit A has various classifications of engineers whose time is spent in working directly on the production of the goods or services called for by contracts and other final cost objectives. In keeping with its written policy, detailed time records are kept of the hours worked by these engineers, showing the job/account numbers representing various cost objectives. On the basis of these detailed time records, Unit A allocates the labor costs of these engineers as direct labor costs of final cost objectives. This practice is in accordance with the requirements of 9904.418-50(a)(1).

(b) Business Unit B has a fabrication department, employees of which perform various functions on units of the work-in-process of multiple final cost objectives. These employees are grouped by labor skills and are interchangeable within the skill grouping. The average wage rate for each group is multiplied by the hours worked on each cost objective by employees in that group. The contractor classifies these costs as direct labor costs of each final cost objective. This cost accounting treatment is in accordance with the provisions of 9904.418-50(a)(2)(ii)(B).

(c) Business Unit C accumulates the costs relating to building ownership, maintenance, and utility into one indirect cost pool designated "Occupancy Costs" for allocation to cost objectives. Each of these activities has the same or a similar beneficial or causal relationship to the cost objectives occupying a space. Unit C's practice is in conformance with the provisions of 9904.418-50(b)(1).

(d) Business Unit D includes the indirect costs of machining and assembling activities in a single manufacturing overhead pool. The machining activity does not have the same or similar beneficial or causal relationship to cost objectives as the assembling activity. Also, the allocation of the cost of the machining activity to cost

objectives would be significantly different if allocated separately from the costs of the assembling activity. Unit D's single manufacturing overhead pool is not homogeneous in accordance with the provisions of 9904.418-50(b), and separate pools must be established in accordance with 9904.418-40(b).

(e) In accordance with 9904.418-50(b)(3), Business Unit E includes all the cost of occupancy in an indirect cost pool. In selecting an allocation measure for this indirect cost pool, the contractor establishes that it is impractical to ascertain a measurement of the consumption of resources in relation to the use of facilities by individual cost objectives. An output base, the number of square feet of space provided to users, can be measured practically; however, the cost to provide facilities is significantly different for various types of facilities such as warehouse, factory, and office and each type of facility requires a different level of resource consumption to provide the same number of square feet of usable space. Allocation on a basic unit measure of square feet of space occupied will not adequately reflect the proportional consumption of resources. Unit E establishes a weighted square foot measure for allocating occupancy costs, which reflects the different levels of resource consumption required to provide the different types of facilities. This practice is in conformance with provisions of 9904.418-50(e)(2)(ii).

(f) Business Unit F has an indirect cost pool containing a significant amount of material-related costs. The contractor allocates these costs between his machining overhead cost pool and his assembly overhead cost pool. The business unit finds it impractical to use an allocation measure based on either consumption or output. The business unit selects a dollars of material-issued base which varies in proportion to the services rendered. The dollars of material-issued base is a surrogate base which conforms to the provisions of 9904.418-50(e)(3).

(g) Business Unit G has a machining activity for which it develops a separate overhead rate, using direct labor cost as the allocation base. The machining activity occasionally does significant amounts of work for other activities of the business unit. The labor used in doing the work for other activities is of the same nature as that used for contract work. However, the machining labor for other activities is not included in the base used to allocate the overhead costs of the machining activity. This practice is not in conformance with 9904.418-50(d)(2). Unit G must include the cost of labor doing work for the other activities in the allocation base for the machining activity indirect cost pool.

(h) Business Unit H accounts for the costs of company aircraft in a separate homogeneous indirect cost pool and allocates the cost to benefiting cost objectives using flight hours. Unit H prorates the cost of a single flight between benefiting cost objectives whenever simultaneous services have been rendered. Manager of Contract 2 learns of the trip and goes along with Manager of Contract 1. Unit H prorates the cost of the trip between Contract 1 and Contract 2. This practice is in conformance with the provision of 9904.418-50(e)(5).

(i) During a cost accounting period, Business Unit I allocates the cost of its flight services indirect cost pool to other indirect cost pools and final cost objectives using a preestablished rate. The preestablished rate is based on an estimate of the actual costs and activity for the cost accounting period. For the cost accounting period, Unit I establishes a rate of \$200 per hour for use of the flight services activity. In March, the contractor's operating environment

changes significantly; the contractor now expects a significant increase in the cost of this activity during the remainder of the year. Unit I estimates the rate for the entire cost accounting period to be \$240 an hour. Pursuant to the provisions of 9904.418-50(g)(4), the Business Unit may revise its rate to the expected \$240 an hour. If the accumulated variances are significant, the business unit must also adjust the costs previously allocated to reflect the revised rates.

9904.418-61 Interpretation. [Reserved]

9904.418-62 Exemptions.

This standard shall not apply to contracts and grants with state, local, and Federally recognized Indian tribal governments.

9904.418-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's second full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

9904.419 [Reserved]

Subpart 9904.420—Accounting for Independent Research and Development Costs and Bid and Proposal Costs

9904.420-10 [Reserved]

9904.420-20 Purpose.

The purpose of this Cost Accounting Standard is to provide criteria for the accumulation of independent research and development costs and bid and proposal costs and for the allocation of such costs to cost objectives based on the beneficial or causal relationship between such costs and cost objectives. Consistent application of these criteria will improve cost allocation.

9904.420-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Allocate* means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Bid and proposal (B&P) cost* means the cost incurred in preparing, submitting, or supporting any bid or proposal which effort is neither sponsored by a grant, nor required in the performance of a contract.

(3) *Business unit* means any segment of an organization, or an entire business organization which is not divided into segments.

(4) *General and administrative (G&A) expense* means any management, financial, and other expenses which is incurred by or allocated to a business unit and which is for the general management and administration of the business unit as a whole. G&A expense does not include those management expenses whose beneficial or causal relationship to cost objectives can be more directly measured by a base other than a cost input base representing the total activity of a business unit during a cost accounting period.

(5) *Home office* means an office responsible for directing or managing two or more, but not necessarily all, segments of an organization. It typically establishes policy for, and provides guidance to the segments in their operations. It usually performs management, supervisory, or administrative functions, and may also perform service functions in support of the operations of the various segments. An organization which has intermediate levels, such as groups, may have several home offices which report to a common home office. An intermediate organization may be both a segment and a home office.

(6) *Independent research and development* means the cost of effort which is neither sponsored by a grant, nor required in the performance of a contract, and which falls within any of the following three areas:

- (i) Basic and applied research,
- (ii) Development, and
- (iii) Systems and other concept formulation studies.

(7) *Indirect cost* means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

(8) *Segment* means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. The term includes Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the organization has less than a majority of ownership, but over which it exercises control.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9904.420-40 Fundamental requirement.

(a) The basic unit for the identification and accumulation of Independent Research and Development (IR&D) and Bid and Proposal (B&P) costs shall be the individual IR&D or B&P project.

(b) The IR&D and B&P project costs shall consist of all allocable costs, except business unit general and administrative expenses.

(c) The IR&D and B&P cost pools consist of all IR&D and B&P project costs and other allocable costs, except business unit general and administrative expenses.

(d) The IR&D and B&P cost pools of a home office shall be allocated to segments on the basis of the beneficial or causal relationship between the IR&D and B&P costs and the segments reporting to that home office.

(e) The IR&D and B&P cost pools of a business unit shall be allocated to the final cost objectives of that business unit on the basis of the beneficial or causal relationship between the IR&D and B&P costs and the final cost objectives.

(f)(1) The B&P costs incurred in a cost accounting period shall not be assigned to any other cost accounting period.

(2) The IR&D costs incurred in a cost accounting period shall not be assigned to any other cost accounting period, except as may be permitted pursuant to provisions of existing laws, regulations, and other controlling factors.

9904.420-50 Techniques for application.

(a) The IR&D and B&P project costs shall include (1) costs, which if incurred in like circumstances for a final cost objective, would be treated as direct costs of that final cost objective, and (2) the overhead costs of productive activities and other indirect costs related to the project based on the contractor's cost accounting practice or applicable Cost Accounting Standards for allocation of indirect costs.

(b) The IR&D and B&P cost pools for a segment consist of the project costs plus allocable home office IR&D and B&P costs.

(c) When the costs of individual IR&D or B&P efforts are not material in amount, these costs may be accumulated in one or more project(s) within each of these two types of effort.

(d) The costs of any work performed by one segment for another segment shall not be treated as IR&D costs or B&P costs of the performing segment unless the work is a part of an IR&D or B&P project of the performing segment. If such work is part of a performing segment's IR&D or B&P project, the project will be transferred to the home office to be allocated in accordance with paragraph (e) of this subsection.

(e) The costs of IR&D and B&P projects accumulated at a home office shall be allocated to its segments as follows:

(1) Projects which can be identified with a specific segment(s) shall have their costs allocated to such segment(s).

(2) The costs of all other IR&D and B&P projects shall be allocated among all segments by means of the same base used by the company to allocate its residual expenses in accordance with 9904.403; provided, however, where a particular segment receives significantly more or less benefit from the IR&D or B&P costs than would be reflected by the allocation of such costs to the segment by that base, the Government and the contractor may agree to a special allocation of the IR&D or B&P costs to such segment commensurate with the benefits received. The amount of a special allocation to any segment made pursuant to such an agreement shall be excluded from the IR&D and B&P cost pools to be allocated to other segments and the base data of any such segment shall be excluded from the base used to allocate these pools.

(f) The costs of IR&D and B&P projects accumulated at a business unit shall be allocated to cost objectives as follows:

(1) Where costs of any IR&D or B&P project benefit more than one segment of the organization, the amounts to be allocated to each segment shall be determined in accordance with paragraph (e) of this subsection.

(2) The IR&D and B&P cost pools which are not allocated under subparagraph (f)(1) of this subsection, shall be allocated to all final cost objectives of the business unit by means of the same base used by the business unit to allocate its general and administrative expenses in accordance with 9904.410-50; provided, however, where a particular final cost objective receives significantly more or less benefit from IR&D or B&P costs than would be reflected by the allocation of such costs the Government and the contractor may agree to a special allocation of the IR&D or B&P costs to such final cost objective commensurate with the benefits received. The amount of special allocation to any such final cost objective made pursuant to such an agreement shall be excluded from the IR&D and B&P cost pools to be allocated to other final cost objectives and the particular final cost objective's base data shall be excluded from the base used to allocate these pools.

(g) Notwithstanding the provisions of paragraphs (d), (e) or (f) of this subsection, the costs of IR&D and B&P projects allocable to a home office pursuant to 9904.420-50(d) may be allocated directly to the receiving segments, provided that such allocation not be substantially different from the allocation that would be made if they were first passed through home office accounts.

9904.420-60 Illustrations.

(a) Business Unit A's engineering department in accordance with its established accounting practice, charges administrative effort including typing to its overhead cost pool. In submitting a proposal, the engineering department assigns several typists to the proposal project on a full time basis and charges the typists' time directly to the proposal project, rather than to its overhead pool. Because the engineering department under its established accounting practice does not charge the cost of typing directly to final cost objectives, the direct charge does not meet with the requirements of 9904.420-50(a).

(b) Company B has five segments. The company undertakes an IR&D project which is part of the IR&D plans of segments X, Y, and Z, and will be of general benefit to all five segments. The company designates Segment Z as the project leader in performing the project. In accumulating the costs, each segment allocates overhead to its part of the project but does not allocate segment G&A. The IR&D costs are then allocated to the home office by each segment. The costs are combined with other IR&D costs that benefit the company as a whole. The costs are allocated to all five segments by means of the same base by which the company allocates its residual home office expense costs to all segments. This practice meets the requirements of 9904.420-40(b), 9904.420-50(e)(2), and 9904.420-50(f)(1).

(c) Business Unit C normally accounts for its B&P effort by individual project. It accumulates directly allocated costs and departmental overhead costs by project. The business unit also submits large numbers of bids and proposals whose individual costs of preparation are not material in amount. The business unit collects the cost of these efforts under a single project. Since the cost of preparing each individual bid and proposal is not material, the practice of accumulating these costs in a single project meets the requirements of 9904.420-50(c).

(d) Segment D requests that Segment Y provide support for a Segment D IR&D project. The work being performed by Segment Y is similar in nature to Segment Y's normal product and is not part of its annual IR&D plan. Segment Y allocates to the project all costs it allocates to other final cost objectives, including G&A expense. Segment Y then directly transfers the cost of the project to Segment D in accordance with its normal intersegment transfer procedure. This accounting treatment meets the requirements of 9904.420-50(d) and 9904.410.

(e)(1) Contractor E has six operating segments and a research segment. The research segment performs work under

- (i) Research and development contracts,
- (ii) Projects which are not part of its own IR&D plan but are specifically in support of other segments' IR&D projects, and
- (iii) IR&D projects for the benefit of the company as a whole.

(2) The research segment directly allocates the cost of the projects in support of another segment's IR&D projects, including an allocation of its general and administrative expenses, to the

receiving segment. This practice meets the requirements of 9904.420-50(d).

(3) The costs of the IR&D projects which benefit the company as a whole exclude any allocation of the research segment's general and administrative expenses and are transferred to the home office. The home office allocates these costs on the same base it uses to allocate its residual expenses to all seven segments. This practice meets the requirements of 9904.420-50(e)(2) and (f)(1).

(f) Company F accumulates at the home office the costs of IR&D and B&P projects which generally benefit all segments of the company except Segment X. The company and the contracting officer agree that the nature of the business activity of Segment X is such that the home office IR&D and B&P effort is neither caused by nor provides any benefit to that segment. For the purpose of allocating its home office residual expenses, the company uses a base as provided in 9904.403. For the purpose of allocating the home office IR&D and B&P costs, the company removes the data of Segment X from the base used for the allocation of its residual expenses. This practice meets the requirements of 9904.420-50(e)(2).

(g) Company G has 10 segments. Segment X performs IR&D projects, the results of which benefit it and two other segments but none of the other seven segments. The cost of those projects performed by Segment X are transferred to the home office and allocated to the three segments on the basis of the benefits received by the three segments. This practice meets the requirements of 9904.420-50(e)(1) and 9904.420-50(f)(1).

9904.420-61 Interpretation. [Reserved]

9904.420-62 Exemptions.

This Standard shall not apply to contracts and grants with state, local, and Federally recognized Indian tribal governments.

9904.420-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to which this Standard is applicable. For contractors with no previous contracts subject to this Standard, this Standard shall be applied beginning with the contractor's second full fiscal year beginning after the receipt of a contract to which this Standard is applicable.

PART 9905—COST ACCOUNTING STANDARDS FOR EDUCATIONAL INSTITUTIONS

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- 9905.502-10 [Reserved]
- 9905.502-20 Purpose.
- 9905.502-30 Definitions.
- 9905.502-40 Fundamental requirement.
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- 9905.502-63 Effective date.

Subparts 9905.503—9905.504 [Reserved]

Subpart 9905.505—Accounting for Unallowable Costs—Educational Institutions

- 9905.505-10 [Reserved]
- 9905.505-20 Purpose.
- 9905.505-30 Definitions.
- 9905.505-40 Fundamental requirement.
- 9905.505-50 Techniques for application.
- 9905.505-60 Illustrations.
- 9905.505-61 Interpretation. [Reserved]
- 9905.505-62 Exemption.
- 9905.505-63 Effective date.

Subpart 9905.506—Cost Accounting Period—Educational Institutions

- 9905.506-10 [Reserved]
- 9905.506-20 Purpose.
- 9905.506-30 Definitions.
- 9905.506-40 Fundamental requirement.
- 9905.506-50 Techniques for application.
- 9905.506-60 Illustrations.
- 9905.506-61 Interpretation. [Reserved]
- 9905.506-62 Exemption.
- 9905.506-63 Effective date.

AUTHORITY: Public Law 100-679, 102 Stat. 4056, 41 U.S.C. 422.

Subpart 9905.501—Cost Accounting Standard—Consistency in Estimating, Accumulating and Reporting Costs by Educational Institutions

9905.501-10 [Reserved]

9905.501-20 Purpose.

The purpose of this Cost Accounting Standard is to ensure that each educational institution's practices used in estimating costs for a proposal are consistent with cost accounting practices used by the institution in accumulating and reporting costs. Consistency in the application of cost accounting practices is necessary to enhance the likelihood that comparable transactions are treated alike. With respect to individual contracts, the consistent application of cost accounting practices will facilitate the preparation of reliable cost estimates used in pricing a proposal and their comparison with the costs of performance of the resulting contract. Such comparisons provide one important basis for financial control over costs during

contract performance and aid in establishing accountability for costs in the manner agreed to by both parties at the time of contracting. The comparisons also provide an improved basis for evaluating estimating capabilities.

9905.501-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection requires otherwise.

(1) *Accumulating costs* means the collecting of cost data in an organized manner, such as through a system of accounts.

(2) *Actual cost* means an amount determined on the basis of cost incurred (as distinguished from forecasted cost), including standard cost properly adjusted for applicable variance.

(3) *Estimating costs* means the process of forecasting a future result in terms of cost, based upon information available at the time.

(4) *Indirect cost pool* means a grouping of incurred costs identified with two or more objectives but not identified specifically with any final cost objective.

(5) *Pricing* means the process of establishing the amount or amounts to be paid in return for goods or services.

(6) *Proposal* means any offer or other submission used as a basis for pricing a contract, contract modification or termination settlement or for securing payments thereunder.

(7) *Reporting costs* means the providing of cost information to others.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9905.501-40 Fundamental requirement.

(a) An educational institution's practices used in estimating costs in pricing a proposal shall be consistent with the institution's cost accounting practices used in accumulating and reporting costs.

(b) An educational institution's cost accounting practices used in accumulating and reporting actual costs for a contract shall be consistent with the institution's practices used in estimating costs in pricing the related proposal.

(c) The grouping of homogeneous costs in estimates prepared for proposal purposes shall not *per se* be deemed an inconsistent application of cost accounting practices under paragraphs (a) and (b) of this subsection when such costs are accumulated and reported in greater detail on an actual cost basis during contract performance.

9905.501-50 Techniques for application.

(a) The standard allows grouping of homogeneous costs in order to cover those cases where it is not practicable to estimate contract costs by individual cost element. However, costs estimated for proposal purposes shall be presented in such a manner and in such detail that any significant cost can be compared with the actual cost accumulated and reported therefor. In any event, the cost accounting practices used in estimating costs in pricing a proposal and in accumulating and reporting costs on the resulting contract shall be consistent with respect to:

- (1) The classification of elements of cost as direct or indirect;
- (2) The indirect cost pools to which each element of cost is charged or proposed to be charged; and
- (3) The methods of allocating indirect costs to the contract.

(b) Adherence to the requirement of 9905.501-40(a) of this standard shall be determined as of the date of award of the contract, unless the contractor has submitted cost or pricing data pursuant to 10 U.S.C. 2306(a) or 41 U.S.C. 254(d) (Pub. L. 87-653), in which case adherence to the requirement of 9905.501-40(a) shall be determined as of the date of final agreement on price, as shown on the signed certificate of current cost or pricing data. Notwithstanding 9905.501-40(b), changes in established cost accounting practices during contract performance may be made in accordance with Part 9903 (48 CFR part 9903).

(c) The standard does not prescribe the amount of detail required in accumulating and reporting costs. The basic requirement which must be met, however, is that for any significant amount of estimated cost, the contractor must be able to accumulate and report actual cost at a level which permits sufficient and meaningful comparison with its estimates. The amount of detail required may vary considerably depending on how the proposed costs were estimated, the data presented in justification or lack thereof, and the significance of each situation. Accordingly, it is neither appropriate nor practical to prescribe a single set of accounting practices which would be consistent in all situations with the practices of estimating costs. Therefore, the amount of accounting and statistical detail to be required and maintained in accounting for estimated costs has been and continues to be a matter to be decided by Government procurement authorities on the basis of the individual facts and circumstances.

9905.501-60 Illustration. [Reserved]

9905.501-61 Interpretation. [Reserved]

9905.501-62 Exemption.

None for this Standard.

9905.501-63 Effective date.

This Standard is effective as of January 9, 1995.

9905.502 Cost Accounting Standard—Consistency in Allocating Costs Incurred for the Same Purpose by Educational Institutions

9905.502-10 [Reserved]

9905.502-20 Purpose.

The purpose of this Standard is to require that each type of cost is allocated only once and on only one basis to any contract or other cost objective. The criteria for determining the allocation of costs to a contract or other cost objective should be the same for all similar objectives. Adherence to these cost accounting concepts is necessary to guard against the overcharging of some cost objectives and to prevent double counting. Double counting occurs most commonly when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools which are allocated to that cost objective.

9905.502-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b), below, requires otherwise.

(1) *Allocate* means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both

direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Cost objective* means a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

(3) *Direct cost* means any cost which is identified specifically with a particular final cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the educational institution are direct costs of those cost objectives.

(4) *Final cost objective* means a cost objective which has allocated to it both direct and indirect costs, and in the educational institution's accumulation system, is one of the final accumulation points.

(5) *Indirect cost* means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

(6) *Indirect cost pool* means a grouping of incurred costs identified with two or more cost objectives but not identified with any final cost objective.

(7) *Intermediate cost objective* means a cost objective that is used to accumulate indirect costs or service center costs that are subsequently allocated to one or more indirect cost pools and/or final cost objectives.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9905.502-40 Fundamental requirement.

All costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives. No final cost objective shall have allocated to it as an indirect cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective. Further, no final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that or any other final cost objective.

9905.502-50 Techniques for application.

(a) The Fundamental Requirement is stated in terms of cost incurred and is equally applicable to estimates of costs to be incurred as used in contract proposals.

(b) The Disclosure Statement to be submitted by the educational institution will require that the institution set forth its cost accounting practices with regard to the distinction between direct and indirect costs. In addition, for those types of cost which are sometimes accounted for as direct and sometimes accounted for as indirect, the educational institution will set forth in its Disclosure Statement the specific criteria and circumstances for making such distinctions. In essence, the Disclosure Statement submitted by the educational institution, by distinguishing between direct and indirect costs, and by describing the criteria and circumstances for allocating those items which are sometimes direct and sometimes indirect, will be determinative as to whether or not costs are incurred for the same purpose. Disclosure Statement as used herein refers to the statement

required to be submitted by educational institutions as a condition of contracting as set forth in Subpart 9903.2.

(c) In the event that an educational institution has not submitted a Disclosure Statement, the determination of whether specific costs are directly allocable to contracts shall be based upon the educational institution's cost accounting practices used at the time of contract proposal.

(d) Whenever costs which serve the same purpose cannot equitably be indirectly allocated to one or more final cost objectives in accordance with the educational institution's disclosed accounting practices, the educational institution may either use a method for reassigning all such costs which would provide an equitable distribution to all final cost objectives, or directly assign all such costs to final cost objectives with which they are specifically identified. In the event the educational institution decides to make a change for either purpose, the Disclosure Statement shall be amended to reflect the revised accounting practices involved.

(e) Any direct cost of minor dollar amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives, provided that such treatment produces results which are substantially the same as the results which would have been obtained if such cost had been treated as a direct cost.

9905.502-60 Illustrations.

(a) Illustrations of costs which are incurred for the same purpose:

(1) An educational institution normally allocates all travel as an indirect cost and previously disclosed this accounting practice to the Government. For purposes of a new proposal, the educational institution intends to allocate the travel costs of personnel whose time is accounted for as direct labor directly to the contract. Since travel costs of personnel whose time is accounted for as direct labor working on other contracts are costs which are incurred for the same purpose, these costs may no longer be included within indirect cost pools for purposes of allocation to any covered Government contract. The educational institution's Disclosure Statement must be amended for the proposed changes in accounting practices.

(2) An educational institution normally allocates purchasing activity costs indirectly and allocates this cost to instruction and research on the basis of modified total costs. A proposal for a new contract requires a disproportionate amount of subcontract administration to be performed by the purchasing activity. The educational institution prefers to continue to allocate purchasing activity costs indirectly. In order to equitably allocate the total purchasing activity costs, the educational institution may use a method for allocating all such costs which would provide an equitable distribution to all applicable indirect cost pools. For example, the institution may use the number of transactions processed rather than its former allocation base of modified total costs. The educational institution's Disclosure Statement must be amended for the proposed changes in accounting practices.

(b) Illustrations of costs which are not incurred for the same purpose:

(1) An educational institution normally allocates special test equipment costs directly to contracts. The costs of general purpose test equipment are normally included in the indirect cost pool which is allocated to contracts. Both of these accounting practices were

previously disclosed to the Government. Since both types of costs involved were not incurred for the same purpose in accordance with the criteria set forth in the educational institution's Disclosure Statement, the allocation of general purpose test equipment costs from the indirect cost pool to the contract, in addition to the directly allocated special test equipment costs, is not considered a violation of the Standard.

(2) An educational institution proposes to perform a contract which will require three firemen on 24-hour duty at a fixed-post to provide protection against damage to highly inflammable materials used on the contract. The educational institution presently has a firefighting force of 10 employees for general protection of its facilities. The educational institution's costs for these latter firemen are treated as indirect costs and allocated to all contracts; however, it wants to allocate the three fixed-post firemen directly to the particular contract requiring them and also allocate a portion of the cost of the general firefighting force to the same contract. The institution may do so but only on condition that its disclosed practices indicate that the costs of the separate classes of firemen serve different purposes and that it is the institution's practice to allocate the general firefighting force indirectly and to allocate fixed-post firemen directly.

9905.502-61 Interpretation.

(a) 9905.502, Cost Accounting Standard—Consistency in Allocating Costs Incurred for the Same Purpose by Educational Institutions, provides, in 9905.502-40, that " * * * no final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that or any other final cost objective."

(b) This interpretation deals with the way 9905.502 applies to the treatment of costs incurred in preparing, submitting, and supporting proposals. In essence, it is addressed to whether or not, under the Standard, all such costs are incurred for the same purpose, in like circumstances.

(c) Under 9905.502, costs incurred in preparing, submitting, and supporting proposals pursuant to a specific requirement of an existing contract are considered to have been incurred in different circumstances from the circumstances under which costs are incurred in preparing proposals which do not result from such specific requirement. The circumstances are different because the costs of preparing proposals specifically required by the provisions of an existing contract relate only to that contract while other proposal costs relate to all work of the educational institution.

(d) This interpretation does not preclude the allocation, as indirect costs, of costs incurred in preparing all proposals. The cost accounting practices used by the educational institution, however, must be followed consistently and the method used to reallocate such costs, of course, must provide an equitable distribution to all final cost objectives.

9905.502-62 Exemption.

None for this Standard.

9905.502-63 Effective date.

This Standard is effective as of January 9, 1995.

Subparts 9905.503—9905.504 [Reserved]

Subpart 9905.505—Accounting for Unallowable Costs— Educational Institutions

9905.505-10 [Reserved]

9905.505-20 Purpose.

(a)(1) The purpose of this Cost Accounting Standard is to facilitate the negotiation, audit, administration and settlement of contracts by establishing guidelines covering:

(i) Identification of costs specifically described as unallowable, at the time such costs first become defined or authoritatively designated as unallowable, and

(ii) The cost accounting treatment to be accorded such identified unallowable costs in order to promote the consistent application of sound cost accounting principles covering all incurred costs.

(2) The Standard is predicated on the proposition that costs incurred in carrying on the activities of an educational institution—regardless of the allowability of such costs under Government contracts—are allocable to the cost objectives with which they are identified on the basis of their beneficial or causal relationships.

(b) This Standard does not govern the allowability of costs. This is a function of the appropriate procurement or reviewing authority.

9905.505-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Chapter 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection requires otherwise.

(1) *Directly associated cost* means any cost which is generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred.

(2) *Expressly unallowable cost* means a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable.

(3) *Indirect cost* means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

(4) *Unallowable cost* means any cost which, under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost reimbursements, or settlements under a Government contract to which it is allocable.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9905.505-40 Fundamental requirement.

(a) Costs expressly unallowable or mutually agreed to be unallowable, including costs mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract.

(b) Costs which specifically become designated as unallowable as a result of a written decision furnished by a contracting officer pursuant to contract disputes procedures shall be identified if included in or used in the computation of any billing, claim, or proposal applicable to a Government contract. This identification requirement applies also to any costs incurred for the same purpose

under like circumstances as the costs specifically identified as unallowable under either this paragraph or paragraph (a) of this subsection.

(c) Costs which, in a contracting officer's written decision furnished pursuant to contract disputes procedures, are designated as unallowable directly associated costs of unallowable costs covered by either paragraph (a) or (b) of this subsection shall be accorded the identification required by paragraph (b) of this subsection.

(d) The costs of any work project not contractually authorized, whether or not related to performance of a proposed or existing contract, shall be accounted for, to the extent appropriate, in a manner which permits ready separation from the costs of authorized work projects.

(e) All unallowable costs covered by paragraphs (a) through (d) of this subsection shall be subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they shall remain in such base or bases. Where a directly associated cost is part of a category of costs normally included in an indirect-cost pool that will be allocated over a base containing the unallowable cost with which it is associated, such a directly associated cost shall be retained in the indirect-cost pool and be allocated through the regular allocation process.

(f) Where the total of the allocable and otherwise allowable costs exceeds a limitation-of-cost or ceiling-price provision in a contract, full direct and indirect cost allocation shall be made to the contract cost objective, in accordance with established cost accounting practices and Standards which regularly govern a given entity's allocations to Government contract cost objectives. In any determination of unallowable cost overrun, the amount thereof shall be identified in terms of the excess of allowable costs over the ceiling amount, rather than through specific identification of particular cost items or cost elements.

9905.505-50 Techniques for application.

(a) The detail and depth of records required as backup support for proposals, billings, or claims shall be that which is adequate to establish and maintain visibility of identified unallowable costs (including directly associated costs), their accounting status in terms of their allocability to contract cost objectives, and the cost accounting treatment which has been accorded such costs. Adherence to this cost accounting principle does not require that allocation of unallowable costs to final cost objectives be made in the detailed cost accounting records. It does require that unallowable costs be given appropriate consideration in any cost accounting determinations governing the content of allocation bases used for distributing indirect costs to cost objectives. Unallowable costs involved in the determination of rates used for standard costs, or for indirect-cost bidding or billing, need be identified only at the time rates are proposed, established, revised or adjusted.

(b)(1) The visibility requirement of paragraph (a) of this subsection, may be satisfied by any form of cost identification which is adequate for purposes of contract cost determination and verification. The Standard does not require such cost identification for purposes which are not relevant to the determination of Government contract cost. Thus, to provide visibility for incurred costs, acceptable alternative practices would include:

(i) The segregation of unallowable costs in separate accounts maintained for this purpose in the regular books of account,

(ii) The development and maintenance of separate accounting records or workpapers, or

(iii) The use of any less formal cost accounting techniques which establishes and maintains adequate cost identification to permit audit verification of the accounting recognition given unallowable costs.

(2) Educational institutions may satisfy the visibility requirements for estimated costs either:

(i) By designation and description (in backup data, workpapers, etc.) of the amounts and types of any unallowable costs which have specifically been identified and recognized in making the estimates, or

(ii) By description of any other estimating technique employed to provide appropriate recognition of any unallowable costs pertinent to the estimates.

(c) Specific identification of unallowable costs is not required in circumstances where, based upon considerations of materiality, the Government and the educational institution reach agreement on an alternate method that satisfies the purpose of the Standard.

9905.505-60 Illustrations.

(a) An auditor recommends disallowance of certain direct labor and direct material costs, for which a billing has been submitted under a contract, on the basis that these particular costs were not required for performance and were not authorized by the contract. The contracting officer issues a written decision which supports the auditor's position that the questioned costs are unallowable. Following receipt of the contracting officer's decision, the educational institution must clearly identify the disallowed direct labor and direct material costs in the institution's accounting records and reports covering any subsequent submission which includes such costs. Also, if the educational institution's base for allocation of any indirect cost pool relevant to the subject contract consists of direct labor, direct material, total prime cost, total cost input, etc., the institution must include the disallowed direct labor and material costs in its allocation base for such pool. Had the contracting officer's decision been against the auditor, the educational institution would not, of course, have been required to account separately for the costs questioned by the auditor.

(b) An educational institution incurs, and separately identifies, as a part of a service center or expense pool, certain costs which are expressly unallowable under the existing and currently effective regulations. If the costs of the service center or indirect expense pool are regularly a part of the educational institution's base for allocation of other indirect expenses, the educational institution must allocate the other indirect expenses to contracts and other final cost objectives by means of a base which includes the identified unallowable indirect costs.

(c) An auditor recommends disallowance of certain indirect costs. The educational institution claims that the costs in question are allowable under the provisions of Office Of Management and Budget Circular A-21, Cost Principles For Educational Institutions; the auditor disagrees. The issue is referred to the contracting officer for resolution pursuant to the contract disputes clause. The contracting officer issues a written decision supporting the auditor's position that the total costs questioned are unallowable under the

Circular. Following receipt of the contracting officer's decision, the educational institution must identify the disallowed costs and specific other costs incurred for the same purpose in like circumstances in any subsequent estimating, cost accumulation or reporting for Government contracts, in which such costs are included. If the contracting officer's decision had supported the educational institution's contention, the costs questioned by the auditor would have been allowable and the educational institution would not have been required to provide special identification.

(d) An educational institution incurred certain unallowable costs that were charged indirectly as general administration and general expenses (GA&GE). In the educational institution's proposals for final indirect cost rates to be applied in determining allowable contract costs, the educational institution identified and excluded the expressly unallowable GA&GE costs from the applicable indirect cost pools. In addition, during the course of negotiation of indirect cost rates to be used for bidding and billing purposes, the educational institution agreed to classify as unallowable cost, various directly associated costs of the identifiable unallowable costs. On the basis of negotiations and agreements between the educational institution and the contracting officer's authorized representatives, indirect cost rates were established, based on the net balance of allowable GA&GE. Application of the rates negotiated to proposals, and to billings, for covered contracts constitutes compliance with the Standard.

(e) An employee, whose salary, travel, and subsistence expenses are charged regularly to the general administration and general expenses (GA&GE), an indirect cost category, takes several business associates on what is clearly a business entertainment trip. The entertainment costs of such trips is expressly unallowable because it constitutes entertainment expense prohibited by OMB Circular A-21, and is separately identified by the educational institution. In these circumstances, the employee's travel and subsistence expenses would be directly associated costs for identification with the unallowable entertainment expense. However, unless this type of activity constituted a significant part of the employee's regular duties and responsibilities on which his salary was based, no part of the employee's salary would be required to be identified as a directly associated cost of the unallowable entertainment expense.

9905.505-61 Interpretation. [Reserved]

9905.505-62 Exemption.

None for this Standard.

9905.505-63 Effective date.

This Standard is effective as of January 9, 1995.

Subpart 9905.506—Cost Accounting Period—Educational Institutions

9905.506-10 [Reserved]

9905.506-20 Purpose.

The purpose of this Cost Accounting Standard is to provide criteria for the selection of the time periods to be used as cost accounting periods for contract cost estimating, accumulating, and reporting. This Standard will reduce the effects of variations in the flow of costs within each cost accounting period. It will also enhance objectivity, consistency, and verifiability, and promote uniformity and comparability in contract cost measurements.

9905.506-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this Part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection requires otherwise.

(1) *Allocate* means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Cost objective* means a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

(3) *Fiscal year* means the accounting period for which annual financial statements are regularly prepared, generally a period of 12 months, 52 weeks, or 53 weeks.

(4) *Indirect cost pool* means a grouping of incurred costs identified with two or more cost objectives but not identified specifically with any final cost objective.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard: None.

9905.506-40 Fundamental requirement.

(a) Educational institutions shall use their fiscal year as their cost accounting period, except that:

(1) Costs of an indirect function which exists for only a part of a cost accounting period may be allocated to cost objectives of that same part of the period as provided in 9905.506-50(a).

(2) An annual period other than the fiscal year may, as provided in 9905.506-50(d), be used as the cost accounting period if its use is an established practice of the institution.

(3) A transitional cost accounting period other than a year shall be used whenever a change of fiscal year occurs.

(b) An institution shall follow consistent practices in the selection of the cost accounting period or periods in which any types of expense and any types of adjustment to expense (including prior-period adjustments) are accumulated and allocated.

(c) The same cost accounting period shall be used for accumulating costs in an indirect cost pool as for establishing its allocation base, except that the contracting parties may agree to use a different period for establishing an allocation base as provided in 9905.506-50(e).

9905.506-50 Techniques for application.

(a) The cost of an indirect function which exists for only a part of a cost accounting period may be allocated on the basis of data for that part of the cost accounting period if the cost is:

(1) Material in amount,

(2) Accumulated in a separate indirect cost pool or expense pool, and

(3) Allocated on the basis of an appropriate direct measure of the activity or output of the function during that part of the period.

(b) The practices required by 9905.506-40(b) of this Standard shall include appropriate practices for deferrals, accruals, and other adjustments to be used in identifying the cost accounting periods among which any types of expense and any types of adjustment to expense are distributed. If an expense, such as insurance or employee leave, is identified with a fixed, recurring, annual period

which is different from the institution's cost accounting period, the Standard permits continued use of that different period. Such expenses shall be distributed to cost accounting periods in accordance with the institution's established practices for accruals, deferrals, and other adjustments.

(c) Indirect cost allocation rates, based on estimates, which are used for the purpose of expediting the closing of contracts which are terminated or completed prior to the end of a cost accounting period need not be those finally determined or negotiated for that cost accounting period. They shall, however, be developed to represent a full cost accounting period, except as provided in paragraph (a) of this subsection.

(d) An institution may, upon mutual agreement with the Government, use as its cost accounting period a fixed annual period other than its fiscal year, if the use of such a period is an established practice of the institution and is consistently used for managing and controlling revenues and disbursements, and appropriate accruals, deferrals or other adjustments are made with respect to such annual periods.

(e) The contracting parties may agree to use an annual period which does not coincide precisely with the cost accounting period for developing the data used in establishing an allocation base: Provided,

(1) The practice is necessary to obtain significant administrative convenience,

(2) The practice is consistently followed by the institution,

(3) The annual period used is representative of the activity of the cost accounting period for which the indirect costs to be allocated are accumulated, and

(4) The practice can reasonably be estimated to provide a distribution to cost objectives of the cost accounting period not materially different from that which otherwise would be obtained.

(f)(1) When a transitional cost accounting period is required under the provisions of 9905.506-40(a)(3), the institution may select any one of the following: (i) the period, less than a year in length, extending from the end of its previous cost accounting period to the beginning of its next regular cost accounting period,

(ii) A period in excess of a year, but not longer than 15 months, obtained by combining the period described in subparagraph (f)(1) of this subsection with the previous cost accounting period, or

(iii) A period in excess of a year, but not longer than 15 months, obtained by combining the period described in subparagraph (f)(1) of this subsection with the next regular cost accounting period.

(2) A change in the institution's cost accounting period is a change in accounting practices for which an adjustment in the contract price may be required in accordance with subdivision (a)(4)(ii) or (iii) of the contract clause set out at 9903.201-4(e).

9905.506-60 Illustrations.

(a) An institution allocates indirect expenses for Organized Research on the basis of a modified total direct cost base. In a proposal for a covered contract, it estimates the allocable expenses based solely on the estimated amount of indirect costs allocated to

Organized Research and the amount of the modified total direct cost base estimated to be incurred during the 8 months in which performance is scheduled to be commenced and completed. Such a proposal would be in violation of the requirements of this Standard that the calculation of the amounts of both the indirect cost pools and the allocation bases be based on the contractor's cost accounting period.

(b) An institution whose cost accounting period is the calendar year, installs a computer service center to begin operations on May 1. The operating expense related to the new service center is expected to be material in amount, will be accumulated in an intermediate cost objective, and will be allocated to the benefiting cost objectives on the basis of measured usage. The total operating expenses of the computer service center for the 8-month part of the cost accounting period may be allocated to the benefiting cost objectives of that same 8-month period.

(c) An institution changes its fiscal year from a calendar year to the 12-month period ending May 31. For financial reporting purposes, it has a 5-month transitional "fiscal year." The same 5-month period must be used as the transitional cost accounting period; it may not be combined as provided in 9905.506-50(f), because the transitional period would be longer than 15 months. The new fiscal year must be adopted thereafter as its regular cost accounting period. The change in its cost accounting period is a change in accounting practices; adjustments of the contract prices may thereafter be required in accordance with subdivision (a)(4)(ii) or (iii) of the contract clause at 9903.201-4(e).

(d) Financial reports are prepared on a calendar year basis on a university-wide basis. However, the contracting segment does all internal financial planning, budgeting, and internal reporting on the basis of a twelve month period ended June 30. The contracting parties agree to use the period ended June 30 and they agree to overhead rates on the June 30 basis. They also agree on a technique for prorating fiscal year assignment of the university's central system office expenses between such June 30 periods. This practice is permitted by the Standard.

(e) Most financial accounts and contract cost records are maintained on the basis of a fiscal year which ends November 30 each year. However, employee vacation allowances are regularly managed on the basis of a "vacation year" which ends September 30 each year. Vacation expenses are estimated uniformly during each "vacation year." Adjustments are made each October to adjust the accrued liability to actual, and the estimating rates are modified to the extent deemed appropriate. This use of a sunder 9905.506-50(b)

9905.506-61 Interpretation. [Reserved]

9905.506-62 Exemption.

None for this Standard.

9905.506-63 Effective date.

This Standard is effective as of January 9, 1995. For institutions with no previous CAS-covered contracts, this Standard shall be applied as of the start of its next fiscal year beginning after receipt of a contract to which this Standard is applicable.

**Part I—Preambles to the Cost Accounting
Standards Published by the Cost Accounting
Standards Board**

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PREAMBLES TO THE COST ACCOUNTING STANDARDS, RELATED RULES AND REGULATIONS, AND THE FAR SYSTEM

PART I—PREAMBLES TO THE COST ACCOUNTING STANDARDS PUBLISHED BY THE COST ACCOUNTING STANDARDS BOARD

PREAMBLES TO COST ACCOUNTING STANDARD 401, CONSISTENCY IN ESTIMATING, ACCUMULATING, AND REPORTING COSTS

PREAMBLE A

Original Publication of Part 401, 2-29-72

Preamble to the original publication of 4 CFR Part 401, 37 FR 4139, Feb. 29, 1972. Because that publication also added 4 CFR Parts 331, 351, 400, and 402, material relating to those parts has been omitted. It appears in the Supplements to those parts.

General comments. The purpose of the regulations promulgated today by the Cost Accounting Standards Board is to implement section 719 of the Defense Production Act of 1950, as amended, 50 U.S.C. app. 2168, which provides for development of Cost Accounting Standards to be used in connection with negotiated national defense contracts and for disclosure of cost accounting practices to be used in such contracts. The Board believes the materials being promulgated today constitute a significant initial step toward accomplishing one of its major objectives—improved cost accounting and the proper determination of the cost of negotiated defense contracts. The regulations spell out contract coverage (Part 331), disclosure requirements (Part 351), a compilation of Definitions (Part 400), and two Cost Accounting Standards, one calling for consistency in estimating, accumulating, and reporting costs (Part 401), and the other calling for consistency in allocating costs incurred for the same purpose (Part 402).

Development of the material being promulgated today began many months ago with extensive research. It included examining publications on the subject, conferring with knowledgeable representatives of various Government agencies, Government contractors, industry associations, and professional accounting associations, and identifying and considering all available viewpoints. From this research, the initial versions of the material now being published were developed. As a part of the continuing research effort, these initial drafts were sent to 81 agencies, associations, and Government contractors which had expressed interest in assisting the Board in its work, and their comments were solicited. Some national defense contractors field-tested the material to see how it would apply to and affect their operations and advised the Board of their findings. In each step of the research process, the Board and its staff have urged and received active

participation and assistance by Government, industry, and accounting organizations. Their cooperative efforts contributed in large measure to the exposure draft published in the December 30, 1971, FEDERAL REGISTER for comment.

To better assure that all who might want to comment had an opportunity to do so, the Board supplemented the FEDERAL REGISTER notice by sending copies of the FEDERAL REGISTER materials directly to about 175 organizations and individuals who had expressed interest or had provided assistance in the development of the published material. Also, a press release was distributed announcing the publication, which resulted in numerous articles in journals. The Board availed itself of all opportunities to publicize the proposals and solicit comments on them.

Written comments in response to the published material were requested by February 4, 1972. Comments were received from 105 sources, including Government agencies, professional associations, industry associations, public accounting firms, individual companies and others. The Board appreciates the obvious care and attention devoted by commentators, and as will be seen below, the Board has greatly benefited from the comments received.

Many of the comments received were addressed to all parts of the proposed Board rules as well as to the question of public availability of the Disclosure Statements. All of the comments received have been carefully considered by the Board taking into account the requirements of section 719. Understandably, many of the comments were addressed to issues which recur in two or more of the proposed parts while others dealt only with specific sections. Comments which dealt with 11 general issues are discussed separately below followed by a section-by-section analysis of other comments. Appropriate changes have been made in the material promulgated based on the Board's disposition of the comments received.

Those comments and suggestions received which are of particular significance are discussed below.

Section 401.20 Purpose. Commentators stated that the purpose of the standards would require each contractor to revise his formal system of accounts in order to maintain them on a basis used for estimating Government contracts. The Board did not intend that requirement. The standard does not contain any requirement that a contractor must revise his formal system of accounts. Cost accounting records are supplemental to, and generally subsidiary to a contractor's financial records. However, it is neces-

sary that the cost accounting records be reconcilable to the contractor's general financial records.

Two commentators believed that the term "practices" in the phrase "Practices used in estimating costs in pricing proposals" could be confused as including estimating techniques relating to quantitative determination as well as the cost accounting practices used in estimating. The Board does not agree, because nothing in the standard precludes the use of any quantitative estimating tools.

Section 401.50 Techniques for application. Several commentators believed there may be an inconsistency between the requirements of the standard and the ability to make changes to established cost accounting practices. The Board intends that compliance with respect to proposals shall be determined as of the award date of the contract or as of the date of final agreement on price if the contractor has submitted cost or pricing data pursuant to Pub. L. 87-653. Modifications of established cost accounting practices for accumulating and reporting costs are permitted by other regulations of the Cost Accounting Standards Board without causing a violation of this standard. The Board has modified the standard to express these intentions.

Section 401.60 Illustration. An illustration has been added to this section to emphasize a requirement of the standard that any significant cost must be accumulated and reported in sufficient detail to permit its comparison with the estimates made therefor.

* * * * *

Effective date and application. For the convenience of readers, the following summarizes the effective dates set forth in § 331.8, § 351.4(e), and Parts 400, 401, and 402, which were transmitted to the Congress on February 24, 1972, pursuant to section 719(h)(3) of the Defense Production Act of 1950 as amended. After the expiration of a period of 60 calendar days of continuous session following the date of transmittal to the Congress, the regulations herein promulgated shall take effect as set forth in those regulations, unless there is passed by the two Houses a concurrent resolution stating in substance that the Congress does not favor the proposed standards, rules, or regulations.

* * * * *

4. Any contractor having a contract awarded prior to July 1, 1972, which contains a clause which already incorporates requirements governing submission of Disclosure Statements and application of Cost Accounting Standards will be required to comply with

the provisions of that clause. In this connection, such contractor and the respective contracting agencies whose contracts contain such a clause should review those contracts to determine whether negotiations should be instituted to make Parts 400 through 402 applicable to them.

PREAMBLE B

Preamble to Amendments of 11-7-73

Preamble to revision of the definitions of "actual cost" and "indirect cost pool" in § 401.30(a)(2) and (4), published at 38 FR 30725, Nov. 7, 1973. Material referring to other parts of 4 CFR Chapter III has been omitted; it appears in the Supplements to those parts.

The purpose of this publication by the Cost Accounting Standards Board is to amend Parts 331, 351, 400, 401, 402, 403, and 404 of its rules and regulations. The amendments, which are minor clarifications to the regulations, were published in the FEDERAL REGISTER of September 5, 1973 (38 FR 23971). The amendments: * * * (c) modify certain definitions in Parts 400, 401, 402, 403, and 404 for the purposes of uniformity among the various parts. Only one comment in response to the September publication has been received by the Board. This expressed agreement with the proposed changes.

In view of the foregoing, the following amendments to the Boards regulations are being made effective November 7, 1973.

PREAMBLE C

Amendment published 11-30-76

Preamble to the addition of Appendix— Interpretation No. 1 added on Nov. 30, 1976, at 41 FR 52427.

Interpretation No. 1 to Part 401, Cost Accounting Standard, Consistency in Estimating, Accumulating and Reporting Costs, is being published today by the Cost Accounting Standards Board pursuant to Section 719 of the Defense Production Act of 1950, as amended. (Pub. L. 91-379, 50 U.S.C. App. 2168.)

This Interpretation culminates extensive research over a period of several years on the subject of accounting for the costs of direct materials not incorporated in end items. This research indicated that, as a general rule, the cost of such materials is being allocated properly to cost objectives. Accordingly, the Board concluded that a Cost Accounting Standard on this subject was not warranted at this time. However, the research indicated that frequent questions were raised with respect to the requirements of Part 401 regarding consistency between estimating the costs of certain direct materials in pricing proposals and the accumulation and reporting of such costs. Thus, the Board concluded that

it would be desirable to issue an Interpretation of Part 401 to address specifically the requirements regarding consistency between estimating and accounting for the costs of such direct materials.

Section 401.40 requires that a contractor's "practices used in estimating costs in pricing a proposal shall be consistent with his cost accounting practices used in accumulating and reporting costs." Many contractors estimate the cost of certain direct materials, such as materials that will be scrapped, as a percentage of basic direct material requirements or of some other base. A significant number of questions have been raised as to the cost accounting practices to be followed where the cost of such materials is estimated on the basis of percentage factors. The Interpretation being published clarifies the requirements of Part 401 in this regard.

A proposed Interpretation was published in the FEDERAL REGISTER of June 24, 1976, with an invitation to interested parties to submit written comments. The Board supplemented the invitation in the FEDERAL REGISTER by sending copies of the proposed Interpretation directly to over 1,000 organizations and individuals. The Board received 43 written comments, all of which have been carefully considered by the Board.

In addition to an evaluation of the written comments, conversations were held with thirteen of these commentators who indicated particular problems with the proposed Interpretation. The Board takes this opportunity to express its appreciation for the time and effort expended by those who met with the Board representatives or provided written comments.

Comments of particular significance with respect to the proposed Interpretation are discussed below.

1. NEED FOR AN INTERPRETATION

Several commentators stated that the Interpretation expands the scope and is not consistent with the intent of Part 401, which they say requires only a comparison of actual costs with estimated costs for direct material. They argued that the Defense Contract Audit Agency (DCAA) guidance to its field auditors in October 1973 satisfactorily explained the meaning of Part 401. In general, these commentators felt that an Interpretation to CAS 401 was not needed.

The Board's research indicates that an Interpretation is needed. Numerous and widespread questions have been raised concerning whether application of a percentage factor to a base as a means of estimating the costs of certain additional direct material requirements is in compliance with Part 401 when the contractor accumulates direct material costs in an undifferen-

tiated account. The Board notes that a similar question with respect to direct labor is specifically addressed in Part 401, Section 401.60(b)(5). In that Illustration, the accumulation of total engineering labor in one undifferentiated account is not in compliance with Part 401 where the contractor estimates engineering labor by cost function. Part 401 does not, however, specifically address the consistency requirement for direct materials, nor did the DCAA guidance specifically cover this matter. Accordingly, the Board concludes that this Interpretation is needed.

In view of the fact that the Interpretation clarifies what is already required by Part 401, the Board does not agree that it expands the scope of the Standard.

2. MATERIALITY

A number of commentators maintained that the cost of the materials estimated by means of a percentage factor was usually insignificant. These commentators were concerned that extensive records or analyses would have to be developed for insignificant amounts. The Board, of course, has always been concerned about the question of materiality and is on record as stating that the administration of its rules, regulations, and Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of cost. To assure the application of the materiality criterion in this instance, specific language has been introduced which provides that the Interpretation applies only where "a significant part of costs" is estimated by means of a percentage factor. Furthermore, the Interpretation being published today recognizes that the accounting requirements of Part 401 depend on "the significance of each situation."

3. ESTIMATING TECHNIQUE VERSUS PRACTICE

Several respondents were of the opinion that the proposed Interpretation was inappropriate because they felt that the use of percentage factors to estimate the cost of certain direct materials is an estimating "technique," rather than an estimating "practice." Thus, they contended, the Interpretation is improperly covering an area not subject to Part 401, i.e., "estimating techniques," and would limit the use of estimating factors as quantitative estimating tools. Some of these respondents noted that the Board recognized the difference between techniques and practices in the prefatory comments to Part 401, as published in the FEDERAL REGISTER of February 29, 1972. In that publication, the Board noted the concern of some commentators that the term "practices" in the phrase "practices used in

estimating costs in pricing proposals" could be confused as including estimating techniques relating to quantitative determinations. In response to those comments, the Board stated that "nothing in the Standard precludes the use of any quantitative estimating tools."

The Board reaffirms this conclusion. However, the Board did not intend to deny all interest in practices so readily subject to abuse. There are cases in which contractor percentage estimates are not adequately supported either by data as to relevant past experience or in any other manner. In such cases, particularly, the Board feels that the use of a percentage factor as a means of estimating the costs of additional direct materials is an estimating practice which must be consistent with the practices used in accumulating and reporting costs.

4. RETROACTIVITY

A few commentators were concerned about the possible retroactive application of this Interpretation. They noted that the requirement of Part 401, as interpreted, would apply as of the date a contractor was first required to use that Standard. The commentators were concerned that those contractors who have not accounted for material costs in accordance with the Interpretation could be held to have been in noncompliance with Part 401, and therefore subject to a downward price adjustment in accordance with paragraph a(5) of the Cost Account Standards clause (4 CFR 331.50). These commentators urged that the Interpretation be effective on a prospective basis only. Some of these commentators suggested that the substance of the Interpretation should be a new Standard, with the opportunity for an equitable adjustment under a(4)(A) of the Cost Accounting Standards clause.

As already noted, the Board has carefully considered whether the subject of the Interpretation should be encompassed in a new Standard. The Board has concluded that the accounting for direct material cost as explained by this Interpretation is required by Part 401 and therefore should have been accomplished as of the date that Standard first became applicable to a contractor. Nevertheless, the Board recognizes that there has been widespread uncertainty about the application of Part 401 in situations where certain material costs are estimated on the basis of percentage factors. In addition, the Board believes that the determination of the cost impact of a contractor's failure in the past to follow Part 401 as interpreted would be extremely difficult. Under the circumstances, the Board believes that the effort to seek contract price adjustments as a result of this Interpretation would, in most

cases, be counterproductive. Accordingly, the Board believes that, in most cases, the process of attempting to determine price adjustments as a result of the retroactive application of Part 401 as interpreted would not be warranted.

5. COST ACCOUNTING PRACTICES

The proposed Interpretation stated that contractors who use a percentage factor to estimate certain direct material costs for a contract must "for that contract" maintain an adequate record or prepare an analysis of the actual cost. A number of commentators understood this sentence to require the recording or analysis on a contract-by-contract basis of the actual cost of materials represented by an estimated percentage factor. Many of these commentators noted that it would be difficult, if not impossible, to comply with this requirement. Other commentators questioned what was meant by an adequate record or an analysis.

As noted above the use of percentage factors for estimating direct material costs is an estimating practice which, pursuant to Part 401, must be consistent with the cost accounting practices used in accumulating and reporting costs. The Board notes however that Part 401 neither prescribes nor precludes any particular cost accounting practice. The Board recognizes that the consistency requirement of Part 401, as it pertains to direct material costs, could be met in a variety of ways. The Board is therefore of the view that it would be neither appropriate nor practical to prescribe by means of this Interpretation the amount of detail in accumulating and reporting costs which is deemed to be consistent with the use of percentage factors in estimating costs. The Board believes that the amount of detail which should be maintained with respect to direct material costs is a matter which is best left for decision by the appropriate Government procurement authorities on the basis of facts and circumstances of each situation. The Interpretation being published today has been revised accordingly and all references to the type of records to be maintained or analyses to be performed have been deleted.

6. APPLICATION TO DEVELOPMENTAL AND RESEARCH TYPE CONTRACTS

Many commentators urged that this Interpretation not apply to developmental and research type contracts. They said that since only material issued to these kinds of contracts is charged to such contracts, there would be no overstatement of material costs. They urged further that it would be impossible to maintain actual cost records by contract to record the additional material required and that it

was extremely difficult to estimate additional material requirements because of the lack of past experience. Also, the commentators contended that material requirements on such contracts were not significant. Other commentators suggested that this Interpretation should not apply to cost type contracts.

It appears that these comments were generated mainly by the impression that the proposed Interpretation required records or analyses to be maintained by individual contract. As noted above, the Interpretation has been revised to make clear that no particular record or analysis is required by Part 401. The requirement for consistency in estimating, accumulating and reporting costs, however, applies to all contracts. The fact that a development contract or cost-type contract is involved does not remove this requirement. The Board feels that the changes made in the Interpretation should serve to minimize the problems described by these contractors.

7. APPLICATION TO STANDARD COST ACCOUNTING SYSTEMS

Several commentators suggested that this Interpretation not apply to standard cost systems. They argued that costs are not accumulated by contract or product and, therefore, compliance with the Interpretation would require a complicated and expensive recording system. They felt further that in setting standards, they use past experience plus engineering adjustments and could be charged by the Government with the need to comply with the records requirement of the Interpretation for each of their Standards.

Contractors using standard costs for material must comply with Part 407, the Use of Standard Costs for Direct Material and Direct Labor, which addresses the accounting for direct material and variances from standard costs of material. In the opinion of the Board, these contractors will be in compliance with Part 401 as interpreted.

8. APPLICATION TO SPECIFIC FACTORS

Various commentators inquired about the application of this Interpretation to certain specific factors used in estimating contract price proposals, not necessarily related to the cost of additional direct materials. Among the factors mentioned were those to provide for inflation, contingencies resulting from indefinite or incomplete bills of material, losses in common inventory accounts, and miscellaneous small parts and hardware items.

As noted in the Interpretation, its need was prompted by questions about the use of percentage factors to estimate the costs of "additional direct

materials"; i.e., generally those direct materials not incorporated in end items. Factors such as those used to provide for inflation or allowances for incomplete bills of material do not represent costs of "additional direct materials," as that phrase is used in the Interpretation. In the opinion of the Board, this interpretation does not apply to the costs represented by such factors.

Factors used in a proposal to provide for inventory losses represent the costs of additional materials which are governed by this Interpretation. With respect to factors for small parts, the Board notes that in accordance with Part 401, § 401.60, Illustrations, a practice of estimating an average cost for a minor standard hardware item is considered to be consistent with the practice of recording the actual costs of such items.

The amount of detail to be used in accumulating and recording such costs, however, is a matter to be decided in accordance with this Interpretation.

9. APPLICATION OF INTERPRETATION TO DIRECT LABOR

A number of commentators raised questions concerning the applicability of the Interpretation to direct labor. Several commentators said it should not apply to such labor but should be clearly limited to direct materials. One commentator felt that the Interpretation was equally applicable to direct labor and should so state.

As already noted in paragraph 1, above, Part 401 includes specific provisions on the consistency requirements regarding direct labor. Accordingly, the Board is of the opinion that no further specific coverage of direct labor is required in this Interpretation.

PREAMBLE D

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 401.10. This amendment was part of a publication which added § 331.30(b)(3). Only the portion of the preamble which describes the revision to § 401.10 is printed here. The remainder of the preamble appears as preamble K of the supplement to Part 331.

* * * * *

In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and is amending standards 401 through 409 as set forth below.

PREAMBLES TO COST ACCOUNTING STANDARD 402, CONSISTENCY IN ALLOCATING COSTS INCURRED FOR THE SAME PURPOSE

PREAMBLE A

Preamble to Original Publication of Part 402, 2-29-72

Preamble to original publication of 4 CFR Part 402, 37 FR 4139, Feb. 29, 1972. That publication also included the addition of 4 CFR Parts 331, 351, 400, and 401, and so material relating to those parts has been omitted. It appears in the Supplements to those parts.

General comments. The purpose of the regulations promulgated today by the Cost Accounting Standards Board is to implement section 719 of the Defense Production Act of 1950, as amended, 50 U.S.C. app. 2168, which provides for development of Cost Accounting Standards to be used in connection with negotiated national defense contracts and for disclosure of cost accounting practices to be used in such contracts. The Board believes the materials being promulgated today constitute a significant initial step toward accomplishing one of its major objectives—improved cost accounting and the proper determination of the cost of negotiated defense contracts. The regulations spell out contract coverage (Part 331), disclosure requirements (Part 351), a compilation of Definitions (Part 400), and two Cost Accounting Standards, one calling for consistency in estimating, accumulating, and reporting costs (Part 401), and the other calling for consistency in allocating costs incurred for the same purpose (Part 402).

Development of the material being promulgated today began many months ago with extensive research. It included examining publications on the subject, conferring with knowledgeable representatives of various Government agencies, Government contractors, industry associations, and professional accounting associations, and identifying and considering all available viewpoints. From this research, the initial versions of the material now being published were developed. As a part of the continuing research effort, these initial drafts were sent to 81 agencies, associations, and Government contractors which had expressed interest in assisting the Board in its work, and their comments were solicited. Some national defense contractors field-tested the material to see how it would apply to and affect their operations and advised the Board of their findings. In each step of the research process, the Board and its staff have urged and received active participation and assistance by Government, industry, and accounting organizations. Their cooperative efforts contributed in large measure to the exposure draft published in the De-

ember 30, 1971, FEDERAL REGISTER for comment.

To better assure that all who might want to comment had an opportunity to do so, the Board supplemented the FEDERAL REGISTER notice by sending copies of the FEDERAL REGISTER materials directly to about 175 organizations and individuals who had expressed interest or had provided assistance in the development of the published material. Also, a press release was distributed announcing the publication, which resulted in numerous articles in journals. The Board availed itself of all opportunities to publicize the proposals and solicit comments on them.

Written comments in response to the published material were requested by February 4, 1972. Comments were received from 105 sources, including Government agencies, professional associations, industry associations, public accounting firms, individual companies, and others. The Board appreciates the obvious care and attention devoted by commentators, and as will be seen below, the Board has greatly benefited from the comments received.

Many of the comments received were addressed to all parts of the proposed Board rules as well as to the question of public availability of the Disclosure Statements. All of the comments received have been carefully considered by the Board taking into account the requirements of section 719. Understandably, many of the comments were addressed to issues which recur in two or more of the proposed parts while others dealt only with specific sections. Comments which dealt with 11 general issues are discussed separately below followed by a section-by-section analysis of other comments. Appropriate changes have been made in the material promulgated based on the Board's disposition of the comments received.

Those comments and suggestions received which are of particular significance are discussed below.

* * * * *

Part 402 Title. One commentator pointed out that the definition of the word "allocate" covered all of the actions encompassed by the word "charge" and, therefore, the title of the standard should be changed to delete the words "charging and." The Board agrees and has made the appropriate change here and elsewhere throughout the standard.

Section 402.40 Fundamental requirement. A number of commentators suggested a change to the standard to eliminate the requirement that direct and indirect costs be consistently allocated to all final cost objectives. Making the standard applicable only

to individual contracts would permit a choice to be made solely on the basis of short-term economic benefit; the Board therefore has not adopted the suggestion.

Section 402.50 Techniques for application. Several commentators noted that the standard discusses the required treatment of incurred costs but does not cover estimated costs. The Board intends that both types of costs be covered by the standard and has therefore added a new paragraph to this section to make that intention clear.

A number of commentators suggested that the concept of materiality be included in the standard to allow the handling of minor direct cost items as indirect costs similar to the treatment accorded materiality in current ASPR regulations. The Board agrees, and has included a materiality statement in this section.

Several commentators did not understand the relationship of this standard to the Disclosure Statement. (This relationship is set out in paragraph (b) of this section) The Board intends to allow the contractor to disclose the cost accounting practices and criteria appropriate to his own situation while at the same time imposing the requirement that he adhere consistently to the choices once made. The Disclosure Statement is the vehicle by which the contractor describes the criteria and circumstances which define costs which are or are not incurred for the same purpose.

* * * * *

Effective date and application. For the convenience of readers, the following summarizes the effective dates set forth in § 331.8, § 351.4(e), and Parts 400, 401, and 402, which were transmitted to the Congress on February 24, 1972, pursuant to section 719(h)(3) of the Defense Production Act of 1950 as amended. After the expiration of a period of 60 calendar days of continuous session following the date of transmittal to the Congress, the regulations herein promulgated shall take effect as set forth in those regulations, unless there is passed by the two Houses a concurrent resolution stating in substance that the Congress does not favor the proposed standards, rules, or regulations.

* * * * *

4. Any contractor having a contract awarded prior to July 1, 1972, which contains a clause which already incorporates requirements governing submission of Disclosure Statements and application of Cost Accounting Standards will be required to comply with the provisions of that clause. In this connection, such contractor and the respective contracting agencies whose contracts contain such a clause should

review those contracts to determine whether negotiations should be instituted to make Parts 400 through 402 applicable to them.

PREAMBLE B

Amendments Published 11-7-73

Preamble to revision of the definitions of "cost objective" and "indirect cost pool", § 402.30(a) (2) and (6); 38 FR 30725, Nov. 7, 1973. Material relating to other parts of 4 CFR Chapter III, published in the same document, has been omitted, and appears in the Supplements to those parts.

The purpose of this publication by the Cost Accounting Standards Board is to amend Parts 331, 351, 400, 401, 402, 403, and 404 of its rules and regulations. The amendments, which are minor clarifications to the regulations, were published in the FEDERAL REGISTER of September 5, 1973 (38 FR 23971). The amendments: * * * (c) modify certain definitions in Parts 400, 401, 402, 403, and 404 for the purposes of uniformity among the various parts. Only one comment in response to the September publication has been received by the Board. This expressed agreement with the proposed changes.

In view of the foregoing, the following amendments to the Board's regulations are being made effective November 7, 1973.

PREAMBLE C

Amendment Published 6-18-76

Preamble to the addition of Appendix— Interpretation No. 1 added on June 18, 1976 at 41 FR 24691.

Interpretation No. 1 to Part 402, Cost Accounting Standard, Consistency in Allocating Costs Incurred for the Same Purpose, is being published today by the Cost Accounting Standards Board pursuant to Section 719 of the Defense Production Act of 1950, as amended. (Pub. L. 91-379, 50 U.S.C. App. 2168). The interpretation deals with the application of § 402.40 of Part 402 to proposal costs. Section 402.40 provides that, "All costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives."

A number of questions had been raised by both the Government and contractors as to how Cost Accounting Standard 402 is to be applied to the accounting for proposal costs and, particularly, as to whether all costs incurred in preparing proposals are incurred for the same purpose, in like circumstances. A proposed interpretation was published in the FEDERAL REGISTER of February 4, 1976, with an invitation to interested parties to submit written comments if the proposed interpretation did not respond fully, or did not respond clearly enough, to what the Board understood

to be the questions which had arisen. The Board also supplemented the invitation in the FEDERAL REGISTER by sending copies of the proposed interpretation to several hundred organizations and individuals. The Board received 32 written comments from companies, Government agencies, industry and professional associations, and others. All of these comments have been carefully considered by the Board. The issues of particular significance which were discussed by respondents in connection with the proposed interpretation are summarized below, together with explanations of the changes made in the interpretation being published today. The Board takes this opportunity to express its appreciation for the helpful suggestions and criticisms that were received.

(1) *Specific requirement provision.* Several commentators, while suggesting changes to the proposed interpretation published on February 4, 1976, commended the Board for recognizing the problem with respect to the application of § 402.40 of Part 402 to the costs incurred in preparing proposals and believed that the interpretation would resolve a longstanding area of controversy. The most prevalent comments received dealt with costs incurred in preparing a follow-on proposal which is not specifically required by an existing contract.

Many commentators suggested that the words "specific requirement" be deleted and that, in lieu thereof, words such as "related to," "arising from," "identified with," or "directly associated with," be used. Other commentators, while agreeing that the "specific requirement" provision should be retained, suggested an expansion to also cover proposals "related to" existing contracts such as proposals for follow-on contracts. Still other commentators, however, believed that the "specific requirement" provision was appropriate and should be retained without addition or other change.

In the February 4, 1976, publication of the proposed interpretation, the distinguishing characteristic noted by the Board for determining if circumstances can be considered to be different with respect to costs incurred in preparing two proposals was whether one proposal was prepared pursuant to a specific requirement of an existing contract while the other was not. The Board continues in the belief that the "specific requirement" provision is the distinguishing characteristic and, accordingly, has retained this provision in the interpretation being published today.

Several commentators suggested that proposals prepared in order to comply with other contract provisions, such as when the Government exercises an unpriced option or when an option is repriced, should be consid-

ered to be specifically required under the interpretation. The Board believes that the interpretation being published today accommodates this suggestion.

One commentator suggested that the Board's intent be clarified with respect to whether only proposals required by line items in a contract are considered to be specifically required by the contract. The Board intended that, while the "specific requirement" could be a line item in a contract, it need not be. Proposals specifically required by any other provisions of a contract, such as the requirement in the Changes clause of Standard Form 32, that any "claim by the contractor for adjustment under this clause must be asserted within 30 days from the date of receipt by the contractor of the notification of change," are considered to be specifically required under the interpretation.

(2) *Indirect allocation of all proposal costs.* A few commentators recommended clarification of the final paragraph in the proposed interpretation as published on February 4, 1976. One commentator stated that the paragraph could be interpreted as authorizing contractors to allocate all proposal costs indirectly while another commentator believed that the subject of indirect allocation of all proposal costs should be developed later as a separate issue. The paragraph has been revised (a) to give recognition to the fact that some contractors' accounting practices now provide that all proposal costs are pooled and allocated indirectly and (b) to make it clear that, in this respect, no change in a contractor's accounting practice or allocation method is required by this interpretation if the cost accounting practice is being followed consistently and if the allocation method provides an equitable distribution to all final cost objectives.

(3) *Determination of cost accounting practices by contracting officer.* A few commentators stated that the words, "specific requirement of an existing contract" would place contracting officers in the position of determining cost accounting practices because they could determine whether there would be a specific requirement in a contract.

Contracting officers now decide for almost every contract whether to include or exclude specific contractual requirements covering a wide variety of activities. The Board believes that inclusion or exclusion of a specific requirement in a contract may influence the cost accounting practice being followed but the decision to include or exclude the requirement is not the determinant of the cost accounting practice.

(4) *Prospective application.* Two commentators suggested that, under this interpretation, certain proposal costs which some contractors have allocated directly to contracts will have to be allocated indirectly. One of the

commentators recommended that, consequently, the interpretation should be applied on a prospective basis only.

Cost Accounting Standard 402, which became effective July 1, 1972, states that, "All costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives." Interpretation No. 1 to Part 402 recognizes that the circumstances involved in preparing certain proposals are different from the circumstances involved in preparing other proposals. The interpretation explains when, under the Standard, certain proposal costs are consequently deemed to have been incurred in unlike circumstances and therefore may be accounted for differently.

Although the interpretation is being provided to explain in greater detail how Cost Accounting Standard 402 applies to costs incurred in preparing proposals, the Standard from its inception has applied to these costs in this way. As to any individual contractor, Standard 402 has applied to such costs from whatever date that Standard became applicable to that contractor. The commentator's recommendation therefore has not been accepted. In view of the widespread uncertainty over the application of Standard 402 to proposal costs, however, the Board believes that any failures to follow the Standard in this respect have been inadvertent. The Board also believes that any adjustments should be made with due consideration to the Board's statement on materiality.

(5) *Accounting for the cost of proposals for follow-on contracts.* Several commentators stated that the interpretation would create cost accounting problems with respect to accounting for the cost of proposals for follow-on contracts. The statement was made that a follow-on proposal is prepared by employees assigned full time to the on-going program and that it would be most difficult and impractical to attempt to separate their labor costs for preparing follow-on proposals from their other labor costs of the on-going program.

The Board recognizes the possibility that some contractors may have to refine somewhat their present practices for distributing incurred labor costs in order to separate the costs of preparing proposals for a follow-on contract from the costs of an existing contract. The Board does not agree, however, that whatever refinements may be necessary should be difficult or impractical to develop.

(6) *Other comments.* One commentator suggested that it be clearly stated in the interpretation that proposal costs allocated direct to contracts will have overhead and General and Administrative expenses (including indirect proposal costs) applied. The

Board agrees that proposal costs allocated direct to a contract are no different than any other costs allocated direct to that contract but believes this is self-evident and that no change in the interpretation is required.

Another commentator suggested that the word "bid" be added to the interpretation in conjunction with the word "proposal." The Board intends that the interpretation apply to a "proposal" as defined in 4 CFR, Part 400.

A few commentators requested clarification of the wording of the introductory comments and the proposed interpretation published on February 4, 1976. The introductory comments stated that, "Costs * * * are incurred in different circumstances * * *" whereas the proposed interpretation stated that, "The contracting parties can determine that the circumstances are different * * *." Accordingly, the Board has deleted the words, "The contracting parties can determine that * * *" from the interpretation being published today.

Another commentator suggested that the phrase, "to all work of the contractor," in the last sentence of the third paragraph of the interpretation be clarified because some companies have several indirect cost pools for proposal costs, one for each major product line within a division. The commentator believed that the phrase could be misinterpreted as limiting the number of such indirect cost pools to only one pool for each division. It is not the intent of the Board to change, through this interpretation, any of the established cost accounting practices now being followed by contractors with respect to the pooling and allocation of indirect proposal costs. Accordingly, if it is the contractor's established cost accounting practice to pool and allocate indirect proposal costs by product groupings, he may continue to do so.

One commentator requested a statement in the interpretation with respect to solicited and unsolicited proposals, particularly as to "whether one or the other is properly included in the direct or indirect charge category." The determination as to like or unlike circumstances does not depend on whether a proposal is solicited or unsolicited. The test is whether the proposal was specifically required by an existing contract.

PREAMBLE D

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 402.10. This amendment was part of a publication which added § 331.30(b)(3). Only the portion of the preamble which describes the revision to § 402.10 is printed here. The remainder of the preamble appears as preamble K of the supplement to Part 331.

* * * * *

In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and is amending standards 401 through 409 as set forth below.

**PREAMBLES TO COST ACCOUNTING STANDARD
403, ALLOCATION OF HOME OFFICE EXPENSES TO SEGMENTS**

PREAMBLE A

Preamble to Original Publication, 12-14-72

Preamble to original publication of 4 CFR Part 403, at 38 FR 26680, Dec. 14, 1972.

The Standard on Allocation of Home Office Expenses to Segments is one of a series being promulgated by the Cost Accounting Standards Board pursuant to section 719 of the Defense Production Act of 1950, as amended, Pub. L. 91-379, 50 U.S.C. app. 2168, which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

Work on this Standard was initiated as the result of a variety of continuing problems between contractors and the Government concerning equitable allocations of home office expenses to segments involved in negotiated defense contracts. The problems include disagreements on:

(i) The propriety in certain circumstances of using particular allocation bases, such as cost of sales or direct labor for allocating home office expenses to segments; (ii) whether and to what extent certain kinds of segments such as GOCO's, foreign subsidiaries and partially owned subsidiaries should be included in the allocation base; and (iii) the homogeneity of expense pools.

The allocation of home office expenses to segments is not now specifically governed or guided by an authoritative accounting statement. Home office expenses allocated to segments and then to contracts can constitute an important element of total contract cost. The lack of authoritative standards to guide contractors, procurement officers, auditors, and others, provides a great potential for disagreement and controversy over contract costs. Assurance of equity in cost determinations and contract settlement is singularly lacking.

This Standard prescribes criteria for allocation of the expenses of a home office to segments of an organization. The criteria are based primarily on the beneficial or causal relationship between such expenses and the receiv-

ing segments. The Standard governs how a contractor may allocate expenses of its corporate headquarters to various divisions, subsidiaries, plants, or other subsidiaries of the corporation. The Board believes that application of this Standard will result in sound cost accounting and will provide a great degree of uniformity in the determination of costs of negotiated defense contracts.

Research establishes that some home office expenses are incurred for specific segments and can be assigned directly to them. Other expenses, not incurred for a specific segment, have clear relationships to two or more segments, relationships which are measurable with reasonable objectivity. A third type of home office expense possesses no readily measurable relationship to segments.

The Cost Accounting Standards Board finds that a Cost Accounting Standard to govern the allocation of home office expenses is desirable to reduce wasteful and expensive controversy and to obtain equity for the contracting parties. The Standard published today requires that those home office expenses incurred for specific segments are to be allocated directly to those segments to the maximum extent practical. Those that can be allocated to segments on the basis of objective measurable relationships are to be accumulated and allocated by means of logical and homogenous expense pools established for this purpose. The remaining or residual home office expenses are then to be allocated as discussed below.

The Board expects that this Standard will operate to reduce residual expenses to a relatively minor amount and by this means also reduce controversy and inequity. Where this is the case, the Board sees no reason to require one particular technique to allocate these expenses. Accordingly, where residual expenses are no greater than a specified percentage of operating revenues, the Standard allows the use of any appropriate allocation technique. However, if residual expenses exceed such specified percentages, the Board believes that its objective of reducing controversy and avoiding inequity would best be served by selecting a single allocation technique to be used. Its research in this connection has led the Board to conclude that for this purpose, a three-factor formula is superior to other allocation bases and techniques for the allocation of residual expenses.

Early research on this Standard included an extensive review of available literature on the subject, a review of decisions of contract appeals boards and courts, and a study of home office management philosophy and operations of 40 companies representing a wide variety of industries.

This research led to the publication of a proposed Cost Accounting Stand-

ard in the FEDERAL REGISTER of June 30, 1972, with an invitation for interested parties to submit written data, views, and comments to the Board. To better assure that those who had already expressed interest or provided assistance had an opportunity to comment, the Board supplemented the FEDERAL REGISTER notice by sending copies of the FEDERAL REGISTER materials directly to 196 organizations and individuals, of which 86 companies were invited to furnish the Board with estimates of any additional or reduced costs which could arise from the implementation of the Standard.

Responses were received from 130 sources, including individual companies, Government agencies, professional associations, industry associations, public accounting firms, and others. All of these comments and data have been carefully considered by the Board. Those comments which are of particular significance are discussed below together with an explanation of resultant substantive changes to the Standard as published in the FEDERAL REGISTER of June 30, 1972.

As will be seen from the following discussion, the Board was greatly benefited by the many comments it received on the Standard as published in the FEDERAL REGISTER of June 30, 1972. The Board takes this opportunity to express its considerable debt to those who devoted time and skill to assisting the Board in this endeavor and to thank the many companies and individuals involved.

(1) *Materiality.* Many commentators urged that the Standard contain a general statement on materiality. The Board has previously stated that the administration of its rules, regulations, and Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of cost. The Board does not believe that any further general statement is needed at this time. However, where specific changes could be made to clarify the intent of this Standard with respect to materiality, they have been made as further discussed below.

While most commentators agreed with the concept of maximum direct allocation of home office expenses, and accumulation of nondirectly allocated home office expenses into logical, homogeneous expense pools, a few of these commentators believed that the Standard did not adequately incorporate the concept of materiality for this purpose. The Board agrees that materiality is an important consideration in determining whether to specify that an expense is to be allocated directly or by means of a separate expense pool. Accordingly, § 403.40 of the Standard has been revised to state that expenses are to be allocated to the maximum extent "practical" and that expenses not directly allocated are to be grouped into separate homogeneous expense pools "if significant

in amount and in relation to total home office expenses."

In addition, a number of commentators questioned the need for using what they considered to be a relatively complex formula to allocate residual expenses even when they are minor in amount. This requirement was contained in the Standard as published in the FEDERAL REGISTER of June 30, 1972. The Board believes the formula to be relatively simple, well understood, already used by many companies to satisfy State tax requirements, and based on financial data that is readily available. Nevertheless, the Board agrees that other allocation techniques may be acceptable if residual expenses are not material. Accordingly, § 403.40(c) of the Standard being published today permits the use of any allocation base representative of total activity if residual expenses are less than a specified percentage of operating revenue.

The Board also considered a materiality test conducted periodically which would permit a contractor, otherwise covered, to choose not to follow the Standard if its application would result in little or no change in the total amount he allocates to his segments with Government business. The Board in this instance rejected this approach for the following reasons:

(a) Such an approach would put undue emphasis on the effect of this Standard on the allocation of costs to or away from Government contracts.

(b) The administrative problems and time spent by both the Government and the contractor in estimating the contract cost consequences of application of the Standard periodically and negotiating the pro forma application of the Standard for comparative test purposes would outweigh any benefits that might be derived from waiver of the entire Standard on the basis of materiality of result.

(c) There would be no assurance that a contractor's own procedures, which in the test year happened to provide nearly identical results to the results which would be provided through use of the Standard, would in other, subsequent years also produce the same nearly identical results. In effect, the results in the test year may have been an aberration.

(d) In light of the general acceptance by the majority of commentators of the concept of direct charging and grouping of homogeneous expense pools, the provisions for materiality considerations previously described are deemed sufficient.

(e) The Board has applied the concept of materiality to the extent it believes practical in this Standard. The Board, however, as noted in its prefatory comments on the first two published Standards (37 FR 4141), will give consideration to stating a concept of materiality applicable to all Standards if subsequent events indicate the desirability and feasibility of doing so.

The Board has eliminated a requirement, originally contained in the June 30, 1972, proposal, for interdepartmental allocations of home office expenses. This proposal would have required part of the cost of certain home office functions to be allocated to other home office functions before being reallocated to segments. The Board accepts the views of a number of commentators that this procedure would be complex and unwarranted in the light of a relatively insignificant effect on the allocation of home office expenses.

The proposed Standard, as published in the FEDERAL REGISTER of June 30, 1972, required that all segments be included in an allocation base unless it could be demonstrated that any segment did not receive benefit from, or contribute to the cause of, an expense to be allocated. A number of commentators observed that it would be virtually impossible to demonstrate that a segment received no benefit. Others commented that a segment should not be included in an allocation base if it received only negligible benefit. The June 30, 1972 proposal has been revised to accommodate these comments and to emphasize again the application of the concept of materiality.

(2) *Hierarchy of allocation methods.* A number of commentators were concerned that a provision in the FEDERAL REGISTER of June 30, 1972, that costs be " * * * allocated on the basis of expenses caused by the segments, benefits received by the segments, or benefits available to the segments," did not provide adequate guidance for the selection of appropriate allocation bases. The Board believes that with the exception of centralized service functions, the allocation criteria contained in the fundamental requirement are sufficiently specific so as not to require additional guidance. The Board is persuaded, however, that it is desirable to establish more definitive criteria for the selection of an appropriate allocation base for centralized service functions. For this purpose, the Board has added in § 403.50(b) a hierarchy of allocation methods. The hierarchy is based on achieving the most realistic representation of the beneficial or casual relationship that is practical in the circumstances.

(3) *Allocation of residual expenses.* With few exceptions, commentators objected to the establishment of a single formula to allocate costs of managing the company as a whole, i.e., residual costs. Many noted that the formula, in conjunction with a broadly inclusive definition of a "segment," would produce inequitable allocations to certain segments. Most often concern was expressed that the allocations would have to be made to segments which receive little benefit from the home office, such as independent subsidiary corporations, subsidiaries in

which the organization has only a minority ownership, foreign segments, and Government-owned contractor-operator (COGO) plants. Others were concerned that the formula was unduly complex to administer and that the results of its use would not be worth the effort, particularly where home office expenses are relatively minor in amount.

The most commonly suggested alternative to the formula was that the Standard should provide "criteria" for allocation, rather than a specific method or procedure. Some suggested, for example, that the Standard require only that the allocation base be representative of the activity of the segments. Most often the recommended criteria were phrased in such general terms as equity, fairness, and reasonableness. Some suggested total cost input, cost of sales, revenue, payroll, number of employees, or value-added, as a single allocation base.

The Board recognizes that where residual expenses are minor in amount in relation to a contractor's total business volume, the use of other techniques is unlikely to affect materially the amount allocated to a given segment, and is even less likely to affect materially the allocations to individual contracts. The Board has therefore provided in § 403.40(c) that, where residual expenses are no greater than a specified percentage of the organizations, operating revenue, they may be allocated by means of any appropriate allocation technique. To develop the percentages specified in the Standard, the Board considered both actual statistics of various companies and the results of a staff study to determine the effect of the Standard on the home office allocations of a number of companies. The choice of an alternative technique for allocation of residual expenses is expected to be available to many contractors whose home offices perform relatively few functions, or which adequately employ direct allocation or allocations by means of other homogeneous expense pools.

The Board has concluded that where residual expenses are material in amount, a single allocation technique should be specified. Accordingly, § 403.40(c) of the Standard requires the use of the three-factor formula if residual expenses are in excess of the specified percentage of total company revenues. If residual expenses are material in amount, the Board believes that selection of a single allocation technique is necessary to reduce costly controversy in an area where disputes have been commonplace. Furthermore, the Board is of the view that the greater the amount of residual expenses, the greater the likelihood that the use of a single factor base for all contractors could result in inequitable allocations. The use of the three factors in the formula minimizes any distortion that may result from any one

of the factors.

The three-factor formula is selected because it takes into account the major subjects of management concern, i.e., volume or activity, employees, and invested capital. Some companies consider that the time, effort, and attention of top management attributable to various segments are approximately proportionate to the volume or activity of those segments. Revenue is considered by some companies to be a generally reliable and convenient measure of volume or activity. Other companies believe that top management efforts are primarily devoted to the employees of an organization and, therefore, advocate the use of payroll for allocating the cost of these efforts. Still others believe that a major top management concern is the management and deployment of the capital invested in the organization; for the purpose of this formula, the net book value of tangible capital assets and inventories is considered by the Board to be a reasonable representation of invested capital.

(4) *The formula factors.* In addition to permitting an alternative to the three-factor formula for allocating residual expenses, the Board has made certain modifications to the formula itself.

A number of commentators opposed the inclusion of intraorganizational sales, in the revenue factor. Several of these commentators were concerned that this procedure would "pyramid" the allocation of home office expenses to those products which progress through several segments of an organization before they are finally sold to outside customers. Others noted that a segment established primarily to sell products produced by other segments would receive a disproportionately large share of home office expenses under the formula. However, a segment which sells much or all of its output to other segments would receive a disproportionately small allocation of home office expenses if such sales were excluded from the revenue factor. The Board, therefore, has concluded that the operating revenue of a segment shall include sales to other segments, but such operating revenue shall be reduced by purchases from other segments. This procedure will assure an appropriate allocation to each segment, regardless of whether it sells to other segments or to outside customers while at the same time avoiding "pyramiding" of home office expenses.

As originally published in the FEDERAL REGISTER of June 30, 1972, the Standard required the inclusion of rental property in the property factor of the formula. Such property was to be valued at eight times the annual rental rates. Many commentators opposed the inflexible valuation of such property. Others believed the inclusion of rental property at all was en-

tirely inappropriate. Questions were also raised whether, and to what extent, minor, short-term leases would have to be included. In view of these comments, the Board has concluded that tangible capital assets to be included in the formula should be those capitalized in accordance with a contractor's established practices.

The Board, however, did not adopt the recommendation of many commentators that the value of Government-furnished property be included in computing the property factor of each segment. These commentators were of the view that Government property requires as much, or more, management attention as owned property. The Board believes that such administration is mostly accomplished at the segment level, and therefore, residual expenses of the home office are not significantly related. Rather, property is included in the formula as a measure of top management's attention to invested capital.

(5) *Allocation of residual expenses to special segments.* As originally published in the FEDERAL REGISTER of June 30, 1972, the Standard would have required, as a general rule, the allocation of a proportionate share of residual expenses to all segments pursuant to the three factor formula. For this purpose, "segments" included domestic and foreign subsidiaries owned more than 50 percent as well as those subsidiaries owned between 20 percent and 50 percent if the home office exercised significant guidance and control.

Numerous comments were received in regard to these provisions. Commentators observed variously that the percentage of ownership is not in proportion to the benefits received from the home office, that the amount of guidance and control is not in proportion to the percentage of ownership, or that the benefits received are not in proportion to the amount of guidance and control. Some commentators noted that the absence of significant guidance and control is difficult to demonstrate. A number of commentators were particularly concerned about the resultant allocations to subsidiaries owned less than 50 percent, foreign subsidiaries, unconsolidated subsidiaries, and sales subsidiaries. Many commentators observed that subsidiaries often perform their own home office functions, that the necessary information to make the required allocation would not always be available, that subsidiaries could not always be billed for home office costs, or that such allocations would cause tax and legal problems. Various commentators recommended alternatively that allocations to subsidiaries be based on management judgment, on the degree of guidance and control, or on the basis of benefit, rather than on any ownership criteria. Others recommended variously that no allocation be made to subsidiaries owned less than 100

percent, to subsidiaries owned less than 50 percent, or to subsidiaries which are unconsolidated. Still others suggested partial allocations in various forms. One industry association recommended that allocations to subsidiaries be based on advance agreements with the Government.

Upon analysis of the comments received on this subject, the Board is persuaded that a requirement to allocate a pro rata share of residual expenses by means of the formula or other allocation base to all segments, without exception, could result in inequitable allocation in certain situations. In the opinion of the Board, this problem is not necessarily limited to subsidiary corporations, but can extend to other segments. Accordingly, the Board has provided in § 403.40(c)(3) of the Standard that, where the Contracting Officer and the contractor agree that a particular segment receives significantly more or less benefit from residual expenses than would be reflected by the allocation of such expenses pursuant to the formula or other representative base, they may agree to establishing a special allocation of residual expenses to such segment. Any such special allocation must reasonably reflect the benefits received by the segment. Guidance to implement this provision is contained in a new paragraph (d) under § 403.50 of the Standard.

(6) *GOCO's.* Some commentators urged that GOCO facilities be excluded from the definition of segments to receive allocations of home office expenses, arguing that the GOCO facilities receive little or no benefits from home office activities. Several commentators were concerned that this Standard would result in contractors being required to make greater allocations to GOCO's than would be reimbursed to them under the terms of some GOCO contracts. The Board believes that contractual problems associated with the allocation of costs to a GOCO contract pursuant to this Standard, where such costs represent significantly more or less benefit than the GOCO contract actually receives, can be dealt with by agreement, as discussed in the preceding section. The Board intends to consider in the near future the pervasive question of the treatment required by relevant Federal agencies of the costs allocated in accordance with any Standard.

(7) *State and local income and franchise taxes.* The Board believes that the nature of this expense is essentially the same for all companies and that there is little justification for the observed multiplicity of allocation methods being used to allocate to segments their share of corporate State and local income taxes and franchise taxes. By means of an illustration in the FEDERAL REGISTER publication of June 30, 1972, the Board proposed the

allocation of State and local income taxes on the basis of the profit and loss of each segment and specifically requested comments on this particular illustration. Numerous comments were received. While some commentators agreed with the proposed illustration, most did not. Of those that did not, most advocated an allocation method which would allocate such taxes on the basis of the same factors used to compute a segment's share of total corporate taxable income, that generally being the percentage of payroll, sales, and property of the segment to the corporate total of each of these factors. Several commentators noted that they use different allocation bases, such as income or sales, but that these result in approximately the same allocation as one based on the same factors used to compute the tax.

After evaluating the comments, the Board continues to be of the view that the nature of this expense is essentially the same for all companies. Further, allocation of this expense on the same basis used to compute a segment's share of total corporate taxable income is, in the Board's judgment, more in accord with the concept of allocating home office expenses on the basis of the beneficial or causal relationships between such expenses and receiving segments. The Board has therefore revised the illustration for the allocation of State and local taxes to permit "any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction." As a practical matter, this means that the tax for any State must be allocated only to those segments that contribute to the factors used to measure taxable income for that State. If there are several segments that do business within a State, each segment's share of that State's tax is to be measured by the proportionate contribution made by such segment to the total of the factors for that State.

(8) *Cost-benefits.* Many commentators addressed themselves to the last sentence of section 719(g) of the Act which provides that, "In promulgating such standards, the Board shall take into account the probable costs of implementation compared to the probable benefits."

The Board has not neglected its obligation and continues to measure the costs and benefits involved in implementing both proposed and promulgated standards. Its experience to date leads to the conclusion that the kind and amount of empirical data called for by some commentators is neither available nor possible of accumulation. In the final analysis, the Board must determine whether the information

that has been assembled and evaluated is sufficient to enable it to make reasonable judgments.

In making this determination with respect to the present Standard, the Board gave careful consideration to the evidence bearing on the likely initial and continuing implementation costs involved, both for contractors and for affected agencies of the Government. At the same time, consideration was given to the benefits which will be achieved through simplified negotiation, administration, audit, and settlement procedures; one of the major gains of standards, to contractors and the Government alike, is the reduction in the number of costly controversies. After evaluating the Standard being promulgated today, the Board finds that the probable benefits of this Standard clearly outweigh the probable cost of implementation.

(9) *Exemptions.* A number of educational institutions requested that they be exempted from the provisions of this Standard. There appears to be no disagreement that many educational institutions have "home offices" similar in many respects to those of commercial organizations. However, the educational institutions contend that, unlike commercial organizations, they develop overhead rates for institution-wide functional activities, such as education or research, in lieu of overhead rates for organizational segments. According to these educational institutions, it would serve no purpose, therefore, to require allocation of an institution's "home office" expenses to organizational segments. In addition, a number of these commentators noted that there are problems in defining the segments of an educational institution; e.g., whether a segment is a campus, a school, a department or some other organization.

The Board is persuaded that in the light of the present practices of educational institutions in carrying out Government contracts, little purpose would be served at this time by requiring educational institutions to adhere to a standard which prescribed criteria for allocating home office expenses to organizational segments. The Board recognizes that Office of Management and Budget Circular No. A-21, which contains the cost principles applicable to grants and contracts with educational institutions, does not presently require development of indirect cost rates for individual segments of an educational institution. Therefore, for the time being, these organizations which are subject to Office of Management and Budget Circular No. A-21 are exempted from the provisions of this Standard.

In addition, the Board is exempting State and local governments subject to Office of Management and Budget Circular No. A-87 from the provisions of this Standard pending further study of the applicability of this

Standard to such organizations.

(10) *Effective date.* As originally published in the FEDERAL REGISTER of June 30, 1972, the Standard would have had to be followed by a contractor for his first fiscal year following the receipt of a contract to which the Standard is applicable. A number of commentators observed that if a contractor received a contract shortly after the effective date of the Standard and his fiscal year began shortly thereafter, little time would be available to implement the Standard. Most of these commentators requested that at least 6 months be allowed to make the necessary preparations to implement the Standard. To accommodate these requests, the Standard, now being published, requires that it must be followed for a contractor's fiscal year beginning after September 30, 1973.

(11) *Other comments.* In addition to those changes already discussed, the Board has made a number of other changes as a result of the comments received. While these are considered to be of a minor or editorial nature, the Board calls particular attention to the following additional comments.

Various commentators stated that this Standard would require contractors to accumulate and allocate home office expenses on a different basis than that used for internal management purposes. As a consequence, these commentators were concerned that the Standard would necessitate two separate sets of records. Others urged that the Standard specifically permit the use of memorandum records. The Board notes that even in the absence of this Standard, many contractors now use memorandum records to make home office allocations for purposes of Government contracts because they do not make formal allocations of home office expenses to segments, or do so on a different basis. The Board sees no need to disturb the practice of using memorandum records for home office allocations, nor does it view this as being a significant burden on contractors who find the need to do so. However, the Board does not consider it necessary or appropriate to refer specifically to the use of memorandum records by means of this Standard.

Certain commentators recommended that the Standard be specific as to the use of estimated or budgeted amounts, either for pricing purposes or for purposes of actual allocations. The use of estimates or budgets for pricing purposes or for purposes of provisional rates for cost accumulation is customary, and is not considered by the Board to require specific authority by the terms of this Standard.

There is also being published today (37 FR 26678) an amendment to Part 400. Definitions, to incorporate in that part the words and phrases defined in § 403.30 of the Standard.

PREAMBLE B

Amendments, 11-7-73

Preamble to revisions of the definitions of "home office" and "tangible capital asset," § 403.30(a)(2) and (5), and editorial amendments to §§ 403.50(c)(2) and 403.70, 38 FR 30725, Nov. 7, 1973. The document amended 4 CFR Parts 331, 351, 401, 402, and 404 as well as Part 403; material relating to those parts is omitted. It appears in the supplements to those parts.

The purpose of this publication by the Cost Accounting Standards Board is to amend Parts 331, 351, 400, 401, 402, 403, and 404 of its rules and regulations. The amendments, which are minor clarifications to the regulations, were published in the FEDERAL REGISTER of September 5, 1973 (38 FR 23971). The amendments: * * * (c) modify certain definitions in Parts 400, 401, 402, 403, and 404 for the purposes of uniformity among the various Parts. Only one comment in response to the September publication has been received by the Board. This expressed agreement with the proposed changes.

In view of the foregoing, the following amendments to the Board's regulations are being made effective November 7, 1973.

PREAMBLE C

Amendments, 8-4-75

This publication, 40 FR 32747, August 4, 1975, revised § 403.70(a) and made several amendments to Part 351. Only those portions of the preamble which describe the revision of § 403.70(a) are printed here, although the complete preamble appears as preamble F of the supplement to Part 351. A correction to the language which amended § 403.70 was printed at 40 FR 33819, August 12, 1975.

The purpose of this publication by the Cost Accounting Standards Board is to modify Part 351, Basic Requirements, of its rules and regulations and Part 403, Allocation of Home Office Expenses to Segments. A proposed modification to Part 351 was published in the FEDERAL REGISTER of April 3, 1975 (40 FR 14942). Twenty-seven sets of comments were received in response to that publication. After considering those comments, the most significant of which are discussed below, the Board is today publishing an amendment to its rules relative to the requirement for the submission of Disclosure Statements by defense contractors and subcontractors.

* * * * *

6. *Applicability of CAS 403.* A number of commentators noted that the April 3 proposal deleted paragraph 351.41 of the Board's regulations. This paragraph restated the requirement that only companies that met the Disclosure Statement filing requirement for Federal fiscal year 1971 were re-

quired to comply with CAS 403, *Allocation of Home Office Expenses to Segments*. These commentators asked that the Board's position be clarified as to whether or not any current revision to the Disclosure Statement requirement also changed the coverage of CAS 403. It was not the Board's intention to broaden the coverage of CAS 403 at this time. The possibility of extending the coverage of that Standard is the subject of a separate study currently underway. To make the Board's intention wholly clear, § 403.70 of CAS 403 is being revised to state explicitly rather than by cross reference the continuing coverage of that Standard. This revision has no substantive significance whatever, but instead merely sets out specifically what was and continues to be the exemption from that Standard, which was before today accomplished by reference to § 351.40 of the Board's Basic Requirements. Contractors and subcontractors which together with their subsidiaries did not receive net awards of negotiated national defense prime contracts during Federal fiscal year 1971 totaling more than \$30 million continue to be exempt from Standard 403.

PREAMBLE D

Amendment Published 9-12-77

This document amended § 403.70(a) and designated the existing text of § 403.80 as (a) and added (b). The amendment was published at 42 FR 45625, Sept. 12, 1977 as a part of the publication which added Part 332 and amendments to Parts 331 and 351 of this title. The complete preamble appears on the supplement to Part 332.

COMMENTS ON PART 403

With respect to the amendment of Part 403, the November 30, 1976 proposal was to revise that Standard to make it applicable to any contract which was subject to Cost Accounting Standards generally. The amendment being promulgated today retains this concept. However, as recommended by a number of commentators, the Board deferred the promulgation of this amendment pending the amendments to Parts 331 and 351 and the addition of Part 332 discussed above.

The decision to extend the application of Part 403 to additional contractors was made on the basis of extensive research. This research included both those contractors who were already required to use Part 403 and those who were expected to use it as a result of this amendment. With respect to the current users, the Board is satisfied that this Standard has resulted in more equitable allocations, with little administrative effort in most cases. With respect to potential additional users, the research indicated that many of these would have to make few, if any, changes to comply

with Part 403 and that the remainder could comply with little difficulty. The Board notes in addition, an independent study by the Conference Board which found that defense contractors who are using Part 403 for contract costing purposes are using the same allocation procedures for internal reporting purposes. According to the Conference Board, it was typical of these companies to allocate home office expenses on a blanket basis prior to the promulgation of Part 403. (Information Bulletin No. 17, February 1977.)

A number of commentators suggested various limitations for the application of Part 403. Some of these suggestions were expressed in general terms. Some of the commentators recommended, for example, that the requirement to use Part 403 should not be extended to "small contractors." Alternatively or additionally it was recommended that Part 403 should not be required for a large contractor with little work subject to Cost Accounting Standards. More specifically, recommendations were received to exempt those contractors with less than 10 percent of their revenue from Government work. Others recommended that contractors who have less than \$10 million in contracts subject to Cost Accounting Standards should be exempt. The Board believes that the recommendations of this nature have been accommodated to the extent desirable and practical by the amendments to Parts 331 and 351 and the addition of Part 332 being promulgated today. Accordingly, any further exemption from Part 403, specifically, is considered to be necessary.

In publishing the proposed amendment to Part 403 in the FEDERAL REGISTER of November 30, 1976, the Board stated that there is evidence that almost all contractors who were required to make significant changes in their allocation practices as a result of Part 403 did so without undue trouble or expense. Several commentators questioned the Board's conclusion in this regard. The Board's conclusion was based in part on Staff research involving 147 home offices who now use Part 403 to allocate home office expenses. This research sought to determine, among other things, the administrative problems and expense involved in making allocations pursuant to Part 403. Government auditors reported that of the 147 home offices, only 4 had problems in developing the necessary data and that there was evidence of significant administrative costs at one of these four offices. In addition, evidence of significant administrative costs in making the allocations was found by the Government auditors at four other of the 147 home offices.

Some of the respondents who questioned the Board's conclusions regard-

ing administrative problems and expense referred to an industry report on the economic impact of Cost Accounting Standards as support for this position. These respondents variously referred the Board to those sections of the report which summarized (i) contractor's appraisal of benefits from Part 403; (ii) the number of contractors who were required to make changes as a result of Part 403; (iii) the number of noncompliance notices issued in connection with Part 403; and (iv) the increase and decrease in costs allocated to Government work as a result of CAS 403. Nothing in these sections, however, specifically addresses the question of administrative problems or expense involved in complying with Part 403.

Two associations reported that, contrary to the Board's findings, their member companies had experienced trouble and expense in complying with Part 403. These associations declined to identify the companies involved, the nature of the problems, or the amount of the expenses. Under these circumstances, there is no basis to alter the conclusion that contractors have been able to make changes required as a result of Part 403 without undue trouble or expense.

One commentator stated that it would not be desirable to make more contractors subject to Part 403 because he believes it to be defective, particularly with respect to its application to the allocation of state and local taxes. With respect to the application of the Standard to the allocation of state and local taxes specifically, the Board notes that it reached its conclusion on the basis of considerable research and extensive deliberation. Moreover, it has reexamined its conclusion, even after the promulgation of Part 403. Notwithstanding the views of the commentator, the Board continues of the view that the provision in question is proper. Accordingly, the Board does not agree that this Standard should not be extended to additional contractors because of the tax allocation provision.

EFFECTIVE DATE

The effective date of the regulations being published today is March 10, 1978. Pub. L. 91-379 provides that regulations shall take effect not earlier than the expiration of the first period of sixty calendar days of continuous session of the Congress following the date on which a copy of the regulations is transmitted to the Congress. The calendars of the Congress indicate that the required sixty days will not pass until some time in February 1978. Accordingly, March 10, 1978, has been selected to assure sufficient time for the regulation to lie before the Congress.

PREAMBLE E

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 403.10 and 403.70(b). This amendment was part of a publication which added § 331.30(b)(3). Only the portion of the preamble which describes the revision to §§ 403.10 and 403.70(b) are printed here. The remainder of the preamble appears as preamble K of the supplement of Part 331.

* * * * *

In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and is amending standards 401 through 409 as set forth below.

PREAMBLES TO COST ACCOUNTING STANDARD 404, CAPITALIZATION OF TANGIBLE ASSETS

PREAMBLE A

Preamble to Original Publication of Part 404, 12-27-73

Preamble, published at 38 FR 5318, Feb. 27, 1973, to the original publication of this part.

The Standard on Capitalization of Tangible Assets published today is one of a series being promulgated by the Cost Accounting Standards Board pursuant to section 719 of the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. app. 2168), which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

Work preliminary to the development of this Standard was initiated as the result of recognition that the general subject of fixed asset accounting has been the source of continuing problems between contractors and the Government concerning equitable determinations of the costs attributable to performance of specific contracts. The problems include (1) determination of the acquisition costs to be capitalized as opposed to those which are charged against revenues of the current period, (2) determination of appropriate depreciation charges for a given fiscal period, (3) determination of the appropriate allocation of depreciation charges among contractor activities, and (4) determination of appropriate techniques for treating dispositions of fixed assets. The Standard establishes the beginning point for fixed asset accounting as described in (1) above. It does not cover the other related topics.

Early research on this Standard included an extensive review of available literature on the subject and a review of decisions of contract appeals boards and courts. A preliminary analysis of the entire topic of fixed asset accounting was made and a number of issues were identified; comments on this analysis were obtained in response to an extensive mailing. After careful evaluation of the comments, the Board developed and circulated a questionnaire on tangible fixed asset accounting practices. The replies to the questionnaire were considered in the preparation of a preliminary draft of the Standard on Capitalization of Tangible Assets, which was, in turn, widely distributed for informal comment by interested parties.

The Standard now being promulgated is derived from the proposal which was published in the FEDERAL REGISTER for October 5, 1972, with an invitation for interested parties to submit data, views, and arguments to the Board. The Board supplemented that FEDERAL REGISTER publication by sending copies of the FEDERAL REGISTER material directly to organizations and individuals who were expected to be interested. Responses were received from 107 sources, including individual companies, Government agencies, professional associations, industry associations, public accounting firms, universities, and others. All of the comments have been carefully considered by the Board.

Most of those who commented expressed general concurrence with the provisions of the proposal. Many of the contractors who commented indicated that their practices in most respects already complied with the Standard; most suggested that the proposal should be modified only in a few respects. The Board takes this opportunity to express its appreciation for the helpful suggestions and criticisms which have been furnished. Many companies and individuals have devoted significant talent and effort to the improvement of this Standard.

The comments below summarize the major issues discussed in connection with the October 5 proposal and explain the major changes which have been made.

(1) *Adequacy of existing situation.* Some commentators contended that the Board should not promulgate any rules in this area because the applicable principles have been well established and accepted. The Board, however, finds that the existing regulations have failed to establish reasonable uniformity of capitalization practices among comparable organizations.

(2) *Specificity.* Some interested parties criticized the proposed Standard on the basis that it was "too procedural." Those who comment in this vein tend to assert that this Cost Accounting Standard should deal only with

criteria and policies. Others criticized the October 5 proposal as being too general and failing to provide sufficient guidance about treatment of specific types of costs (such as sales tax) or certain types of transactions (such as deferred maintenance).

The Standard provides practical implementation for the basic concept of direct identification of costs with final cost objectives to the maximum practical extent. The acquisition costs of tangible assets should be identified and capitalized wherever the service lives and amounts involved are so significant that contract costs would be distorted if the acquisition costs were not capitalized. The main feature of this Standard is the requirement that contractors consistently apply reasonable capitalization policies in accordance with criteria stated in the Standard.

A policy for capitalization is a policy for distinguishing between assets and expenses. Immediate charge-off is justifiable as a practical expedient in those situations where the improved allocation of cost among cost objectives and accounting periods which would be attainable by capitalization is worth the administrative costs which would be required. Assets with either short service lives or minor acquisition costs are conveniently accounted for as charges against current revenues.

When a transaction is identified as the acquisition of a tangible capital asset, the full cost of acquiring the asset should be capitalized. The Board might have applied this concept by requiring the inclusion of specific elements of cost in the determination of acquisition cost. As one example, it would be appropriate in concept to capitalize sales and use taxes as a part of the acquisition cost because such taxes are clearly caused by the acquisition. However, as many commentators have stated, as requirement to capitalize such taxes and similar costs would require significant changes in contractor's accounting systems, and the benefit from such increased uniformity may not exceed the expected cost to contractors if required to change from their present practices. The Standard, therefore, does not specifically require the capitalization of sales or use taxes or other collateral costs of acquiring tangible capital assets. The subject remains under active consideration by the Board and if further study should indicate that the benefits from increased uniformity in this area would outweigh probable administrative costs, the Board will take affirmative action on this subject.

This Standard does not provide procedural detail for determining the accounting treatment for some specific kinds of transactions related to existing assets. The major problems encountered in practice are those of classification; once specific work is de-

finied, for example, as "preventive maintenance," "routine repair," "major overhaul," "extensive renovation," "addition," "betterment," or some other such classification in accordance with contractor policy, the appropriate accounting treatment can readily be agreed upon.

The Standard leaves latitude to the contractor in establishing his capitalization policy, but it provides some reasonable limits. A major purpose of Cost Accounting Standards is increased uniformity and consistency; this goal implies some reduction in the flexibility which was formerly available.

(3) *Capitalization as an independent issue.* As indicated above, the research which has led to this Standard began as a broad inquiry into a number of closely related issues. Capitalization is only one of those issues. Interested parties have suggested that the Board should not issue a Standard on any single part of the subject of fixed asset accounting until it is prepared to deal comprehensively with all related issues. The major objection is that changes in this Standard may be found to be appropriate when the details of a Standard on depreciation are agreed upon.

After careful consideration of all issues presented, the Board is confident that the Standard being promulgated will be compatible with future Standards. Nonetheless the Board acknowledges that because of future Standards, or for other reasons, modification in this, or indeed in any Standard which it promulgates, may be necessary. Should such modifications be needed, they will be made. This Standard, by helping identify those acquisitions which should be capitalized, will be useful immediately in connection with identifying items whose cost should not be allocated to current contracts.

(4) *Definition of tangible capital asset.* The term "Tangible Capital Asset" has already been defined by the Board in connection with the Cost Accounting Standard on Allocation of Home Office Expenses to Segments. The definition provides that such assets "are to be held for continued use or possession * * * for the services they yield." Some interested parties have suggested that this definition could apply to inventories which are held for sale. The Board considers that the phrase "for the services they yield" is sufficient to show that the term does not apply to inventories. No change is deemed necessary in the published definition.

(5) *Nature of limits.* The Standard requires that each contractor establish and adhere to a reasonable capitalization policy. The Board feels that, in most cases, the contractor is best able to determine what policy will be most suitable for his situation, and that all interested parties will be benefited by

consistent application of appropriate criteria for distinguishing between capital items and those which should be charged off at time of acquisition. In consideration of the possible distortion and inequity which might result from application of an unreasonable policy (significant amounts of long-term fixed asset costs charged to expense at acquisition), the Board considered the desirability of a specific definition of the limits of reasonableness. The proposal published in October, as well as earlier drafts distributed informally, included the requirements that the policy deal with both the expected service life and the acquisition cost. An acceptable policy would not allow an asset to be charged off immediately against revenue if its service life was expected to be in excess of 2 years and its acquisition cost was in excess of \$500.

The Board received many comments on the provision of these specific limitations. Critics have used the term "arbitrary." The Board has considered carefully all the pertinent points and has continued the limits which were earlier proposed. Disclosure statements and other research data obtained by the Board indicate that very few contractors will be required to change their present policies and those few required changes will impact only a few acquisitions. A review of disclosure statements filed with the Board indicates that only 3 percent of the reporting companies had dollar capitalization criteria in excess of \$500. In addition, the fact that specific limits, appropriate today, may need to be revised in the future is not a reason to avoid establishing them today. Limitations can be revised promptly if developments warrant a change.

There have been no established limits on capitalization policies. Accordingly, wide diversity exists among contractors. The Board does not seek to establish a single uniform accounting system for all contractors, but it believes that limits for total cost and useful life should be placed under some uniform constraints. Indeed, the Board feels that procurement authorities are entitled to assurance that contractor capitalization policies will result in the capitalization of those acquired assets which are within specific limits of reasonableness.

(6) *Comparing benefits and costs.* The Congress provided, in section 719(g) of the Act which established the Board, that in promulgating Cost Accounting Standards "the Board shall take into account the probable costs of implementation compared to the probable benefits." Those commenting on the Board's work show considerable interest in this aspect; the comments on the October proposal included a number of remarks on this comparison.

The Board considers the benefits

and the costs which can be related to each specific proposal and also to the total program of developing Cost Accounting Standards. This Standard has, for most contractors, almost no cost. It requires the adoption of a policy; most contractors already have policies which comply with the criteria. Some contractors, however, will have to establish or modify capitalization policies; for these contractors there may be costs. Benefits will be available immediately; contract administration will be improved. Once a capitalization policy is established in accordance with the standard, individual acquisitions can be handled in accordance with the established policy, with a reduction in controversy. This Standard establishes the beginning point for the determination of the costs associated with use of capitalized tangible assets. One of the major benefits of this Standard is, therefore, the provision of a more uniform basis on which the Government and contractors may deal with depreciation expense.

During the development process which led to this Standard, the Board asked for, and received, a number of comments from contractors about the likely costs attributable to the implementation of a proposal such as this one. Most replies indicated little or no cost. Some indicated compliance with this Standard will cause divergence from practices now accepted for other purposes. The Board has found no requirement imposed by other authoritative bodies for continuance of practices inconsistent with this Standard. Divergence, therefore, will occur only if an affected contractor elects, for other purposes, practices inconsistent with the criteria set forth in this Standard.

The Board concludes that this Standard will provide benefits which outweigh the costs of implementation.

(7) *Accounting for assets acquired by lease.* Many commentators suggested to the Board various methods of accounting for assets acquired by lease. This problem is not a new one. Tangible assets can be acquired by various kinds of business transactions and relationships. The accounting principles related to capitalization are most readily applied in connection with purchases. Some lease agreements provide to the user of an asset many of the attributes of ownership. The accounting profession has long been cognizant of difficulties related to determining when assets acquired by lease should be treated as purchases.

The Board agrees that assets actually purchased should (if otherwise appropriate for capitalization) be capitalized even when the purchase transaction is in the form of a lease agreement.

This same determination must be made for other accounting purposes. The accounting profession is now

guided, in this regard, primarily by opinions of the Accounting Principles Board; it is our understanding that the Financial Accounting Standards Board will soon undertake to provide a new statement for the profession on this issue. This Board will carefully consider all authoritative statements of accounting principles to the extent that it can do so while maintaining progress toward its own primary goal of increased uniformity and consistency in cost accounting for contracts.

Those lease acquisitions which are treated as purchases will be subject to this standard; those which are treated as leases will for the time being be subject to the existing procurement regulations which deal with rental costs. The Board is, therefore, willing that the contractor determine, for each acquisition, whether it is a purchase and hence subject to his capitalization policy (which must comply with the criteria established in this Standard) or a rental transaction and hence subject to established regulations on rental costs. In either case, determination of the reasonableness of the lease costs remains the responsibility of the procurement agencies and is not dealt with here by the Cost Accounting Standards Board.

(8) *Investment Credit.* The October proposal included a specific provision that the Investment Credit pursuant to the Revenue Act of 1971, Pub. L. 92-178, need not be deducted from the purchase price of tangible capital assets in establishing the acquisition cost of the assets. Several interested parties criticized the language used in this provision. Public policy on the point is clear; the Board, by including a specific provision, did not intend to change the situation. The Investment Credit need not be deducted, and there is no need for a specific provision on this point. The Board has, therefore, removed the provision.

(9) *Indirect cost for constructed assets.* The October 5 proposal contained a provision that the acquisition costs of assets constructed or fabricated by a contractor should include the indirect costs allocable to final cost objectives. The Board specifically drew attention to this treatment of such assets and requested that anyone advocating an alternative treatment should set it forth in detail with reasons for favoring it. Numerous commentators opposed the Board's proposed treatment of constructed assets, stating variously that the allocation of general and administrative expenses to such assets was contrary to generally accepted accounting principles (since such expenses are period costs), was not required by existing Government regulations, and no one accounts for such assets in this manner. A few suggestions for alternative treatment were made. Most of them dealt with allocating to constructed assets only variable indirect costs that could be di-

rectly identified with the assets constructed.

For financial reporting purposes some indirect costs are identified as period costs and are not considered to be inventoriable. Consistent application of the full costing concept generally applicable to Government contract costing is not compatible with that period cost concept; for such contract costing, all costs—including those otherwise considered as period costs—must be associated with final cost objectives. The October 5 proposal identified constructed assets as projects which should be treated as final cost objectives and share in indirect cost allocations. This treatment is consistent with the costing practice which would be followed if the Government contracted for the construction of fabrication of the assets in question.

The Board continues to be of the view that application of the full costing techniques applicable to Government contract costing requires that full consideration be given to the applicability of fixed overhead including general and administrative expense to constructed assets. Some fixed overhead at the operations level and certain general and administrative expenses are often allocable to constructed assets based on their beneficial relationship to the construction effort. Costs generally not so allocable could include selling expenses, bid and proposal expenses, and the like.

Therefore, tangible capital assets constructed which are identical with or similar to the contractor's normal product should receive an appropriate share of all indirect cost including general and administrative expenses. In addition, other constructed tangible capital assets requiring significant indirect support also should be burdened with their allocable share of indirect costs, where such indirect costs are material. The revised § 404.50(b) reflects this position.

(10) *Grouping of assets.* The proposed standard as published October 5 was construed by a number of readers to imply that capital assets should be accounted for on a unit basis and not in groups. The Board did not intend any such implication. The Board's interest is in costing principles and the requirements to capitalize does not extend to the specific type of records to be maintained.

(11) *Rearrangement costs.* Many of the controversies related to capitalization are encountered in connection with costs incurred subsequent to the acquisition of an asset. Routine repair costs are unquestionably to be charged off against current revenues, while costs of major betterments are clearly to be capitalized. Costs which are not at either extreme are more difficult to account for. The October 5 proposal included a restatement of the principle that "costs incurred subsequent to the acquisition of a tangible capital

asset for activities which extend the life or increase the usefulness of that asset (e.g., betterments) and which meet the contractor's established criteria for capitalization shall be capitalized." This aspect of the proposal was generally favored by commentators. The proposal continued with the requirement that expenditures for rearrangement and reconversion of tangible capital assets, if they extend the life or increase the usefulness of those assets, and which meet the capitalization criteria, should be capitalized. This requirement has been criticized; many contractors assert that rearrangement costs, as they use the term, should never be capitalized.

The Board agrees that rearrangements of the sort normally expected to maintain the usefulness of assets should not be capitalized. The Board expects that rearrangements of the sort which extend the life or increase the usefulness otherwise anticipated from tangible capital assets, will be classified as betterments and capitalized in accordance with the requirements of the standard. Accordingly, the term "rearrangement" has been deleted from the standard.

(12) *Special purpose equipment.* The Board has received a number of suggestions that the Standard should provide explicit coverage for special purpose assets. Consideration was given to this issue in the research which led to the October 5 proposal. "Special tooling" and "special test equipment" are defined in Government procurement regulations; expenditures of such assets are properly charged against the contracts for which their acquisition is authorized. The suggestions for modification of the October 5 proposal on this point mostly deal with acquisitions which do not qualify as "special tooling" or "special test equipment."

Contractors do acquire assets which are expected to have technological or engineering capabilities for long periods but for which the contractor does not foresee any significant utility after the completion of a particular contract. Such assets are not "special purpose" assets. Rather they are assets for which the contractor expects relatively short economic service life (as compared with the physical potential). Most suggestions for a change in the standard at this point seemed to be based on the belief that these assets should not be capitalized. The standard being promulgated today is applicable to all acquisitions; each contractor's policy is required to include appropriate criteria (e.g., estimated service life and economic usefulness) for identification of capitalizable assets, including those which are unusual.

(13) *Donated assets.* Some commentators opposed that part of the standard which requires the capitalization of assets donated by the Government. These commentators pointed out that such treatment may eventually result

in depreciation charges to Government contracts and that Government regulations today make such depreciation charges unallowable. The allowability of depreciation costs of assets donated by the Government will not be influenced by the requirement that such assets be capitalized.

(14) *Original complements of low cost equipment.* A number of interested parties were concerned with the concept of original complement. Those who commented asserted that there was an inconsistency in capitalizing items of little value, that it would be difficult to identify or control individual items, and that alternative accounting methods were used to achieve the same results of normalization of cost between periods.

The Board's primary purpose in requiring the capitalization of original complements is to assure allocation of incurred cost to applicable current and future accounting periods. The Board sees no inconsistency in this purpose.

The total original complement should be treated as a tangible capital asset. Therefore, the Board expects that a contractor will identify and control the original complement as an entity rather than account separately for each individual item which comprises the total complement.

The Board recognizes that several methods are used to distribute the cost of original complements to future accounting periods:

(1) Treating the complement as a tangible capital asset subject to depreciation, (2) treating the cost as a deferral charge, or (3) treating the original complement as an inventoriable asset. A standard on depreciation is expected to prescribe acceptable methods for charging the cost of original complements to accounting periods; the standard being promulgated today requires that the complement be capitalized.

(15) *Asset accountability unit.* A number of interested parties indicated problems with both the concept and definition of a retirement unit as published in the October proposal. The term retirement unit has been changed to "Asset Accountability Unit" which the Board believes to be more descriptive of the concept actually applied in identifying components of major assets. These units, to the maximum extent practical, should be identified and separately capitalized upon acquisition and, whether or not they have been previously separately capitalized, they should be removed from the asset accounts when disposed of. Replacement units should also be capitalized.

(16) *Application of the standard.* Several universities commented that the proposed Standard should not apply to them because universities generally do not use depreciation techniques. Under existing procurement regulations, universities are entitled to

a use allowance for fixed assets in lieu of a depreciation charge. The Board believes that the Standard on Capitalization is applicable to universities and others in determining capitalized cost for computation of use allowances or similar purposes and for identifying those items which are not appropriate for current charges. Therefore, no exemptions are provided for by this Standard.

There is also being published today (38 FR 5318) and amendment to Part 400, Definitions, to incorporate in that part the words and phrases defined in § 404.30 of the Standard.

PREAMBLE B

Amendments, 11-7-73

This publication, 38 FR 30725, Nov. 7, 1973, amended § 404.30(a)(4) by revising the definition of "tangible capital assets".

The purpose of this publication by the Cost Accounting Standards Board is to amend Parts 331, 351, 400, 401, 402, 403, and 404 of its rules and regulations. The amendments, which are minor clarifications to the regulations, were published in the FEDERAL REGISTER of September 5, 1973 (38 FR 23971). The amendments: (a) Re-number Parts 331 and 351 to facilitate insertion of future modifications to those parts; (b) clarify one section of the contract clause at § 331.5; and (c) modify certain definitions in Parts 400, 401, 402, 403, and 404 for the purposes of uniformity among the various Parts. Only one comment in response to the September publication has been received by the Board. This expressed agreement with the proposed changes.

In view of the foregoing, the following amendments to the Board's regulations are being made effective November 7, 1973.

PREAMBLE C

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 404.10. This amendment was part of a publication which added § 331.30(b)(3). Only the portion of the preamble which describes the revision to § 404.10 is printed here. The remainder of the preamble appears as preamble K of the supplemental to Part 331.

* * * * *

In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and is amending standards 401 through 409 as set forth below.

PREAMBLE D

Amendments published 3-3-80

This publication, 45 FR 13721, Mar. 3, 1980, revised § 404.40(b)(1) and § 404.80(b) and amended § 404.60(a)(1) introductory text, (a)(1)(i) and (ii).

SUMMARY

Part 404 includes a requirement that defense contractors have written policies for capitalization of tangible assets. Each such policy must include a minimum acquisition cost criterion, which has not been allowed to exceed \$500. The Standard is being amended to raise the limit to \$1,000. The purpose of the change is to permit contractors to adopt practices appropriate in today's economy.

EFFECTIVE DATE

December 20, 1980.

SUPPLEMENTARY INFORMATION

(1) *Background.* The amendment being promulgated today was, in one sense, anticipated at the time the Board promulgated Cost Accounting Standard 404. In its publication of February 27, 1973 the Board commented ". . . that specific limits, appropriate today, may need to be revised in the future. . . . Limitations can be revised promptly if developments warrant a change." This amendment is a specific recognition that a change is warranted.

The amendment now being promulgated is derived directly from the proposal which was published in the FEDERAL REGISTER for January 2, 1980 (45 FR 48) with an invitation for interested parties to submit comments. The Board sent copies of the proposal directly to organizations who were expected to be interested. The Board received 25 letters of comment on the January 2 proposal. The Board appreciates the participation by interested parties in its continuing effort to maintain the effectiveness of its Standards and regulations.

The remarks which follow summarize the major issues discussed in the comments on the January 2 proposal.

(2) *The specific change from \$500 to \$1,000.* CAS 404, as promulgated in 1973, contained a requirement for a written capitalization policy. The policy was required to include a minimum acquisition cost criterion, and that criterion was not allowed to exceed \$500. The \$500 limitation, selected as a ceiling to prevent unreasonable policies, encompassed the practices of 97% of the companies whose Disclosure Statements were filed with the Board.

The Board, recognizing that circumstances have changed significantly since the promulgation of Standard 404, authorized an inquiry into capitalization practices. With the cooperation

of the National Association of Accountants, the Board mailed a questionnaire to about 200 NAA members who were able to describe the practices of large, medium, and small manufacturing firms which had not been influenced by the limitation of Standard 404. The Financial Executives Institute also mailed a similar questionnaire to about 900 of its members and asked them to furnish information directly to the Board. The responses received by the Board indicated that capitalization practices have indeed changed since the promulgation of Standard 404. Freely adopted policies now tend to include higher monetary criteria than were common in 1973.

The Board is persuaded that the change is related to changing economic circumstances, and that a change in the acquisition cost criterion is warranted. The January 2 proposal was to change from \$500 to \$1,000. Those who commented on the proposal were generally in favor of the specific change which had been proposed. The amendment being promulgated is unchanged from the January 2 proposal in this regard.

(3) *Use of index techniques for future changes.* The Board received several suggestions dealing with the idea that, in considering similar revisions in future years, the Board should use index techniques. The Board considered this general idea before making the January 2 proposal. The Board had reviewed the performance of several official measures which might have been used if an index technique were to be adopted. The increases from 1972 to 1979 were from about 60% to about 80%, suggesting that if \$500 was the right limit at the time Standard 404 was developed, a limit of about \$800 or \$900 might be appropriate at the end of 1979. The questionnaire responses included a significant number of business units using \$1,000.

The Board will continue to consider the appropriateness of the \$1,000 limitation now being imposed. The impact of inflation, as recorded in several official indexes, will be among the factors considered. The Board is, however, not prepared to provide for any automatic amendment of the dollar limitation in Standard 404.

(4) *Other clarifying language.* It was suggested that, while the Standard is being amended anyway, the Board could reduce possible misunderstandings by modifying the language in two places.

The fundamental requirement of the Standard calls for a written capitalization policy which designates ". . . economic and physical characteristics for capitalization of tangible assets." The suggestion was made that this provision be modified by adding a clarifying phrase so that it would read ". . . economic and physical characteristics which must be met before an

item is required to be capitalized." This suggestion was made in order to emphasize that the service life and unit cost are not the only characteristics to be considered in making a capitalization decision. The basic belief behind the suggestion is valid. The Board agrees that other criteria, such as ability to maintain physical identifiability, may be appropriately included in a policy, and items which are not capitalizable because of failure to meet one of the criteria specified in the policy should not be capitalized even if the estimated service life and monetary cost are in excess of those stated in the policy. The Board believes that the existing language of § 404.40(b) is clear in this regard, and no change is considered necessary.

The Standard now provides, at § 404.40(b)(4), that ". . . higher minimum dollar limitations . . ." may be designated for betterments and for original complements. Some accountants believe that the distinction between an expenditure for "repair" and one for "betterment or improvement" can best be made by considering the relationship between the expenditure and the original cost or the replacement value of the item being rebuilt or modernized. They believe it is reasonable to propose a capitalization policy which includes a percentage criterion which will, in turn, result in a different dollar criterion in each situation. One commentator suggested that the Board should eliminate the word "dollar," so that the amended Standard would allow the designation of ". . . higher minimum limitations. . ." The Board has no objection to policies which are stated in percentage terms over the range of typical application. The Board, however, feels that it is quite reasonable to provide a monetary limit above which any betterment will be capitalized even if its cost is a low percentage of some other asset's cost. The Board is therefore not making the suggested change, but it does take this opportunity to recognize that a capitalization policy for betterments can quite reasonably include a sliding scale or percentage technique provided that it also includes a specific monetary limit.

(5) *Effective date.* The January 2 proposal would have applied to assets acquired in contractors' cost accounting periods which begin on or after January 10, 1981. Several commentators urged an earlier effective date. The Board always tries to allow adequate time for contract administrators to prepare for changes. This amendment does not require any action; rather it provides the possibility for action. The Board has changed the effective date to December 20, 1980. This change will make the amendment effective much sooner for many contractors while still allowing sufficient

time for administrative implementation of the amendment.

(6) *Comparing Costs and Benefits.* The Board's January 2 publication included an explicit request for advice with respect to probable costs of implementation as compared with probable benefits. Only a few commentators dealt at all with this issue, and none of them in quantitative terms. All those who discussed this issue indicated that they expected benefits from the amendment, and that the benefits would outweigh any costs of implementation. No commentator objected to the proposal. The Board is persuaded that the probable benefits will exceed the probable costs of implementation.

Title 4 CFR 404, Capitalization of Tangible Assets is amended as follows:

PREAMBLES TO COST ACCOUNTING STANDARD 405, ACCOUNTING FOR UNALLOWABLE COSTS

PREAMBLE A

Preamble to Original Publication, 9-6-73

Preamble to the original publication of Part 405, Sept. 6, 1973, at 38 FR 24195.

The Standard on Accounting for Unallowable Costs is one of a series being promulgated by the Cost Accounting Standards Board pursuant to section 719 of the Defense Production Act of 1950, as amended, Pub. L. 91-379, 50 U.S.C. app. 2168, which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

Work preliminary to the development of this Standard was started as a result of recognition of the continuing problem concerning the accounting treatment of unallowable contract costs. There has been a lack of uniformity or comparability in the cost accounting treatment accorded unallowable costs after specific determination of their unallowability. There have also been reported problems concerning the content of indirect-cost allocation bases where unallowable costs are involved. Further, there have been instances reported of inclusion of unallowable costs in the base for progress payment billings.

There is no present requirement in agency regulations for contractor identification of unallowable costs. As a result, reports prepared by Government auditors contain frequent references to costs which are known to be unallowable but disclosed only through an audit. The Board has concluded that the identification of costs determined to be unallowable should be the subject of a Cost Accounting Standard.

This Standard requires the identification of specific costs at the time

such costs first become defined or authoritatively designated as unallowable. The Standard also establishes guidelines for the cost accounting treatment to be accorded such identified costs. The Board believes that application of this Standard will provide a greater degree of uniformity in the determination of costs of negotiated defense contracts.

Early research on this Standard included a review of available literature on the subject, a review of the decisions of contract appeals boards and courts, and meetings with contractors and other organizations and individuals concerning their operations and philosophy relative to the treatment of unallowable costs.

This research led to the publication of a proposed Cost Accounting Standard in the FEDERAL REGISTER of March 30, 1973, with an invitation for interested parties to submit written data, views, and comments to the Board. To assure that those who had already expressed interest in the proposed Standard had an opportunity to comment, the Board supplemented the FEDERAL REGISTER notice by sending copies of the published material directly to several hundred organizations and individuals.

Responses were received from 67 sources, consisting of individual companies, Government agencies, professional associations, industry associations, public accounting firms and others. All of these comments have been carefully considered by the Board. Those comments which are of particular significance are discussed below, together with an explanation of the changes made to the proposed Standard published in the FEDERAL REGISTER of March 30, 1973.

Government commentators generally regarded a requirement for identification of unallowable costs as being reasonable and desirable as long as it recognized that there is room for agency judgment relative to the allowability of individual cost elements. The reaction from industry sources was generally in opposition to a Standard on this subject. The reaction from other commentators was mixed. The Board notes that in the comments by industry representatives are a significant number of admissions that at least some unallowable costs can be identified clearly in advance and, in fact, are so identified by many contractors.

The Board has greatly benefited from the many comments it received on the Standard as published in the FEDERAL REGISTER of March 30, 1973. The Board takes this opportunity to express its appreciation for the suggestions it has received, and for the time devoted to assisting the Board in this endeavor by the many companies and individuals involved.

1. *General—Need for a Standard.*

Those who took specific exception to the need for or propriety of a Standard raised a number of issues. Following is a summary and discussion of each of the major issues raised:

(a) *Existing procurement regulations and procedures are adequate to resolve what is essentially an administrative issue, and are more appropriately relied upon for accomplishing the stated purposes of the Standard.*

The Board does not agree with this argument. Although the regulations of procurement agencies deal extensively with the definition of those items of cost which are not to be accepted as allowable under Government contracts, they do not require contractor identification of unallowable costs and provide only minimal guidance as to the cost accounting treatment to be accorded such costs.

The Board notes that the idea of "unallowable costs" is a concept not generally applied in commercial cost accounting, and that it apparently has no direct relevance to the process of allocating costs incurred to final cost objectives. The Board's function is to promulgate Cost Accounting Standards to "be used by all relevant Federal agencies and by defense contractors and subcontractors in estimating, accumulating, and reporting costs in connection with the pricing, administration and settlement of all negotiated prime contract and subcontract national defense procurements with the United States in excess of \$100,000." The identification and measurement of unallowable costs are directly relevant to this function. In the performance of its assigned responsibility, therefore, the Board finds that a Standard establishing a concept of unallowable costs and providing for the identification, measurement, and reporting of such costs will be useful and desirable.

The Board believes that recognition of the cost accounting concept that all costs incurred in carrying on the activities of an enterprise are allocable to the cost objectives of the enterprise is essential to the maintenance of sound and consistent contract cost accounting. This is particularly significant in providing for consistent policies governing allocations of indirect costs, as discussed in greater detail in connection with the issue of indirect-cost allocation bases. It is also important in connection with the profit determinations of the Renegotiation Board, where it is necessary to determine the total costs properly allocable to renegotiable contracts. Cost Accounting Standards should result in determination of costs which are allocable to contracts and other cost objectives. The use of Cost Accounting Standards, however, has no direct bearing on allowability determinations.

(b) *The published proposal constitutes an inflexible procedural requirement rather than a cost accounting standard; it deals with minutiae and will necessitate considerable additional accounting effort and record keeping.*

The Board does not believe that a requirement for contractor identification of costs known to be unallowable, or which have clearly been designated as unallowable, represents an undue burden. It is reinforced in this belief by the fact, as stated in several of the comments received and as further shown by the Board's research, that many contractors already provide this identification, and often with a greater detail of recorded cost segregation than is required by the Standard. Revised wording has been provided to make clear the Board's intent to require only such detail and depth of cost allocation and record keeping as is necessary to provide appropriate cost visibility. Provisions for accounting recognition of unallowable costs are considered appropriate for a Standard.

The Board does not agree that this standard deals with minutiae. A significant amount of the time of both Government and contractor personnel is spent in identifying contract costs and in negotiating their allowability. The cumulative impact of unallowable costs can significantly affect contract cost reimbursement and pricing. For example, in fiscal year 1973, the Department of Defense disallowed costs exceeding \$200 million. The Board believes that a Standard which will foster earlier and more precise identification of unallowable costs, and thereby narrow the areas of cost search, disagreement and negotiation of differences, will be beneficial.

(c) *A standard requiring specific identification of unallowable costs will only lead to added controversy and impair the freedom of contracting parties to negotiate equitable treatment of costs.*

This issue is closely related to the first issue discussed above, but is addressed to the problems and interpretative differences involved in the classification of costs as allowable or unallowable.

The Board acknowledges that there may seldom be full agreement between the parties to a contract as to all of the specific items of costs which are unallowable under pertinent laws, regulations and contractual provisions, and that negotiation must, therefore, be resorted to as a practical means of resolving differences. The Standard does not contemplate interference with such negotiations. However, by requiring consistent cost accounting recognition and appropriate accounting treatment of costs agreed to be unallowable, or which are authoritatively designated as unallowable, the Standard should encourage more definitive

negotiated agreements. More specificity in agreements should help to limit the areas of future negotiation or dispute to those where there is a rational basis for disagreement.

2. *Directly Associated Costs.* The published version of the proposed Standard defined a directly associated cost as, "Any cost which is generated solely as a result of the incurrence of another cost and which would not have been incurred had the other cost not been incurred." It then provided, in effect, that directly associated costs of identified unallowable costs should be included with the unallowable costs with which they are associated, and be accorded similar cost accounting treatment. These provision of the Standard, which were intended solely to cover costs which were incremental with respect to identified unallowable costs, drew comment from disparate sources. Those who disagreed with any attribution of nonallowability to costs which were not unallowable by nature but merely by association were opposed to the directly associated cost concept. Also, some of those favoring such attribution, while not opposed to the concept, interpreted the Standard as encroaching upon, or narrowing the application of, existing regulatory provisions governing cost disallowances, and expressed disagreement with the proposed coverage on this basis. After careful consideration of the comments on this issue, the Board has concluded that coverage in the Standard of directly associated costs is appropriate and necessary.

The Board notes that various regulatory provisions use such nondefinitive terms as "corollary administrative costs," "related collection costs," "related legal costs," "incidental costs relating thereto," "other related costs," etc., in describing unallowable costs. In such cases, the Board considers that the identification and measurement of costs covered by these broadly worded provisions is a function of cost accounting, and therefore appropriate for coverage in this Cost Accounting Standard as directly associated costs.

In light of the above considerations, the Board has retained coverage of directly associated costs. The Board, however, recognizes that treatment of a cost as an unallowable directly associated cost in certain circumstances could result in double counting with respect to a class or category of costs included in an indirect-cost pool that will be allocated over a base containing the designated unallowable costs with which the cost in question is associated. In such circumstances, the Standard requires that the cost shall not be classified as a directly associated cost, but rather shall be retained in the indirect-cost pool and allocated through the regular allocation process.

3. *Expressly Unallowable Costs.* The

requirement in the proposed Standard for contractor identification of "costs which are patently unallowable" gave rise to expressions of concern on the part of number of respondents. These ranged from allegations of general impracticability of compliance to apprehensions that the lack of a clear definition would lead to overzealous implementation by auditors and contracting officers and to increased controversy.

Various alternative suggestions were made by commentators. One such suggestion was that identification be required only when there is mutual agreement on unallowable costs by the parties to a contract. This, however, would be likely to minimize one of the benefits of the Standard; namely, the reduction of the time and effort spent in audit and negotiation covering costs whose nonallowability is obvious. Also, items requiring agreement are covered by other provisions of the Standard.

A second suggestion made by respondents was that this requirement be made applicable only to costs which the contractor considers or determines to be "patently" unallowable. This suggestion, however, is subject to the obvious criticism that any requirement that would provide the party subject thereto with absolute freedom of choice as to what constitutes compliance would be of dubious effectiveness. The Standard, of course, clearly provides for the contractor to be the party having the primary responsibility of making the initial determination as to what costs incurred by him are obviously unallowable.

A third suggestion offered by respondents was that the Standard provide a definition, or examples, covering the costs which are considered to be "patently" unallowable. The Board felt that this suggestion had merit. Because of apparent confusion as to the usage of the term "patently," the Board has substituted the word "expressly" in the Standard, and has included a definition of "expressly unallowable cost." Most of the items of cost that are of the type required to be accounted for as expressly unallowable are specified in agency procurement regulations (e.g., ASPR 15-205). It would not be practical to list the items of cost that may be made expressly unallowable under the specific provisions of contracts. The Board, in its definition of an "expressly unallowable cost," has used the word "expressly" in the broad dictionary sense—that which is in direct or unmistakable terms.

With regard to the stated concern about overzealous implementation by auditors and contracting officers, the Board has previously stated that the administration of its rules, regulations, and Cost Accounting Standards should be reasonable. The Board anticipates that this rule of reason will be applied in the implementation of this Standard. Thus, where a good faith effort

has been made by a contractor, in the development and implementation of his cost accounting rules, procedures, and practices, to provide for identification of expressly unallowable costs, it is intended that inadvertent failure to properly classify a particular item of cost will not be regarded as noncompliance.

The Board has retained the requirement for contractor identification of costs which are unequivocally made unallowable by the express provisions of an applicable law, regulation or contract. The Standard, however, has been revised to make clearer the accounting distinction between costs which are either expressly unallowable or mutually agreed to be unallowable and costs which are designated as unallowable by the unilateral exercise of a contracting officer's authority under contract disputes procedures. Solely for the purposes of this distinction, the provision in the revised Standard setting forth the identification requirement for expressly unallowable and mutually-agreed unallowable costs also specifies that these are costs which shall be excluded from Government-contract billings, claims, or proposals.

4. *Indirect-cost allocation bases.* By far the largest number of comments were addressed to the requirement in paragraph (c) of § 405.40 of the proposed Standard, that unallowable costs shall be subject to the same cost accounting requirements as allowable costs in determining the content of cost-oriented bases for allocation of indirect costs. This is an issue which appears to have produced an almost complete polarization of the viewpoints of Government representatives and of the parties with whom they contract.

Current agency regulations (e.g. ASPR 15-203(c)) provide, in essence, that indirect-cost allocation bases should not be fragmented for purposes of removing individual elements therefrom. They therefore provide that unallowable costs in an allocation base shall "bear" their pro rata share of the indirect costs in the pool being distributed. The wording of these regulatory provisions has commonly been interpreted as meaning that the indirect costs shall assume the allowability status of the costs in the allocation base. Comments on this regulatory requirement, therefore, have centered on the issue of making otherwise allowable costs unallowable, rather than on the broader accounting principles that should govern cost allocation.

As previously indicated, the Board believes that the issues concerning cost allocation and those relating to cost allowance are distinct and separate. Allowability should not be a factor in the selection or in the determination of the content of an allocation base used to distribute a pool of indirect costs. The appropriateness of

a particular allocation base should be determined primarily in terms of its distributive characteristics. Any selective fragmentation of that base which eliminates given base elements for only some of the relevant cost objectives would produce a distortion in the resulting allocations. The Board, therefore, is retaining the requirement that unallowable costs be subject to the same cost accounting principles as those governing allowable costs.

When an item, activity, or function has been deemed unallowable by other relevant authority, the Board in this Standard has approached the determination of the costs related to the unallowable item, activity, or function in three stages: (a) Its direct cost, (b) its directly associated cost, and (c) the indirect costs allocable by means of a base containing such costs. This has been done because, while there is usually no question that the relevant authority intended that the direct cost (a) be disallowed, there may be questions as to whether costs (b) and (c), otherwise allowable, were intended to be disallowed. The latter two costs are, therefore, required to be separately identified and measured so that their allowability can be resolved through the procurement process.

In concluding that indirect-cost allocation bases should not be fragmented solely for purposes of removing unallowable base elements, the Board is not implying that the elimination of all or part of a base element for other purposes is always inappropriate and inconsistent with sound cost accounting.

5. *Contracting Officer decision.* Many respondents questioned the requirement, in § 405.40(a) of the proposed Standard, for identifying as unallowable those costs "designated as unallowable as a result * * * of * * * a final decision of the contracting officer issued pursuant to contract disputes procedures." Concern was expressed that this gave too much standing to the unilateral administrative decision of the contracting officer, and did not recognize contractors' right of appeal to the boards of contract appeals and the courts.

The Board recognizes that legitimate disagreements over allowability often are not finally resolved by contracting officers' decisions. The Board notes, however, that the Standard distinguishes between costs which are "expressly unallowable" and costs which are "designated as unallowable." To further the distinction, and to remove a possible source of misinterpretation, the words "final decision" have been changed to "written decision," to conform to wording in agency regulations governing disputes procedures. The Board believes that, although the written decisions of contracting officers pursuant to formal disputes clause procedures are subject

to appeal and possible reversal, they nevertheless constitute authoritative designations, and represent the culmination of a process of audit and negotiation. Furthermore, they are binding on the parties to a contract until and unless changed on appeal. The Board, therefore, considers that any definitive designations of unallowable costs which are provided in the contracting officers' written decisions warrant identification, and it has retained this requirement.

A further objection was raised by some commentators to the requirement, in paragraph (a) of § 405.50 of the published proposal, for future recognition of costs identified as unallowable, or of other costs incurred for the same purpose in like circumstances. The observation was made that future circumstances might warrant different conclusions as to allowability.

The Board recognizes that identical costs may be unallowable under one set of circumstances, but nevertheless be determined to be allowable under different conditions, or as a result of changed criteria. The Board, however, believes that specific designations of the allowability status of particular classes or categories of cost should be given consideration in the evaluations of any like costs which are governed by the same allowability criteria and which are incurred for the same purpose in like circumstances. The provisions in the Standard which reflect this viewpoint have been clarified.

The Board notes that the identification of costs covered by an adverse contracting officer decision will not prevent a contractor from continuing to claim such costs, where disagreement as to allowability continues. It serves merely to identify the costs for special consideration, thereby helping to assure adequate reevaluations, and to promote resolution of the issues involved in the disagreement. Reversal of the contracting officer's decision by a final appeals board or court ruling would, of course, relieve the contractor of any identification requirement under the Standard covering the costs involved in the ruling.

6. *Accountability for unallowable costs.* A number of comments were received concerning what some writers interpreted as an unnecessary and improper requirement for detailed accountability covering costs which are absorbed by the contractor and therefore should not be of any legitimate concern to the customer. The Board does not intend requiring cost identification or cost allocation which is not relevant to the determination of Government contract cost. The Standard requires identification of unallowable costs only to the extent needed for audit verification of the costs which are included in, or which provide backup support for, proposals, billings, or claims. Appropriate revisions have

been made in the Standard.

7. *Colleges and universities.* A number of comments were received from university officials expressing concern that, because colleges and universities contracting with the Government are subject to a different set of contract cost reimbursement principles than commercial organizations, and operate in a different accounting environment, the proposed Standard might present implementation problems if applied to these institutions. These comments have been carefully considered, and supplementary discussions have been held with some of the officials concerned.

On the basis of its analysis of the practices described by commentators as having been deemed acceptable in the past, and of the underlying principles and contractual requirements, the Board believes that the Standard, as revised, can be applied to colleges and universities without any disruption of practices which are acceptable under applicable laws and regulations.

Particular concern was expressed over what was reported to be a common situation, where certain costs, such as faculty salaries, are excluded from contract costs even though such costs may directly pertain to work performance which is an intrinsic part of the contract project. The Board notes that specific identification with, or allocation to, individual contracts and other final cost objectives is not required for costs which will not be included in, nor constitute pertinent backup support for, any proposal, billing, or claim. The Standard requires only that sufficient identification be provided to enable verification of the allocability status of unallowable costs and the accounting treatment actually accorded such costs. The Board, therefore, does not believe that any special provision is required covering the situation described.

8. *Materiality.* A number of comments were received suggesting that the question of materiality be given more consideration in the Standard. The recognition of the materiality problem in paragraph (f) of § 405.50 of the proposed standard was endorsed, but concern was expressed that limiting application to circumstances where there was a "low incidence of negotiated Government contracts relative to other types of work" would render the provision ineffective.

Several instances of potential problem areas were mentioned. One of these concerned the situation where corporate headquarters' expenses are allocated to segments which are involved in a relatively insignificant volume of Government contract work. Another cited the case of a standard cost accounting system covering the manufacture of standard products which may incidentally be used as material or components in contract work. A third referred to the problem of de-

termining "true" cost of an individual product in a joint-product, joint-cost production situation. Another problem area is that involving determination of the share of indirect expense to be assigned as costs of a proscribed organizational or functional activity.

The Board recognizes that accounting for unallowable costs (which are themselves often determined only through negotiation) is an area where the question of materiality should be given special consideration. In providing this consideration, many factors should be taken into account. These include not only the materiality of the total unallowable costs, but also the materiality of the refinements in determinations of unallowable costs which might be achieved through requiring detailed application of the Standard, as contrasted with negotiating the agreements authorized under the proposed paragraph (f) of § 405.50. The Board, accordingly, has revised the Standard to include an amended paragraph (c) which, "based upon considerations of materiality," permits agreements that will satisfy the purpose of the Standard. The Board believes that, in applying the materiality provision of the revised paragraph (c), consideration should be given to the criteria listed in the section titled "MATERIALITY" in the Board's March 1973 "Statement of Operating Policies, Procedures and Objectives."

9. *Improperly allocated costs.* One commentator raised a question concerning the accounting treatment to be accorded costs which are disallowed because they are erroneously allocated to the contract under which they are claimed. The Board does not believe that the Standard needs to deal with accounting errors of this type. It is obvious that the accounting treatment to be accorded any item of cost should be determined by that cost's correct positioning in the cost accounting structure.

10. *Cost/benefit.* Only limited comments were received on the subject of the implementation cost of the Standard, and several of these indicated only minimal impact. Of those claiming significant additional implementation expense, none provided any data as justification for the claim. The Board has concluded from its research that the Standard, as revised, constitutes a reasonable requirement, and that the costs of implementation will be minimal. The potential benefits to the audit and negotiation processes accruing from the increase in visibility and in uniformity of cost accounting treatment will be substantial and will greatly outweigh any added costs.

11. *Effective date and application.* With respect to the date that this standard becomes effective, it is anticipated that its provisions will be applicable to all solicitations issued on or

after January 1, 1974, which are likely to lead to contracts covered by Standards, rules, and regulations of the Cost Accounting Standards Board.

There is also being published today an amendment to Part 400. Definitions, to incorporate in that part the words and phrases defined in § 405.30 of the Standard.

PREAMBLE B

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 405.10. This amendment was part of a publication which added § 331.30(b)(3). Only the portion of the preamble which describes the revision to § 405.10 is printed here. The remainder of the preamble appears as preamble K of the supplement to Part 331.

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In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and is amending standards 401 through 409 as set forth below.

PREAMBLES TO COST ACCOUNTING STANDARD 406, COST ACCOUNTING PERIOD

PREAMBLE A

Preamble to Original Publication, 11-7-73

The material below is the preamble to the original publication of Part 406, on Nov. 7, 1973, at 38 FR 30732.

The Standard on Cost Accounting Period published today is one of a series being promulgated by the Cost Accounting Standards Board pursuant to section 719 of the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. app. 2168), which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

Work preliminary to the development of this Standard was initiated as the result of recognition that the selection of time periods to be used for contract cost accumulation and allocation has been the source of continuing problems between contractors and the Government. The problems include:

(1) The lack of a firm requirement specifying the cost accounting period to be used, (2) the absence of specificity as to when a cost accounting period other than a contractor's fiscal year should be used, and (3) the lack of consistency in selecting the cost accounting period in which specific types of expenses and adjustments are recognized.

Early research on this Standard included an extensive review of available literature on the subject and a review of decisions of contract appeals boards and courts. A preliminary draft of the Standard on Cost Accounting Period was widely distributed for informal comment by interested parties.

The Standard now being promulgated is derived from the proposal which was published in the FEDERAL REGISTER for August 7, 1973, with an invitation for interested parties to submit data, views, and arguments to the Board. The Board supplemented that FEDERAL REGISTER publication by sending copies of the FEDERAL REGISTER directly to organizations and individuals who were expected to be interested. Responses were received from 50 sources, including individual companies, Government agencies, professional associations, and industry associations. All of the comments have been carefully considered by the Board.

Most of those who replied to the Board's solicitation indicated satisfaction with the proposal as published. Several contractors indicated that their practices already complied with the Standard. Several commentators voiced objection to parts of the Standard.

The Board takes this opportunity to express its appreciation for the helpful suggestions and constructive criticisms which have been furnished, both informally in response to the circulation of a Staff draft of a Standard and formally in response to the initial FEDERAL REGISTER publication.

The comments below summarize the major issues raised in connection with the August 7 proposal and explain the decisions which have been made.

(1) *Monthly allocations.* A few commentators felt that the Standard should permit monthly allocations of indirect costs on the basis of the data accumulated for each month. This alternative was considered by the Board; however, the idea of monthly cost accounting periods is not appropriate for contract cost accounting. A number of fairly stringent requirements for accruals, deferrals, and other adjustments would have to be incorporated in the provisions of any Standard if there were to be assurance that monthly accruals, deferrals, and other adjustments were appropriate. The administrative costs would outweigh any benefits. To allow monthly closings for some contract situations and to require full-year allocations for others would not be in the interest of comparability and uniformity. The Board, therefore, has not adopted the suggestion.

(2) *Identity of cost accounting periods for indirect cost pools and allocation bases.* A few commentators stated that it may not be necessary to require in every instance the identical allocation base period as the cost accumulation period. They stated that they

presently use various clerical expedients to accomplish this, such as measuring the base for a period other than, but representative of the activity of, the period used for accumulating costs in an indirect cost pool. As a matter of principle, the Board does not agree that mismatched periods are proper. The Board, however, recognizes the value of appropriate expedients where cost allocations are not expected to be materially affected. It acknowledges that there may be occasions when it is necessary to use combinations of actual and estimated data to comply with this Standard.

The Board has given recognition to issues of materiality in its Statement of Operating Policies, Procedures, and Objectives in the FEDERAL REGISTER of March 6, 1973, and believes that materiality should be considered in the administration of its Standards. In order to alleviate practical problems which might be experienced in implementing this concept of materiality, the Board has changed § 406.40(c) and has added § 406.50(e).

(3) *Use of a cost accounting period for estimating.* Several commentators stated that § 406.50(c) was ambiguous. Some pointed out that this provision might be interpreted as always requiring the use of a full fiscal year, not withstanding the permissible use of a short period under the conditions provided in § 406.50(a). There was no provision in § 406.50(a) which precluded its application, when appropriate, in the circumstances described in § 406.50(c). Nevertheless, the Board has modified § 406.50(c) to assure that there is no misinterpretation of its intent.

One commentator recommended that detailed guidelines be established for estimating cost data when estimates were necessary under the provisions of § 406.50(c). The Board believes that this is a matter of contract administration and negotiation. If the parties do not agree on proposed overhead rates for early settlement or closing of contracts, they are not required by this Standard to agree to an expedited settlement.

Two commentators recommended that variances resulting from a difference between the estimated overhead rates used for expediting the closing of contracts and the rates finally negotiated or determined for a cost accounting period should be accounted for by making appropriate eliminations from affected indirect cost pools and allocation bases. As a matter of principle, the Board believes that actual cost should be allocated in accordance with the contractor's disclosed or established practices to all cost objectives of the cost accounting period, including closed or settled contracts. In a settlement the price is fixed, but costs are not. By agreeing to a settlement price, the parties take the risk that actual costs allocated to that contract might

be higher or lower than expected. However, the Board finds no need to specify how variances are to be accounted for in this Standard. Normally, the expected variances will be estimated to be minor in amount, or the parties will not agree on the settlement price. Also, the manner of accounting for the actual variance should be agreed upon by the contractor and the Administrative Contracting Officer. If the amount is negligible, it may be agreed that it should be absorbed by other cost objectives of the period. In any event, the Board believes that this is a matter of contract administration and negotiation.

(4) *Terminations.* A few commentators recommended that guidance be provided in § 406.50(c) for the treatment of unabsorbed overhead and continuing overhead charges allocable to contract terminations. The Board has noted the possible need for Cost Accounting Standards on termination costs and delay claims, situations in which the problems of unabsorbed overhead and continuing overhead charges frequently arise, and has initiated research projects on those subjects. At this time, the Board sees no need to disturb the expectations of the parties to a contract with respect to the absorption of overhead assigned to cost accounting periods (normally, fiscal years) by cost objectives of those same periods, whether or not those cost objectives exist throughout a cost accounting period.

(5) *Applicability of the standard to both direct and indirect costs.* One commentator recommended that the Standard be applied only to indirect costs. The Standard does apply to both direct costs and indirect costs as those terms are defined in 4 CFR Part 400. However, this Standard also includes provisions with specific applicability only to indirect cost pools. The Standard does not require that direct costs be allocated in the same manner as indirect costs. For example, it does not require that direct costs be annualized or averaged for purposes of cost allocation. Direct costs, however, are often used in establishing allocation bases for a period; therefore, they must be assigned and accounted for as costs of the particular cost accounting periods to which they are applicable. Consistency in making adjustments to both direct and indirect costs for purposes of determining the total costs allocable to the cost objectives of a cost accounting period is an important objective of this Standard.

(6) *Permitting the use of periods less than a year.* A few interested parties recommended that the Standard permit the use of a period shorter than a fiscal year when, for example, a significant contract was begun or concluded during a fiscal year. No one advanced any criteria for determining when to use a short period or how to apply it, even after specific requests

for such suggestions. The only rationale advanced for using less than an annual period in such circumstances was the assertion that a short period might be employed to arrive at "more equitable allocations," or to avoid inequitable burdens on other cost objectives. In view of the vagueness of the criterion of "equity," the possible effect of changing the risks assumed by the respective parties at the time of contracting, the possible impact on matters of cost allowability and contract administration and negotiation responsibilities, and the continuance of disputes and disagreements over the equity of a short period in particular circumstances, the Board has concluded that the Standard should not authorize the use of a short period except for allocating the costs of an indirect function which exists for only a part of a cost accounting period and for establishing a transitional period when a change of fiscal year occurs. As published this Standard precludes either party to the contract from insisting upon a short period in order to maximize or minimize cost recoupment. It precludes, for example, the calculation of overhead rates after-the-fact for alternative application on the basis of either the fiscal year or the period of performance, and the consequent polarization of the positions of the parties as to which period is appropriate or "equitable" when there is a substantial difference between these rates. The Board believes that this Standard will significantly enhance fairness and objectivity in this regard.

(7) *Equitable adjustments.* One professional accounting organization requested that a specific provision be added whereby an equitable adjustment would be made where the contract cost was affected by a change in the contractor's fiscal year and the change in the fiscal year was adopted for financial accounting and income tax purposes as well as for contract cost accounting. The principal argument advanced for this position is that "there seems to be no valid reason why a contractor should necessarily suffer and the Government should necessarily benefit in such a circumstance." In the illustration in § 406.60(c), the Board noted that under this Standard, a change in the fiscal year data is a change in accounting practices, and that an adjustment of the contract price might therefore be required in accordance with the adjustment provisions of the contract clause set out at 4 CFR 331.50. Those provisions do contemplate that no change in disclosed or established cost accounting practices, other than changes under paragraph (a)(4)(A) of the clause, may result in an agreement whereby costs paid by the United States are increased. The Board recognizes that a contractor may change his fiscal year ending date for substantial

business reasons, and has illustrated this possibility in the Standard. A change in fiscal year may not have any cost impact. Where it does, the Board believes that it would be improper for the Government to agree to pay increased costs caused by a voluntary change in accounting practices, no matter how valid and unrelated to cost recovery the motives of the contractor for making the change in this fiscal year ending date may have been. A new paragraph (f) in § 406.50 makes it clear that a change in the contractor's cost accounting period is a change in accounting practices for which an adjustment in contract prices may be required in accordance with paragraph (a)(4)(B) of the contract clause set out at 4 CFR 331.50.

(8) *Choice of transitional period.* A public accounting firm suggested that it might help to avoid disagreements if the Standard made it clear as to the permissible choices in selecting the transitional period other than a year whenever a change of fiscal year occurred. This suggestion has been adopted in the new paragraph (f) of § 406.50.

(9) *Applicability to Renegotiation Board.* One commentator noted that the Renegotiation Board, a "relevant Federal agency" under Pub. L. 91-379, defines the term "fiscal year" to mean the taxable year of the contractor or subcontractor under Chapter I of the Internal Revenue Code, and that it has been the Renegotiation Board's practice to renegotiate a contractor on the same basis as the contractor reports for Federal income tax purposes. Hence, it was recommended that, especially because of §§ 406.40(a)(2) and 406.50(d) of the Standard, the Renegotiation Board be exempted from the application of the Standard.

The Board's research confirms the possibility that a few contractors may use cost accounting periods which are different from their tax years. In most cases, however, there will be no conflict. Where there are differences, any use of a cost accounting period or fiscal year which is not identical with the period used for Federal income tax reports will involve reconciliations by the taxpayer. Contractors who presently use "model years" for their cost accounting periods now file reports with the Renegotiation Board on a taxable year basis. The Board finds no need to disturb this practice, and has provided a new § 406.40(a)(4) to acknowledge it as an exception. The Board believes that the Standard is, however, otherwise applicable, and that there is no need for an exemption.

(10) *Comparing benefits and costs.* The Board concludes that this Standard as published herein has, for most contractors and for the Government, almost no cost impact. The only contrary expressions received in response

to our requests have been answered by the changes described above. One major Defense agency expressed concern that the Standard might result in higher cost allocations to its contracts insofar as it did not permit the use of short periods. While this may be true, the Standard might also yield lower cost allocations to Government contracts as a result of the requirement to use a full fiscal year. No estimate of the amount of any shifts in cost allocations was provided. Because of the different circumstances of each application of the requirement, both increases and decreases in cost allocations can be expected.

The Board concludes that significant benefits, far outweighing any costs of implementation, will be realized from the promulgation of this Standard. Such benefits include reduction of disagreements and disputes; increased consistency, fairness, and objectivity; and improvement of estimates for proposals.

(11) *Effective date.* It is anticipated that the effective date in § 406.80(a) may be July 1, 1974.

There is also being published in this document an amendment to Part 400, Definitions, to incorporate in that part the term "fiscal year" defined in § 406.30 of the Standard.

PREAMBLE B

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 406.10. This amendment was part of a publication which added § 331.30(b)(3). Only the portion of the preamble which describes the revision to § 406.10 is printed here. The remainder of the preamble appears as preamble K of the supplement to Part 331.

* * * * *

In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and is amending standards 401 through 409 as set forth below.

PREAMBLES TO COST ACCOUNTING STANDARD 407, USE OF STANDARD COSTS FOR DIRECT MATERIAL AND DIRECT LABOR

PREAMBLE A

Preamble to Original Publication, 4-1-74

Following is the preamble to the original publication of Part 407, on April 1, 1974, at 39 FR 11869.

The Cost Accounting Standard on the Use of Standard Costs for Direct Material and Direct Labor published

today is one of a series being promulgated by the Cost Accounting Standards Board pursuant to section 719 of the Defense Production Act of 1950, as amended, Pub L. 91-379, 50 U.S.C. App. 2168, which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

Work preliminary to the development of this Cost Accounting Standard was initiated as the result of the recognition that practices concerning the use of standard costs for contract costing purposes have not been well defined in Government procurement regulations. The Board has undertaken research on this subject with a view that Cost Accounting Standards promulgated on this subject will provide better guidance in the use of standard costs.

Because the subject of standard costs is extremely complex, the Board has elected to address this subject in phases. The Cost Accounting Standard being promulgated covers the use of standard costs for direct material and direct labor; the use of standard costs for service centers and the use of standard costs for overhead represent two other phases of this subject that are currently under research.

Early research on this Cost Accounting Standard included a study of available literature on the subject and of relevant decisions of boards of contract appeals and courts. Following this study, several issues were identified. A review of Disclosure Statements on file suggested that standard costs are in use by a large number of defense contractors. In an effort to learn the reasons underlying the use or non-use of standard costs for contract costing purposes, and to gain a better understanding of the standard-cost practices by companies in different industries, the Board developed and circulated a questionnaire on the use of standard costs. Selected respondents of this questionnaire were then visited for further discussion. Information derived from replies to the questionnaire and from visits suggested the complexity of the subject and the desirability of addressing it in phases. Accordingly, in the preparation of a preliminary draft, the subject was limited to the use of standard costs for direct material and direct labor. This preliminary draft was widely distributed for comment. Incorporating many comments thus received, a revised proposal was drafted and published in the FEDERAL REGISTER of November 21, 1973, with an invitation for interested parties to submit written views and comments to the Board. The Board also supplemented the invitation in the FEDERAL REGISTER by sending copies of that issue directly to several hundred organizations and individuals who had expressed an interest in the proposal or who had pro-

vided the Board with comments on the earlier proposal.

These direct and public invitations for comments resulted in the Board's receiving 47 sets of written comments from individual companies, Government agencies, professional associations, industry associations, public accounting firms, universities, and others. Some of these commentators also supplemented their written comments with discussions at individual or group meetings. All of these comments and views have been carefully considered by the Board. Those issues that are of significance are discussed below, together with an explanation of the changes made in the Cost Accounting Standard being promulgated from the proposal published in the FEDERAL REGISTER of November 21, 1973.

The Board wishes to take this opportunity to express its appreciation for the helpful suggestions and constructive criticisms it has received, and for the time devoted to assisting the Board in this endeavor by the many organizations and individuals involved.

1. *Management uses of standard costs.* Several commentators emphasized the value of information generated from the use of standard costs for management-control purposes and urged the Board to retain these control features. The Board agrees with this view and has consequently modified the proposed Standard to better assure that its use will be fully compatible with the use of standard costs for management-control purposes.

2. *Exclusion of overhead and service centers in the Cost Accounting Standard.* A few commentators expressed the view that the Cost Accounting Standard being promulgated should be broadened to include the treatment of overhead and service centers. The Board believes that the Cost Accounting Standard being promulgated may be used effectively without such broadening. Further, because the use of standard costs for overhead and for service centers involves different issues, the Board believes that this Cost Accounting Standard should be promulgated as is.

3. *Coverage of this standard.* Many commentators suggested that the proposed Standard did not clearly state that the use of standard costs for Government contract costing purposes is at the option of a contractor; they recommended various changes in wording to make this point clear. The Board has accommodated this suggestion by appropriate modifications in § 407.40.

4. *Use of the term production unit.* Many commentators expressed a need for a better understanding of the meaning and significance of the term production unit. As defined in § 407.30(a)(7), a production unit is a grouping of activities which either uses homogeneous inputs of direct material and direct labor or yields homogeneous outputs. Where a grouping of

activities meets either one of these two criteria, it is the proper level at which to accumulate standard costs of direct material and direct labor, and to accumulate variances related thereto. Since variances are allocated on the bases of costs and statistics of each production unit, homogeneity of standard costs of direct material and direct labor would assure that data thus accumulated would be appropriate as bases for allocating variances to cost objectives. The concept of homogeneity embodied in the term production unit, then, would permit contractors a degree of flexibility in setting and revising standards based on individual needs and circumstances and still provide for the proper cost assignment of variances.

To further clarify the intended meaning and purpose of a production unit, the Board has added an illustration as § 407.60(b).

5. *Homogeneous grouping of material.* A few commentators suggested that the concept embodied in the term homogeneous grouping of material be enunciated. The Board agrees; accordingly, the Board has added a statement under § 407.50(b)(2) and an illustration as § 407.60(d).

6. *Cost accounting period.* Quite a few commentators felt that relating the establishment of standards to a cost accounting period, which is the subject of a Cost Accounting Standard (4 CFR Part 406), is both undesirable and unnecessary, in view of the differences in industry practices and management needs for establishing and using standards; they urged the Board to reconsider. Upon reconsideration, the Board finds this argument persuasive. The Board has revised § 407.50(a)(1), which provides that a contractor shall state the period during which standards are to remain effective.

7. *Interim revision of standards.* Many commentators stated that, to maintain comparable information for management-evaluation purposes, revising standards during a cost accounting period is undesirable and counterproductive; they suggested the deletion of this provision. The Board finds this suggestion persuasive; accordingly, the Board has deleted this provision from the Cost Accounting Standard being promulgated.

8. *Procedural details.* Several commentators felt that the proposed Cost Accounting Standard contained too much procedural detail. The Board does not share this feeling. This Cost Accounting Standard, in addressing itself to the entire process of standard-cost accounting for direct material and direct labor and to alternatives in each step of the process, necessitates attention to a great many issues. The Board feels that the provisions of this Cost Accounting Standard only reflect the complexity of the subject matter and the diversity of practices being ad-

dressed.

9. *Recording allocation of variances in books of account.* A few commentators misconstrued the proposed Cost Accounting Standard and thought that certain provisions required the recording of variance allocations in formal accounting records; they urged the Board to permit the use of adjustments based on memorandum worksheets for covered contracts. To avoid this misconception, the Board has made appropriate revisions in the Cost Accounting Standard being promulgated by using the term books of account to mean formal accounting records, and by adding § 407.50(e) to specifically permit the use of memorandum worksheet adjustments.

10. *Adjustment of material-price variance recognized at the time of purchase.* Several commentators objected to a provision whereby material-price variances, recognized at the time purchases of material are entered into books of account, are allocated between items introduced into production units and items remaining in ending purchased-items inventory. They argued that this provision does not conform to their practices, particularly where the allocation of unfavorable variances would increase inventory carrying values, and that the provision infringes upon financial accounting.

In all its research, the Board gives extensive consideration to existing contractor practices. In this instance, however, the practices advocated by those contractors are likely to create inequities and are without adequate conceptual support. As to the second argument, the Board believes that this provision, which concerns the proper allocation of material-price variances between reporting periods for cost accounting purposes, is compatible with objectives of financial accounting. In view of these considerations, the Board has retained this provision in § 407.50(b)(3).

11. *Annual allocation of variances.* Quite a few commentators felt that a provision that permitted the allocation of variances not more frequently than once each cost accounting period does not reflect industry practices and management needs. The Board finds this argument persuasive. Accordingly, a provision that permits the allocation of variances more frequently than annually has been added under § 407.50(d)(1).

12. *Five percent materiality criterion.* Many commentators to the proposed Cost Accounting Standard objected to the inclusion of a 5 percent materiality criterion as a basis for determining whether variances are allocated to cost objectives or are included in indirect cost pools for subsequent allocation. Several of the commentators felt that the materiality criterion was arbitrary; others felt that it would delay the process of allocation where

it is undertaken monthly; and still others felt that it could result in inconsistencies.

The Board's early research showed that a majority of respondents had variances below 5 percent, and quite a few experienced variances below 2 percent. Later, an overwhelming majority of those commenting on a preliminary draft of this Cost Accounting Standard, which contained a 2 percent materiality criterion, suggested that a materiality criterion set at 5 percent would be reasonable.

The intent of the materiality provision was to permit contractors to use a simpler method of allocation of variances where the amount was below the 5 percent level. Nevertheless, the Board is persuaded by the comments received, and has deleted this provision from the Cost Accounting Standard being promulgated. In its stead, the Board, in § 407.50(b)(4) and (d)(2), provides that, where variances are immaterial, such variances may be included in appropriate indirect cost pools for subsequent allocation.

13. *Cost/benefit.* As to benefits, this Standard provides needed criteria which the Board believes will improve cost measurement and will result in more equitable assignment of contract costs. As to costs, the Board anticipates little or no cost of implementation by those contractors who are currently using standard costs: the Standard permits contractors to choose from many recognized standard cost practices. Consequently, the Board believes that the benefits to be derived by this Standard clearly outweigh any costs of implementation.

The Board expects that the effective date of this Cost Accounting Standard will be October 1, 1974.

There is also being published today an amendment to Part 400, Definitions, to incorporate in that part terms defined in § 407.30(a) of this Cost Accounting Standard.

PREAMBLE B

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 407.10. This amendment was part of a publication which added § 331.30(b)(3). Only the portion of the preamble which describes the revision to § 407.10 is printed here. The remainder of the preamble appears as preamble K of the supplement to Part 331.

* * * * *

In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section 10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and

is amending standards 401 through 409 as set forth below.

PREAMBLES TO COST ACCOUNTING STANDARD 408, ACCOUNTING FOR COSTS OF COMPENSATED PERSONAL ABSENCE

PREAMBLE A

Preamble to Original Publication, 9-19-74

The following is the preamble to the original publication of Part 408, on Sept. 19, 1974, at 39 FR 33681.

The Cost Accounting Standard on Accounting for Costs of Compensated Personal Absence is one of a series being promulgated by the Cost Accounting Standards Board pursuant to section 719 of the Defense Production Act of 1950, as amended, Pub. L. 91-379, 50 U.S.C. App. 2168, which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts. This Standard deals primarily with the amount and time of recognition of costs of compensated personal absence.

Work preliminary to the development of this Cost Accounting Standard was initiated as a part of the study of the larger subject of accounting for labor costs. The costs of compensated personal absence are an important element of labor costs, but under existing procurement regulations there is no assurance that the costs of compensated personal absence are assigned to the cost accounting period in which the related labor is performed and in which the related wage or salary costs are recognized. Because the volume and mix of contracts of a particular contractor may vary significantly from period to period, the assignment of costs to the proper cost accounting periods is important.

Early research on this Cost Accounting Standard included a study of available literature and relevant decisions of boards of contract appeals and courts. Initial meetings were held with major procurement agencies and with a number of contractors, and certain issues were tentatively identified. The relationship of Government procurement regulations to Federal Income Tax laws which govern the accounting for costs of compensated personal absence was explored. It was noted that the exact nature of the employer's liability to employees under a specific plan was an important consideration in determining the income tax treatment which might be permitted. A review of Disclosure Statements on file indicated a disparity in existing accounting practices.

A questionnaire and a statement of issues were then sent to 117 companies, 40 Government agencies, and 53 others, including industry and professional associations, to obtain detailed information, particularly in regard to benefit plans and the reasons for se-

lecting a specific accounting method. Data on benefit plans and accounting practices were received from 68 companies and comments on the issues were received from 37 respondents. Analysis of the data and comments indicated that the issues could be classified broadly into two groups—those relating to the amount and timing of recognition of costs of compensated personal absence and those relating to methods of allocation of these costs to cost objectives. Some problems were noted in connection with the charging of costs of compensated personal absence directly to final cost objectives at the time of payment; these have been addressed in the Standard. Detailed criteria for the allocation of costs of compensated personal absence are not included in this Standard. Additional study of other labor-related costs is being undertaken and when it has been completed such criteria may be provided.

Based on analysis of the responses to the questionnaire and issues paper and on further discussions, a preliminary draft Standard was developed and widely distributed for comment. Comments and suggestions were received from 87 respondents; these comments were considered in developing a revised Standard which was published in the FEDERAL REGISTER of March 4, 1974, with an invitation to interested parties to submit written views and comments to the Board. The Board also supplemented the invitation in the FEDERAL REGISTER by sending copies of that issue to several hundred organizations and individuals who had provided the Board with comments on the earlier proposal or who had otherwise expressed interest in the proposal.

Following the FEDERAL REGISTER publication, the Board received 86 sets of written comments from companies, Government agencies, professional associations, industry associations, public accounting firms, universities, and others. All comments have been carefully considered by the Board and those addressing areas of significance are discussed below, together with explanations of the changes made in the Cost Accounting Standard being promulgated from the proposal published in the FEDERAL REGISTER of March 4, 1974.

The Board wishes to take this opportunity to express its appreciation for the helpful suggestions and constructive criticisms it has received, and for the time devoted to assisting the Board in this endeavor by the many organizations and individuals involved.

(1) *Need for a standard.* The most significant problems and issues relate to the amount and timing of recognition of costs of compensated personal absence appear to stem from the reliance of existing procurement regulations on the Internal Revenue Code and income tax regulations to govern

accounting for these costs. Three disadvantages arise from this reliance. First, current regulations and prior rulings permit, but do not require, the use of accrual accounting for vacation pay, and they do not specify the amount to be accrued if accrual is elected; of three contractors with identical vacation plans, one may elect to recognize vacation costs pro-rata as the related work is performed, the second in the year the related work is completed, and the third only at the time vacation is taken. Consequently, current regulations do not require uniformity in the measurement of such costs among years. Second, the Internal Revenue Code and Treasury Department rulings have imposed different criteria at different times; of two contractors with identical plans, one historically may have been permitted to recognize costs of compensated personal absence on the accrual basis, while the other, who applied at a later date, is denied the same privilege because of a subsequent ruling. Finally, a change in the Internal Revenue Code or income tax regulations may not be appropriate for contract cost accounting.

Many commentators said that they were not aware of problems relating to accounting for costs of compensated personal absence and they questioned the need for a Standard on the subject. Discussions with a number of these commentators disclosed, however, that they were unaware of the lack of uniformity created by the reliance of Government Procurement regulations on income tax regulations. The Board believes that the promulgation of a Standard dealing with accounting for costs of compensated personal absence is desirable to improve, and provide uniformity in, the measurement of these costs for a cost accounting period and thereby to increase the probability that the measured costs are allocated to the proper cost objectives.

(2) *Scope of the standard.* Several commentators questioned the exclusion of such costs as severance pay or group insurance from the Standard and they concluded that these costs were thereby unallowable as contract costs. This conclusion is not correct. A Standard does not define which costs are or are not allowable. Moreover, these costs were excluded from this Standard because our research disclosed that the associated accounting problems are sufficiently dissimilar from those of compensated personal absence to warrant separate consideration.

(3) *Basis for recognition of cost.* The Standard that was published for public comment relied on the degree of certainty of the employer's obligation as the principal criterion for accrual or nonaccrual of costs of compensated personal absence. Some commentators suggested that costs not be

recognized prior to payment unless the obligation to provide the benefits were irrevocable in all circumstances. Using this test, most company benefit plans which we have seen in the course of our research would not qualify for accrual accounting. Others suggested that the Standard set no restrictions whatsoever on the use of accrual accounting for these costs.

After considering all of the comments and after additional staff research and discussions with contractors, Government agencies, and others, the Board has concluded that the distinction which it previously stated between a "certain" and a "reasonably certain" obligation for purposes of determining liability, was unnecessary. The Standard has been simplified to state directly that the proper measure of the liability and the criterion for cost recognition is the amount which would be payable if the employer were to terminate the employment for any reason not involving disciplinary action. Under generally accepted accounting principles, liabilities are usually recorded when obligations to transfer assets or provide services in the future are incurred. If the employee would be paid a given amount in the event of lay-off, then that employee must have completed the service necessary to have earned that amount of entitlement to benefits.

Some commentators suggested that only so much of the employer's liability as would be payable on voluntary termination be considered to be "earned." The Board does not accept this position. Even in cases where voluntary termination causes a forfeiture, the employer cannot unilaterally avoid the liability. The employer's liability should not be disregarded merely because an employee may later act to relieve the employer of actually making the payment.

Even if the obligation is viewed as one of a contingent nature, generally accepted accounting principles provide that where the outcome is reasonably foreseeable and the contingency may be expected to result in a cost, it should be reflected in the accounts. Based on its research, the Board believes that only a small percentage of those employees of any contractor who are entitled to benefits forfeit those benefits. Therefore, the Board believes that the obligation should properly be recognized (with appropriate adjustment for anticipated forfeitures), and to fail to do so is to misstate the costs of compensated personal absence which are properly assignable to that cost accounting period.

(4) *Utilization of benefits criterion.* A number of commentators objected to the provision in the proposed Standard that if the employer's obligation were not "certain," then accrual accounting could be used only if at

least 80 percent of the entitlement which was potentially earned in any year would ultimately be used by the employees. The intent of this provision was to assure that accrual accounting was not permitted in situations where the utilization rate was so low that it was questionable whether accruals based on estimated utilization provided any better cost accounting information than did actual cash disbursements. The Board has reviewed the utilization data of a number of contractors and finds that by adhering to the amount which is payable on involuntary termination of employment as the measure of the accrual, a utilization criterion is unnecessary. It has therefore been deleted.

(5) *Adjustments for unrecognized liabilities.* The Standard requires the recognition of costs when the entitlement to compensated personal absence is earned. Initial application of the Standard or a change of compensated personal absence plan may necessitate an adjustment to recognize the cost of entitlement already earned but not yet recognized for cost accounting purposes. The proposed Standard made no explicit provision for the disposition of such adjustments. A number of commentators cited the failure to provide explicitly for the disposition of adjustments as a deficiency in the proposed Standard. For example, it was hypothesized that a contractor who was recording vacation costs at the time of payment might not recognize any vacation cost in the year an employee was hired; on the completion of the contract, the employee might be terminated and paid for both the vacation and the vacation earned in that year. If the Standard were applicable to the contractor, he might be able to allocate only those costs accrued in that year. As a result, he might not recover costs paid in that year for vacations earned before accrual was instituted. The Board recognizes the validity of this hypothesis in some instances. However, if the contractor is viewed as a going concern and Government contracting as a continuing process, then that hypothetical "last year of contracting" may be infinitely far in the future, the lay-offs may never take place, and the contractor will continue to receive "one year's worth of costs" in each year.

All commentators who questioned the method of adjustment, and certain other contractors who did not raise the question but who the Board believed might be significantly affected by the Standard, were asked to provide detailed information concerning benefit plans involved, the number of employees, and the estimated amount of the adjustment. In addition, each contractor was asked to provide background information concerning its history as a Government contractor and, to the extent available, data on past

employment, labor costs, and extent of contracts. The Board also contracted several contractors who already record costs of compensated personal absence on the accrual basis to determine the circumstances under which this accounting treatment had been adopted, whether adoption resulted in adjustment and, if so, how it had been handled.

The Board reviewed the information submitted in response to its requests. The Board has considered (1) refraining from explicitly providing for handling the adjustment, (2) providing a procedure by which the adjustment could all be assigned to the year of change, and (3) providing a procedure for amortizing the adjustment over a fixed period of years. The Board finds disadvantages to each of these alternatives. If no procedure for adjustment is provided, appropriate procedures for cost recovery may not be devised by contracting parties. If the procedure resulted in assignment of the entire adjustment to the year of change, then some contractors may recover more than the appropriate cost of that year and all of the contracts in the year of change will be overcharged. The same deficiencies, albeit to a lesser extent, exist if the procedure provides for the adjustment to be amortized over a fixed period.

The Standard has been revised to provide an explicit procedure for disposing of the adjustment for unrecognized liability. Under it, the adjustment is initially placed in a suspense account. In the cost accounting period of change and in any subsequent period, if the employer's liability for compensated personal absence under the related plan at the end of a period is less than the amount in the suspense account at the beginning of that period, the suspense account is reduced by the amount of the difference. That difference is assigned to that cost accounting period as an additional cost of compensated personal absence.

If the employer's liability remains above that at the time of change, then costs of compensated personal absence are measured on the accrual basis. If the employer's liability falls below that amount because of additional cash payments to employees, then the costs are measured on the cash basis. This latter condition will arise whenever employment levels fall below that existing at the time of change. Whenever such conditions occur, the costs of those periods are measured on a cash basis until the entire suspense has been written off. The contractor is not precluded from allocating costs which might otherwise have been allocable, absent the Standard but he cannot allocate more than he otherwise would have allocated, so that premature cost allocations cannot occur.

(6) *Complexity.* Many of the commentators suggested that the pro-

posed Standard was too complex, too detailed, or too procedural. As previously mentioned, the criteria for accrual have been changed to eliminate the distinction between a "certain" and a "reasonably certain" obligation and to eliminate the utilization test. These changes permitted a significant reduction in the length and complexity of the Standard. In addition, the Board has made a number of simplifying changes in the wording of the Standard based on suggestions from commentators.

(7) *Adjustments for interim rates.* A number of commentators objected to the requirement in the proposed Standard that where costs of compensated personal absence are allocated using an interim rate, any difference between the interim rate and actual cost must be adjusted in the same period. They objected on the grounds that the necessary computations to determine the actual cost in accordance with the provisions of the Standard could not be completed by the end of the cost accounting period. Although the Board is not persuaded by this argument, the provision involved has been deleted for the following reasons. The accrual required by this Standard is identical to that required for any other year-end accrual, and the adjustment process is not essentially different from that which is required to adjust any interim allocation for a cost difference.

The requirement is well established that if overhead costs are allocated to Government contracts on an interim basis, there must be an adjustment when the actual costs are known. The Board therefore has concluded that it is unnecessary to restate it in the Standard, although the requirement, of course, remains in effect.

(8) *Requirement to maintain records.* Some contractors were concerned about the nature and extent of records which might be necessary to support the determinations and computations required by the proposed Standard. In particular, the need to maintain records of benefit utilization was questioned. The benefit utilization criterion has been deleted from the Standard; consequently, the maintenance of special records for this purpose is unnecessary. Others were concerned that the proposed Standard would require changes in their formal accounting records. Upon further consideration, the Board believes maintaining appropriate records is implicit in cost accounting and that the inclusion of additional record-keeping requirements in the Standard is unnecessary. In determining what records are necessary to achieve verifiability for purposes of this Standard, consideration should be given to the relative ease or difficulty of making and verifying assumptions and estimates, to the materiality of the amounts involved, and to the use of techniques such as statistical sam-

pling for determining the amount of the employer's liability.

(9) *Exemptions.* Representatives of educational institutions pointed out two problems with the proposed Standard. First, it required that where costs of compensated personal absence are allocated using an interim rate, any difference between the interim rate and actual cost must be adjusted in the same period. These commentators pointed out that Pub. L. 87-638 authorized use of negotiated predetermined overhead rates by these institutions and that this permission is presently set forth in Federal Management Circular 73-8: Cost Principles for Educational Institutions. Second, they pointed out that many educational institutions do not record costs on an accrual basis; but use fund accounting on a cash basis; and that for state and local governmental institutions, such accounting may be required by law. While the Standard does not require any change in the formal accounting records, in many instances it would be very difficult for these institutions to comply with the Standard.

In view of the foregoing, the Board does not believe it desirable to require educational institutions or state and local governmental agencies to account for costs of compensated personal absence on the accrual basis. Accordingly, the Board has exempted such institutions and state and local governmental agencies from the provisions of this Standard.

(10) *Costs and benefits.* The anticipated benefits of this Standard are improved cost measurement and increased uniformity in accounting for costs of compensated personal absence, leading to increased assurance that the measured costs are assigned to the proper cost objectives.

Several commentators objected that the Standard would not increase uniformity because the accounting for a particular benefit plan would depend on the provisions of that plan, and not all benefit plans are alike. The Board is aware of the diversity of benefit plans. However, under present procurement regulations different contractors with essentially similar plans could be accounting differently for them and may be prevented from using similar accounting even if they wish to do so. To the extent that uniformity is thus actually inhibited, the Standard will correct the situation. Other past problems relating to the measurement of these costs in the event of layoffs, or employe transfers would also be alleviated.

Many commentators said that they were already accounting for costs of compensated personal absence in the manner required by the Standard. Some commentators said that implementation costs would depend on the extent of detail which would be required to comply. The Board has attempted to minimize such detail: First,

by its previous statements that compliance with Standards may be accomplished through the use of memorandum records; second, by eliminating the utilization of benefits test and, thereby, the necessity of maintaining the supporting utilization records; and, finally, by emphasizing the acceptability of estimates based on statistical sampling or historical data. As a consequence, the costs of implementation should be negligible.

In summary, the Board believes that the benefits to be derived from this Standard clearly outweigh any costs of implementation.

The Board expects that this Standard will become effective on April 1, 1975.

PREAMBLE B

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised §§ 408.10 and 408.70. This amendment was part of a publication which added § 331.30 (b)(3). Only the portion of the preamble which describes the revision to §§ 408.10, 408.70 are printed here. The remainder of the preamble appears as Preamble K of the supplement to Part 331.

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In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and is amending standards 401 through 409 as set forth below.

PREAMBLES TO COST ACCOUNTING STANDARD 409, DEPRECIATION OF TANGIBLE CAPITAL ASSETS

PREAMBLE A

Preamble to Original Publication, 1-29-75

The following is the preamble to the original publication of Part 409, 40 FR 4259, Jan. 29, 1975.

The Standards on Depreciation of Tangible Capital Assets being published today is one of a series being promulgated by the Cost Accounting Standards Board (CASB) pursuant to sec. 719 of the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. App. 2168), which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

On February 27, 1973, the Board promulgated a Standard on Capitalization of Tangible Assets. At that time the Board described its work to date in the area of fixed asset accounting including studies of practices used for

both capitalization and depreciation. The responses to an issues paper and a questionnaire which were used in the development of the capitalization Standard were also useful in the development of the Standard being promulgated today. A preliminary draft of the Cost Accounting Standard on Depreciation of Tangible Capital Assets was widely distributed in March 1973 for informal comment by interested parties. The Board's further consideration of the issues related to depreciation has been significantly enhanced by the responses received from well over 100 respondents to that informal proposal.

The Board's research into fixed asset accounting practices included a survey of 107 profit centers selected to be representative of the diversity of firms to which Cost Accounting Standards apply. Reports on their fixed asset accounting practices and statistical information for a five-year period were received and analyzed. The Board was assisted in its deliberation by information available from the 1960 Treasury Department Survey which provided the data base for the "Asset Guideline Lives" used in Revenue Procedure 62-21 and data developed in an accounting research study performed for the American Institute of Certified Public Accountants.

A proposed Cost Accounting Standard dealing with depreciation was published by the Board on June 11, 1974 (39 FR 20505). After reviewing the responses to that publication, the Board revised its proposal. The revised version was published in the FEDERAL REGISTER for October 3, 1974 (39 FR 35678). The Board supplemented both FEDERAL REGISTER publications by sending copies of the FEDERAL REGISTER material directly to organizations and individuals who were expected to be interested. The Board received almost 200 responses to the June 11 and the October 3 proposals. Comments were received from individual companies, Government agencies, professional associations, industry associations, public accounting firms, universities, and individuals. All of these comments have been carefully considered by the Board. In addition, the Board invited representatives of Government agencies, professional accounting and industry associations, and defense contractors to attend Board meetings and discuss their views on the significant issues concerning depreciation practices in Government contract costing. The Board takes this opportunity to express its appreciation for the helpful suggestions and criticisms which have been furnished. The comments furnished by organizations and individuals have resulted in many changes in the Standard.

The comments below summarize the major issues discussed by respondents in connection with both preliminary publications. They explain the major

changes which have been made since the June 11 proposal.

(1) *Economic Impact of the Standard.* Many of the comments on the June 11 and October 3 proposals were concerned with the economic impact of the Standard. They cited such concerns as delays in cash flow, impact of inflation, incentives for modernization, and administrative cost of additional recordkeeping requirements.

The Board's consideration of each of these primary concerns is dealt with in detail in other sections of these prefatory comments. The Board has recognized the potential overall impact of the Standard as expressed in the comments received and has endeavored to establish the needed guidance on depreciation accounting with as little disruption as possible to contractors and current contractual relationships.

The Standard provides for a phasing in of requirements over a period of time so that the principal impact of the Standard will be a number of years in the future. The Standard applies only to assets acquired by a contractor after the beginning of its next fiscal year after receipt of a CAS covered contract. If the Standard were to become effective six months after submission to Congress, application of any provisions of the Standard to any newly acquired assets would be delayed more than six months from date of promulgation and for most contractors at least 12 months.

The Standard provides for a two-year period to develop records on past experience to support estimates of service lives. The same period could be used to develop any necessary changes in accounting for fixed asset lives. The two-year period begins after required compliance with the Standard, and, therefore, most contractors would have at least three years in which to apply the recordkeeping provisions for newly acquired fixed assets.

For those contractors who use the two-year period to develop new estimated service lives, the effect of the use of those new estimates would begin on assets acquired in the fourth year after submission of this Standard to Congress. In the fourth year and the next several years thereafter the impact of changes in cash flow because of changes in service life estimates would be minimal, since the difference in cash flow each year is the difference between depreciation amounts under the old and new estimates of service life for the newly acquired assets. The total impact on cash flow of changes in estimates of service life would not occur until the full cycle of asset replacement is completed. In addition, the impact of the rules on accounting for gain or loss would only begin to take place where new assets acquired after compliance with the Standard would be sold or otherwise disposed of and such impact

will be many years in the future.

It is the Board's opinion that the immediate economic and administrative impact of the Standard is minimal and will, over time, provide for a more appropriate recognition of cost accounting considerations distinct and apart from profit level determinations for defense contract cost and pricing actions.

(2) *Need for a Standard.* The accounting profession has established general principles to govern depreciation accounting. These broad principles require that depreciation practices be systematic and rational. Accountants consistently urge that the estimates of service lives used for depreciation should be realistic. These broad goals are almost universally agreed upon.

Some commentators suggested that the Board should not promulgate any Standard dealing with depreciation because the applicable principles have been well established as a part of generally accepted accounting principles. These same commentators also argue that procurement regulations have allowed contractors to rely on depreciation practices found to be acceptable for other purposes; they believe that contract costing should continue to rely entirely upon the depreciation practices used for Federal income tax and for financial reporting purposes pursuant to the current procurement regulations. The Board believes, however, that depreciation charges based entirely on income tax and financial reporting practices do not necessarily assure reasonable representation of the costs of the services provided on Government contracts.

Various mathematical formulas have been suggested to represent the typical patterns of consumption of services over the lives of assets. Certain of these methods of depreciation have been incorporated into the Internal Revenue Code as acceptable for Federal income tax purposes. These same methods have, in general, been accepted as systematic and rational and therefore within the scope of generally accepted accounting principles. The Board finds that there has been a range of choice as to depreciation methods available for contract costing, without adequate criteria for the choices made.

The Treasury Department and Internal Revenue Service have established guidelines for determination of estimated periods of useful service. These guideline periods are said to be based on observed industry experience, but lives shorter than the averages experienced were established so that most companies would experience longer actual asset utilization periods than the permitted tax lives. Tax accounting lives for an industry are, therefore, not good representations of

expected actual asset utilization periods for many individual contractors within that industry.

The Board's research has indicated that the asset lives and depreciation methods selected by defense contractors under existing regulations may result in an unduly accelerated allocation of depreciation to the final cost objectives of earlier cost accounting periods in the life of a tangible capital asset. Contractor representatives have expressed the view that the choices are typically appropriate in view of the uncertainties of Government contracting. These uncertainties, however, have not precluded utilization of assets well beyond the short estimated service lives based on the IRS guideline periods. Other commentators were concerned that any Standard which would restrict cash flow would adversely impact profits. The Board has determined that a Cost Accounting Standard is needed to provide more assurance that depreciation costs identified with performance of negotiated defense contracts are appropriately measured. Consideration of risk and capital investment in the determination of the adequacy of profits is a policy question for the procuring agencies and not a cost accounting problem.

(3) *Method of Depreciation.* Many of the comments received on depreciation method center on whether accelerated methods or straightline methods are more appropriate for contract costing purposes. The Board, however, believes that no particular method is necessarily appropriate for all contract cost accounting situations. The Board is establishing criteria by which the method or methods appropriate in the specific situation can be determined.

Both the June 11 proposal and the October 3 revision provided that the method selected "shall reflect the expected consumption of services in each accounting period." This basic goal is generally recognized as appropriate. Commentators have raised questions relating to the practical aspects of compliance with the basic goal. What kind of evidence should be available to support a selection of a depreciation method? In the absence of authoritative criteria for selection, contractors have had no need to support their choices, nor have they accumulated much experience in collecting evidence relevant to the consumption of services. Thus a requirement for support of accelerated methods is seen by some as a prohibition of the use of such methods. However, the proposals made no distinction between an accelerated method or the straight-line method of depreciation in determining the quantity and quality of supporting evidence. The Board's proposals included descriptions of the techniques which should be used to determine ap-

propriate methods for depreciation. The Board recognized the difficulty which might be experienced by contractors attempting to demonstrate the appropriateness of their choices. The Board's proposals included, therefore, the provision that the method of depreciation used for financial accounting purposes should generally be acceptable for contract costing.

Representatives of the accounting profession pointed out that there is strong economic motivation to choose rapid depreciation write-off techniques where cost is the basis for pricing and reimbursement, as in the defense contracting environment. They say that this same motivation may not apply to external financial accounting for the same companies. Accordingly, they expect that any Cost Accounting Standard which required that, in order to use a technique for contract costing, a company must use the same technique for financial accounting, might create an incentive to modify financial accounting practices solely for the purpose of obtaining an advantage in contract pricing. Because of these considerations the Board would prefer not to base its criteria primarily on practices used for external financial reporting.

Most commentators have asserted that the depreciation methods now in use for external reporting purposes are appropriate methods for contract costing, too. The Board believes that this is generally true, and it further recognizes that a requirement to change to a particular depreciation method might result in significant cost to many contractors. In the belief that the methods selected as appropriate for financial accounting are usually intended to approximate the actual consumption of services, the Board has provided for continuance of those methods where this is a reasonable assumption. Therefore, in the October 3 proposal the word "reasonably" was used to modify the requirement that the method of depreciation reflect the expected consumption of services; this provision is continued in the Standard being promulgated today. In those few cases where existing methods used for financial accounting purposes are obviously poor representatives of the expected pattern of consumption, and in any case when the contractor proposes to change methods, the choice should be made on the basis of a reasonable expectation of the future pattern of consumption of services in accordance with the criteria provided in this Standard.

It has been asserted that some assets purchased for Government contract purposes are used on an intermittent basis with periods of use and periods of nonuse following one another in a pattern that fits neither the classical accelerated nor straight-line models and that does not conform with the

active-standby dichotomy. "The pattern of consumption of services" for such an asset is difficult to determine either prospectively or historically and is not necessarily dependent solely on use.

In circumstances such as the foregoing, it is not the intent of the Board to introduce uncertainty into contract negotiation and settlement by encouraging challenge of contractors' depreciation methods. If the method selected is also used for external financial reporting and is acceptable for income tax purposes, the Board's expectation is that it will be accepted.

(4) *Service Lives.* Depreciation is to be charged during the period of estimated usefulness of a tangible capital asset. Some commentators have expressed concern lest the Board not give appropriate recognition to the importance of possible obsolescence in estimating the period of usefulness. The Board recognizes that for many contractors the likelihood of obsolescence is an important factor in estimating the period of usefulness, and has so provided in the Standard.

The June 11 proposal provided that estimated service lives used for financial accounting, where such lives reasonably represented expected usefulness, were to be used for contract costing. However, several commentators expressed concern that the requirement to use financial accounting lives would continue to influence the motivation of some financial reporting entities to select for financial accounting purposes those practices which would be most advantageous for other purposes. The Board's research showed that defense contractors often used minimum lives permitted for tax purposes for financial accounting rather than lives based on actual experience. Therefore, the October 3 revised proposal placed the primary reliance for estimation of service lives on records of the age of assets at disposal or withdrawal from active use. The proposal further provided that the historical data would be a baseline for estimates of useful life which could be adjusted based on expected changes in physical or economic lives.

Contractors commenting on the October 3 proposal pointed out that they have not been required to have records which would show the retention periods of assets. Therefore, while most contractors have the basic information from which they could determine typical asset retention periods, few contractors have made analyses or summaries of the information available. Furthermore, they stated that contractors did not have records reflecting the withdrawal of assets from active use. The contractors expressed the opinion that to develop such records would be costly. The Standard has been modified to provide that the

development of records of asset withdrawal from active use be at the option of the contractor; however, it should be pointed out that such records could be additional support to reduce historical asset lives.

The Standard also provides a two-year period for the development of analyses of historical asset lives. The Board believes the two-year period should provide adequate working time to develop such analyses. The Standard does not prescribe the nature of the analyses which should be performed, nor does it prescribe the number of prior years to be analyzed or the extent of support necessary; it recognizes that the adequacy of records depends upon individual needs and circumstances. The Board believes that most contractors have adequate records on asset retention. Estimates of experienced lives can be developed from these existing records on the basis of samples. Statistical sampling from existing records or judgmental samples with analyses to support a large portion of the dollar amounts involved may allow reasonable estimates in many cases with a relatively small sample. The Board expects that contractors will develop sufficient data to support the lives used and that procurement agencies will enforce this requirement in a reasonable manner.

Several commentators criticized the October 3 proposal on the basis that it would engender disagreements about the impact of the physical and economic factors recognized as appropriate to consider in relating actual past experience to expected future usefulness. The Board, in effect, places a burden of proof on the contractor who proposes that expected changes in physical and economic factors should be used to justify any specific reduction in estimate from that supported by his records.

The Board recognizes that many contractors would still be concerned not only about the concept of developing service life estimates from records of actual use but also about the risk of disagreements related to the appropriate adjustments to be made in relating actual past experience to expected future usefulness. The Board believes that procurement agencies generally recognize the significance of the physical and economic factors listed in the Standard. The Board encourages the procurement agencies to provide written guidance for use by field personnel, with the goal of making an effective transition from amortization periods derived from tax regulations to those based on reasonable estimates of actual useful service. The staff of the Board will participate, if requested, in the development of appropriate guidance to field personnel.

(5) *Reliance on Internal Revenue Service.* Many commentators, throughout the Board's research proc-

ess in the development of this Standard, have suggested that the Board should rely on the experience accumulated by the Internal Revenue Service. Under this general approach the Board would be expected to concede that there is so much uncertainty about depreciation that auditors should not ask for support of estimates from individual contractors, but should accept for contract purposes the operation of a broad band of averages which have been developed for other purposes but which do deal with the same depreciation practices. The Board has recognized that contract costing often deals with the same expenditures and the same problems of allocation to time periods as are of interest in income tax accounting. Tax regulations, however, are intended to achieve a variety of social goals quite foreign to the purposes of contract costing. In this regard, the "Asset Guideline Periods," first established in 1962, were based on write-off periods substantially shorter than actual average experienced lives and these periods were subject to further reduction under the "Asset Depreciation Range System" in 1971.

In addition, tax assessment and collection are continuous so that, except for differences in tax rates, shifts of income or expense from one year to another generally do not have a significant effect on total tax paid over a period of time. However, similar shifts of cost from one year to another could have a decided impact on the costs chargeable to the Government on contracts with it.

The Board has considered very seriously the issues which are related to its decision not to rely solely or necessarily on I.R.S. regulations with respect to depreciation. Early versions of this Standard placed some reliance on I.R.S. regulations. However, spokesmen for contractors criticized the specific techniques used, including the difficulty of using lives shorter than those permitted by I.R.S., while representatives of the accounting profession tended to encourage less reliance on I.R.S. in any way. The Standard now being promulgated continues to make limited use of I.R.S. regulations for estimating service lives where more pertinent information is not available.

(6) *Beginning and Ending Periods.* Several commentators expressed concern that the proposed Standard (both the June 11 and October 3 versions, which were alike in this regard) would not permit accounting conventions to be used for the beginning and ending periods of asset use. The Standard permits the application of conventions (such as the half-year convention) where reasonable in the circumstances and consistently followed. The Board sees no need for change in this respect.

(7) *Asset Groups.* Some commenta-

tors felt that the June 11 proposal implied a desire by the Board for depreciation accounting on an asset-by-asset basis. The Board does not intend to force any changes in decisions reasonably made with respect to accounting in terms of groups or of individual assets. Since depreciation is largely based on the application of estimates, when groups are used the estimates are intended to represent the average or typical experience for all individual assets in the group. The October 3 proposal was modified to make clear the Board's acceptance of grouping practices in accounting for assets and in determining applicable depreciation lives and methods. The Standard permits accounting for assets either individually or in any reasonable grouping, provided that the accounting treatment is consistently applied.

(8) *Use Rates.* In its June 11 proposal, the Board pointed out that the proposed Standard is expected to be applied by contractors in situations where depreciation cost is a factor in determining equitable charging rates to be used as a basis for contract costing. For example, the development of rate schedules for construction plant and equipment and ownership costs for comparison to lease or rental costs would be accomplished in conformance with the requirements of the proposed Standard. The proposed Standard also would have been required to be used by educational institutions in determining amounts to be compensated for use of buildings, capital improvements and equipment.

University commentators stated that few colleges and universities recognize depreciation in their accounting records. Replacement of capital assets is often handled by special appropriations or by bequests and other contributions. Federal Management Circular 73-8 has provided for use allowances as recognition for the employment of capital assets on contract work.

A number of commentators have pointed out that many educational institutions prefer the current use allowance system even though they recognize that conventional depreciation accounting would result in higher recognized costs. The most important reason stated is that the administrative cost and effort involved in establishing depreciation accounts would be significant.

These comments have been persuasive. Universities who choose not to incur the additional administrative expense should have an acceptable alternative basis for reimbursement for the use of tangible capital assets. The Standard has been modified to provide that it does not apply where FMC 73-8 use allowances are a part of contract costs. However, the Standard does apply whenever depreciation accounting is used by an educational institution for a covered contract.

(9) *Residual Value.* Several commentators expressed concern that the proposed Standard defined "residual value" even though the only available numeric value during the service life of an asset is that for "estimated residual value." The wording in the definition has been modified to clarify the Board's recognition of this point.

The proposal included permission to disregard minor residual values (those under ten percent of capitalized cost) in determining a schedule of depreciation charges—until the net book value approaches the residual value. Some commentators suggested that residual values be ignored completely. Others suggested that they be permitted to depreciate beyond actual residual values because of practicality considerations.

The Board has several times expressed its belief that the administration of Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of cost. (See, for example, the March 1973 "Statement of Operating Policies, Procedures and Objectives.") Except for depreciable real property, there would usually be little improvement in the accuracy of cost measurements if estimates of minor residual values were explicitly considered in establishing amounts to be depreciated. However, the Board continues to believe that the magnitude of the expected residual value should be considered for each asset or for each group. If the estimate is greater than ten percent of capitalized cost or if it is applicable to depreciable real property it should be deducted from the capitalized amount in determining the depreciable cost. The Standard has been modified to clarify the applicability of the ten percent materiality rule to personal property only.

The June 11 proposal prohibited the charging of any depreciation amount which would reduce book value below residual value. Where fixed asset accounting is by groups, this provision was not intended to require separate identification of the book values and residual values of individual assets. For individual assets, where actual residual values are not material, the Board does not intend that such immaterial amounts be identified. The criterion of materiality applies to all Board promulgations, and therefore, the Board does not believe it necessary to restate it in every circumstance.

(10) *Gain or Loss.* Both the June 11 and October 3 proposals required that gain or loss on disposition of tangible capital assets be assigned to the cost accounting period in which disposition occurs. A number of commentators suggested that gain or loss on disposition, as an adjustment of depreciation previously recognized, should be assigned to the cost accounting periods and cost objectives to which the depre-

ciation had been charged. This suggestion is conceptually sound but impractical to apply. The records necessary to identify prior depreciation charges would be difficult to maintain. In addition, where losses occur on disposition, application of the cost to prior periods and cost objectives would often be precluded because applicable contracts may have been closed or funding for the additional cost may not be available. Accordingly, the Board believes it would be fair to both contractors and the Government to adjust for gain or loss in the current cost accounting period.

Commentators suggested that if adjustment is to be made in the current cost accounting period, it should be made to some general indirect cost pool so that adjustments could be absorbed by all work of the period. The Board believes, however, that—to the extent practical—adjustments should be made to the same cost accounts to which the depreciation cost of the asset had been or would have been allocated in that cost accounting period. To the extent that depreciation cost is assigned to individual departments or cost centers, so should the adjustments to depreciation resulting from the disposition of assets.

Commentators expressed the opinion that gains on disposition of assets in today's economy are often the result of inflation and not adjustments of depreciation expense. The Board recognizes that assets held for long periods, especially real property, may be disposed of for amounts in excess of net book value. The gain may have been caused by any of several factors, including the rising general price level. In some situations it may be arguable that the gains should not be considered as corrections to previous depreciation charges. The Board and others in the accounting profession are examining new techniques to deal with accounting for inflation. However, accounting for cost on an historical basis is now generally accepted and until the new techniques are developed and accepted, the Board does not see a practical way to differentiate those gains deemed by some to be based on inflation from those resulting from excessive depreciation charges. Because the Standard applies only to assets acquired after the date when the Standard must first be followed by a contractor, the impact of the Standard on recognition of gains or losses in some years in the future. At that time it is expected that guidance will be available on the appropriate treatment for price-level changes reflected in gains or losses from disposition of fixed assets.

Current procurement regulations of Government agencies are not consistent in their provisions for gains and losses. A number of commentators were apparently unaware of this diver-

sity; they encouraged the Board to leave the present situation alone. The existing procurement regulations have been carefully considered and the Board believes that contract cost determinations will be improved by more uniform treatment of such gains and losses.

Several commentators were concerned that the treatment of gain or loss from involuntary conversion, while in agreement with the Federal income tax treatment, differed from the generally accepted financial accounting practice. The Standard has been changed to permit the contractor to use either basis in accounting for involuntary conversions.

(11) *Original Complements.* The Standard on Capitalization of Tangible Assets defined and required the capitalization of original complements of low-cost equipment. There has been some controversy over the appropriate write-off technique for such capitalized amounts. Informal staff proposals to require amortization over the life of the complement, or of the asset for which it has been required, were challenged by contractors as being unreasonable. The Board recognized the intensity of this feeling and the June 11 proposal included a provision developed specifically to assign such costs among cost accounting periods.

Some commentators pointed out that the June 11 proposal for amortization of original complements would have required a practice which is not at all common and would be difficult to implement.

The provisions of the proposal were modified for the October 3 version to require simply that an original complement be treated as a tangible capital asset, and that the basic requirements of the Standard be applied to it. Thus, the costs of each original complement would be amortized over its period of expected usefulness, and in accordance with its pattern of expected usage, either separately or as a part of an appropriate group. Comments received on the October 3 version have suggested some misunderstanding of the principle involved. Some additional language has been added to the illustration on depreciation for original complements in § 409.60(c) to further clarify the principle that an original complement is a single asset and not a group of individual items.

(12) *Retroactive Impact of Changes.* The Board called attention, in the June 11 publication, to the conflict between some aspects of Opinion No. 20 of the Accounting Principles Board and the treatment proposed, in § 409.50(i), for changes made in depreciation accounting during the service life of an asset. The position proposed by the Board, that of making changes applicable prospectively only, was approved by most of those who commented on the point. A very few com-

mentators asked that the Board agree with the financial accounting principle and insist upon retroactive impact, even though this would require reopening settled contracts. The Board was not convinced that any improvement in costing accuracy resulting from reopening settled contracts would merit the obvious administrative inconvenience involved. The Standard is, therefore, not changed in this regard.

(13) *Service Center Costs.* The June 11 proposal provided that when depreciable assets are part of an organizational unit whose costs are charged to users on the basis of service, the depreciation cost of such assets should be included as part of the costs of the organizational unit. A number of commentators expressed concern that the Standard might be thought to require the assignment of building depreciation separately to each organizational unit which occupied a building, even though the applicable building depreciation might be only a very minor part of the total organizational unit cost. If an organizational unit occupies a entire building, and the depreciation cost of that building is significant and can practicably be identified, that building depreciation cost should be included as a cost of the organizational unit for assignment to cost objectives on the basis of service. If, however, the total depreciation cost of a building, which is allocable to a number of cost objectives, is accounted for as indirect cost and its allocation on that basis would not materially distort the measurement of costs to any benefiting cost objective, little point would be served by insisting that each organizational unit receive a specific charge for building depreciation.

Several commentators were concerned that the paragraph on service centers might restrict the base or bases used for charging service center costs to other cost objectives. Nothing in that paragraph is intended to limit or prescribe the base or bases used for charging service center costs.

(14) *Cost of Capital.* Many commentators have pointed out that the requirements to be imposed by the Standard may result, on assets acquired after the effective date, in less depreciation charged in earlier years of asset life. The resultant slowdown in recovery of funds could, they pointed out, have an adverse impact on the profitability of defense contracts. Many of the comments seek to justify rapid write-off as a partial offset to the costs of capital actually involved but not directly recognized in contract pricing.

The purpose of this Standard is to provide a better measurement and allocation of depreciation cost. Accounting practices used for these functions should be justified on the basis of their effectiveness for such measure-

ment and allocation. They should not be justified on the basis of problems identified with other aspects (e.g., profitability) of defense contracts.

The Board has no authority to extend itself into the area of profitability of defense contracts. This is a matter for the procuring agencies. In this regard, current procurement regulations provide guidance with respect to negotiating proposed profits; this guidance includes some implicit recognition of the cost of capital. The Board believes that accounting for the costs of capital and determining equitable measures of profit are issues separate from depreciation accounting and these issues cannot be resolved effectively by adoption of any particular depreciation practices.

(15) *Modernization and Public Policy.* Many commentators have pointed out, throughout the process of developing this Standard, that no Cost Accounting Standard should be adopted if it would interfere with public policy to encourage investment in facilities which might provide a more modern, more effective industrial mobilization base. The Board favors appropriate improvements in the physical facilities used in performance of negotiated defense contracts; its purpose however does not include such public policy decisions as the introduction or continuation of incentives to encourage investment in certain classes of assets. This Standard is being promulgated for the purpose of improving the measurement and allocation of depreciation on acquired assets. The Board does not believe that this purpose is inconsistent with or a deterrent to effective plant modernization.

(16) *Inflation Accounting.* Some commentators were concerned with the effect of inflation in depreciation accounting. They suggested that this Cost Accounting Standard should provide for the use of replacement cost or current value rather than historical cost as the basis for determining depreciable amounts. Present Government procurement regulations as well as financial and tax accounting are based on historical costs. Current inflationary trends, however, suggest that more attention should be given to the impact of inflation on established accounting concepts.

The Financial Accounting Standards Board (FASB) is considering this subject. The FASB issued an Exposure Draft on "Financial Reporting in Units of General Purchasing Power" on December 31, 1974. The CASB is also studying the subject.

The cost impact of this Standard for most contractors is some years in the future. The Standard is required to be followed by contractors at the start of their next fiscal year after receipt of a covered contract requiring compliance with this Standard. The Standard provides for a two-year period after re-

quired compliance to accumulate necessary supporting records. The requirement of the Standard for determining lives applies only to new assets acquired after the necessary records are available. Therefore, for most contractors implementation of the requirements of life determination will apply only to new assets acquired in accounting periods beginning January 1, 1978, or later.

The Board sees this Standard as establishing proper techniques for the measurement and allocation of depreciation expense. The Board believes, therefore, that this Standard can properly be promulgated at this time. The subject of inflation accounting concerns not only depreciation cost but all costs, and will be dealt with as part of the studies now in progress by both the CASB and the FASB.

(17) *Costs and Benefits.* Comments received on the June 11 and October 3 proposals indicated that there would be substantial administrative cost entailed in complying with this Standard. Part of the increased cost is attributed to required changes in accounting practices; a greater part is alleged to be related to increased controversy over the acceptability of current and proposed depreciation methods and lives.

A number of the administrative problems described in the comments have been reduced or eliminated by changes to the Standard. The requirement for recordkeeping, however, has not been eliminated. As discussed above, the Board recognizes that for some companies additional cost will be incurred to implement this aspect of the Standard. Also as discussed above, there may be some one-time analytical effort during the next two years to develop starting estimates of actual retention periods. The Board believes that these administrative costs, when reasonably managed in light of the purpose to be served, are warranted by the likelihood of better measurement of depreciation cost than has previously been available.

The Standard does not prescribe uniform accounting treatment. It enunciates principles and criteria for the implementation of these principles, which will achieve a practical degree of increased uniformity and consistency in fixed asset depreciation accounting techniques. In some cases, as for the determination of estimated service life, the Standard requires the establishment of records to achieve a better measurement of cost based on the manner in which contractors manage their fixed assets.

The benefits to be expected are better accounting for depreciation cost and enhanced ability to meet the responsibilities of the Government and of defense contractors to properly account for the expenditure of public funds. The Board recognizes that

some additional costs will be incurred in obtaining compliance with this Standard. The benefits to be obtained are substantial, and the Standard contributes to fulfilling the Board's obligation to seek improved accounting for defense contracts.

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There is also being published today (40 FR 4259) an amendment to Part 400, Definitions, to incorporate in that part terms defined in § 409.30(a) of this Cost Accounting Standard.

PREAMBLE B

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 409.10. This amendment was part of a publication which added § 331.30 (b)(3). Only the portion of the preamble which describes the revision to § 409.10 is printed here. The remainder of the preamble appears as preamble K of the supplement to Part 331.

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In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and is amending standards 401 through 409 as set forth below.

PREAMBLES TO COST ACCOUNTING STANDARD 410, ALLOCATION OF BUSINESS UNIT GENERAL AND ADMINISTRATIVE EXPENSES TO FINAL COST OBJECTIVES

PREAMBLE A

Preamble to Original Publication, 4-16-76

The following is the preamble to the original publication of Part 410, 41 FR 16141, Apr. 16, 1976, as corrected at 41 FR 22241, June 2, 1976.

The Standard on Allocation of Business Unit General and Administrative (G&A) Expenses to Final Cost Objectives being published today is one of a series being promulgated by the Cost Accounting Standards Board (CASB) pursuant to section 719 of the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. App. 2168), which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

Preliminary work on the development of this Standard was based in part on the "Report on The Feasibility of Applying Uniform Cost-Accounting Standards to Negotiated Defense Contracts," which cited the allocation of G&A expenses as one of the most frequently encountered problems in the area of allocation of indirect cost.

Another basis for the early work in this area was the absence of a requirement in procurement agency regulations dealing specifically with the allocation of business unit G&A expenses. Up to now, practices related to the allocation of G&A expenses have been covered by general provisions dealing with allocability and indirect costs. These provisions do not include criteria for the selection of allocation practices in given circumstances. The Board undertook research with the view that a Cost Accounting Standard on this subject should increase the likelihood of achieving objectivity in the allocation of G&A expenses to final cost objectives and comparability of cost data among contractors in similar circumstances.

Early research included an extensive review of available literature including decisions of contract appeals boards and courts. A preliminary analysis of accounting for the allocation of G&A expenses was made and significant issues were identified. A research questionnaire based on these issues was distributed on July 28, 1972; it was designed to solicit a sample of existing practices used for the allocation of G&A expenses and the reasons supporting existing practices. Responses were obtained from 65 sources.

After evaluation of the responses to the questionnaire, the Board developed a preliminary research draft of the Standard which was widely distributed, on December 13, 1973, to obtain informal comment and to ascertain the cost impact of adoption of the Standard as proposed. The Board's further consideration of the issues related to the allocation of G&A expenses has been enhanced by almost 100 responses to this preliminary proposal.

A proposed Standard was published in the FEDERAL REGISTER of September 24, 1974, (39 FR 34300). After reviewing the responses to that publication, the Board revised its proposal. As part of its research in preparing the revised proposal, the Board surveyed, as described below, a number of companies who use a cost of sales base to allocate G&A expenses. The revised proposal was published in the FEDERAL REGISTER of September 9, 1975, (40 FR 41801). As part of the comments with the September 9, 1975 publication, the Board stated that it was particularly interested in receiving comments on the alternative methods for the proposed requirement for the transition from a cost of sales base for allocation of the G&A expense pool to use of a cost input base. Respondents were specifically asked to comment on the administrative cost and effort entailed by each of the alternatives and to indicate their preference between the alternatives. The Board supplemented both FEDERAL REGISTER publications by sending copies of the FEDERAL REGIS-

TER material directly to organizations and individuals who had expressed an interest in the work of the Board.

The Board received a total of 136 responses to both FEDERAL REGISTER publications; 65 to the September 24, 1974 proposal and 71 to the September 9, 1975 proposal. Responses were received from individual companies, Government agencies, professional associations, industry associations, public accounting firms, universities and others. The Board takes this opportunity to express its appreciation for the helpful suggestions and criticisms which have been furnished. The comments furnished by organizations and individuals have resulted in a number of changes in the Standard.

The comments below summarize the issues discussed by respondents in connection with both proposed Standards. They incorporate the still relevant portions of the comments which accompanied the September 24, 1974 publication. The comments also explain the major changes which have been made to the prior proposals.

1. SELECTION OF AN ALLOCATION BASE FOR THE G&A EXPENSE POOL

Allocation Relationship. Commentators expressed the view that the choice of an allocation relationship between the G&A expense pool and final cost objectives is arbitrary; particularly, the selection of any single allocation base is arbitrary. Commentators also took the position that the G&A expense pool cannot be allocated on a demonstrable beneficial or causal relationship, that G&A is not specifically related to all costs, nor does it bear any relationship to cost objectives or any particular final cost objectives. Other commentators stated that the selection of the cost input base must be based on the assumption that G&A is caused by cost input. The commentators with reference to the Martin-Marietta case, ASBCA 14159, March 16, 1971, noted that the decision in that case rejected this position.

While some commentators on the September 9, 1975 publication supported the choice of cost input, others agreed with the views expressed above. The Board has concluded that the expenses in the G&A expense pool are the expenses of the general management and administration of a business unit as a whole; that the allocation base chosen should be one which measures the total activity of the business unit during a cost accounting period and not just some part of total activity, and that a cost input base accomplishes this objective.

Cost of Sales Survey. Shortly after the initial FEDERAL REGISTER publication, the Board surveyed segments of a number of companies who use a cost of sales base to allocate G&A expenses. The survey was designed to

compare the results of using a cost of sales base with the results of using a cost input base to allocate these expenses. Responses were received from 91 segments. The results of the survey established that in the case of individual segments the use of a cost of sales base as compared with a cost input base can result in a significant difference in the G&A rate and in the allocations of G&A expenses to final cost objectives. For example, one of the segments in the survey had a G&A rate based on cost of sales of 8.0 percent. When that segment used a total cost input rate, its G&A rate for the same period was 10.4 percent or a 30 percent difference. A change to a total cost input rate would have resulted in substantially different allocations of G&A expense to that segment's final cost objectives.

Some commentators were critical of the Board's using a single year as the basis for the survey. These commentators noted that there could be isolated instances where the use of a cost of sales base would not produce equitable results. However, they noted that over time a cost of sales base will give equitable costing results.

For a cost of sales base to provide an equitable allocation consistent with that of an allocation to the total activity of a business unit during a cost accounting period, a contractor's mix of work between Government and commercial, types of contracts and the level of G&A expenses would have to remain constant over many periods. In this regard, the cost of sales survey demonstrated that in any given period, one period being selected, the use of a cost of sales base can result in significant differences in the allocation of G&A expenses to final cost objectives as compared with the results obtained using a cost input base.

Cost of Sales Base. A number of commentators suggested that the use of cost of sales as a measurement of the allocation base for the G&A expense pool should be permitted. Commentators asserted that this base has long been used for the allocation of the G&A expense pool and is consistent with generally accepted accounting principles and the concept of period costs. The Board's position is that the measurement of a cost of sales base is representative, in part, of the productive activities of prior periods and is subject to fluctuations which can distort the allocation of G&A expenses to activities of the current period. Although the measurement of cost of sales is based on a recorded date of sale, that is not necessarily an index of the activities of a period.

Under current regulations as interpreted by the Armed Services Board of Contract Appeals, the use of a cost of sales base will not result in an equitable allocation of G&A expenses where there are significant changes in the

mix of business or significant changes in the beginning and ending inventory balances. The Board has considered the existence of these past disputes and cases involving the use of a cost of sales allocation base. In given circumstances, due to the definition and accounting for sales under various types of contracts, the cost of similar types of productive activities may be treated differently in terms of the measurement of a cost of sales allocation base. The use of a cost of sales base can result in unwarranted shifting of costs between different types of final cost objectives. Therefore, the Board has concluded that the use of a cost of sales base is inappropriate for establishing the proper cost of final cost objectives within a cost accounting period.

Cost Input Base. Commentators took the position that the use of a cost input base would violate generally accepted accounting principles used for financial accounting purposes because G&A expenses are most commonly viewed as a period cost and not allocated to production nor inventoried. The use of a cost input base would result in inventorying G&A expenses for contract costing purposes. Further, commentators asserted that there is no beneficial or causal relationship between the G&A expense pool and cost input, cost objectives or specific final cost objectives.

The logical extension of this argument is that these expenses should not be allocable to Government contracts. If no beneficial or causal relationship can be established then there should be no recovery, because for a cost to be attached to cost objectives some beneficial or causal relationship should exist.

There are a number of firms which inventory G&A expenses on Government contracts for financial disclosure purposes. Moreover, the IRS and the SEC have recognized that in some instances G&A expenses are being applied to the inventory of Government contracts, and the G&A expense pool allocation remains in the inventory of these contracts at the end of the accounting period. While the Standard does not require that G&A expense be inventoried for financial reporting purposes, the inventorying of G&A expenses on Government contracts has been an acceptable accounting procedure for financial reporting as well as for filing with the SEC. Under current IRS regulations, G&A expenses may be allocated to inventory.

The Standard being promulgated today is based on the concept of full-costing of final cost objectives. For Government contracting purposes, both direct and indirect costs, including G&A expenses, are allocable. Thus, for contract costing purposes, the concept of period expense is inap-

plicable. The Board has concluded that there is a beneficial or causal relationship between G&A expenses and all of the final cost objectives of a cost accounting period. Therefore, these costs are allocable to such final cost objectives.

Commentators also asserted that the Standard was unduly rigid because it permitted only one base for the allocation of the G&A expense pool. The Standard is not limited to the use of one allocation base; rather, the scope of the base, the measurement of total activity, is limited to cost input as this is the measure of the total activity of the business unit. The Standard provides that the measure of cost input best representing the total activity of the business unit during a cost accounting period is to be the one chosen as the base. The Standard includes criteria for determining the cost input base which will best measure total activity. The criteria are provided so that the allocation base for the G&A expense pool can be selected giving consideration to the differing circumstances of individual business units.

Commentators expressed a variety of views concerning the criteria for the selection of a cost input allocation base. Some commentators noted that the criteria included the necessary guidance and means for selecting the base. Others expressed concern that the criteria for selection of a particular cost input base were not clear and could lead to disputes. Some commentators expressed the view that the inclusion of value-added and single-element allocation bases was redundant. Also, a contractor should be required to demonstrate that the use of a total cost input base would not result in an appropriate allocation before the use of one of the other bases was permitted. Other commentators stated that explicit inclusion of direct labor hours and direct dollars serves to clarify the Standard. Commentators suggested that the selection criteria should be modified to remove any bias favoring a total cost input base.

The Board has recognized the merit of the numerous comments and suggestions received during the research process. The Standard has been modified to clarify the criteria for the selection of an allocation base in a particular circumstance.

Under the Standard, only a cost input base may be used. Three cost input bases have been provided and criteria have been established for selection of the appropriate base. The individual circumstances of a given business unit must be analyzed, and the cost input base that best represents the total activity of that business unit would be the base selected. The Board's research indicates that generally total cost input, because it is a broad measure of all of the work

done and includes all of the costs allocable to the contracts of the period, will be a measure that is representative of the total activity of the cost accounting period.

In this context the term "total activity" refers to the production of goods and services during a cost accounting period. This scope of activity is selected in light of the fact that the purpose of this Standard is to provide guidelines for the allocation of expense to all of the work of a given cost accounting period.

Commentators questioned whether other indirect costs not part of cost of goods sold, such as unallowables and nonoperating expenses, should be part of the measurement of cost input. These commentators took the position that such costs should not be part of cost input. Commentators pointed out that there could be an inconsistency in the cost input bases used by various contractors depending on whether costs such as selling costs or IR&D and B&P costs were included in the G&A pool or excluded from the G&A pool and included as part of the cost input base. Commentators also questioned whether costs such as service center costs and intersegment transfers should be included in the cost input base for the allocation of the G&A expense pool.

The cost input base has been selected as the measure of the total activity of the work performed during the cost accounting period. Therefore, it is appropriate that the costs of all activities, functions, materials, services, etc., allocable to final cost objectives during a cost accounting period be included in the total cost input base for that period. This relationship is based on the scope of the G&A expenses which represent the cost of the general management and administration of the business unit as a whole. For example, where a total cost input base has been selected, all significant costs other than the costs included in the G&A expense pool should be included in the base. The Board is aware that there can be a difference in the allocation bases used depending upon the treatment of selling costs and IR&D and B&P costs. This result occurs from the Board's accommodation of existing practices for accounting for selling costs and IR&D and B&P costs within the structure of this Standard. The Board has specifically required the inclusion of these costs in the cost input base in § 410.50(f). The illustrations concerning the accounting for these indirect costs as part of a cost input base have been revised to clarify the required treatment.

Commentators suggested that minor variations from the specific bases presented should be allowed. The Board points out that the Standard requires that the allocation base selected should include all significant elements

of cost input necessary to represent the total activity. If in a given circumstance, the exclusion of a particular item does not invalidate the chosen base's representation of total activity, this is acceptable under the Standard. The Board notes that these are the kinds of decisions which involve consideration of the individual circumstances of a business unit; accordingly, the Standard provides the opportunity for the exercise of judgment in these situations.

Commentators noted the Standard lacks an explicit consistency requirement for the use of the cost input base selected. It was pointed out that allocation bases once selected are then used for considerable periods of time, usually as long as the underlying economic circumstances do not change. In this situation the selected base would remain representative of the total activity of the business unit. The Board does not intend to change this practice. In fact, the Board notes that in concert with Cost Accounting Standard 401, the selection of the allocation base for the G&A expense pool should provide the basis for allocation of that pool until such time as the basic economic circumstances change. The Standard has been modified to require that the base selected should be one that measures activity of a typical cost accounting period.

Commentators were uncertain as to the relationship of cost input to the purchase of raw materials inventory and to Cost Accounting Standard (CAS) 404—Capitalization of Tangible Assets. To help clarify the relationship of this Standard to the purchase of raw material inventories and to CAS 404, an illustration has been added. Cost input is basically a measure of the costs and expenses allocated to production of goods and services during a cost accounting period. The illustration has been revised to make clear that items purchased for raw material inventory which have not been committed or used in production during a cost accounting period would not be part of the cost input base for that cost accounting period. As to the acquisition costs of assets constructed or fabricated by a contractor, CAS 404 and the Standard must be read together. The requirements of CAS 404 provide that those G&A expenses which are identifiable with the constructed asset and are material in amount shall be allocated to the cost of the asset. CAS 404 also provides that the cost of constructed assets that are identical with or similar to the contractor's regular product shall include a full share of indirect costs—thus, the costs of these assets will be included in the cost input base.

2. A TRANSITION PROVISION

Some commentators suggested that to avoid disputes and inequities the

Board should provide a specific method of transition for any contractor that is required to change from a cost of sales or sales base to a cost input base. In the September 9, 1975 publication, the Board proposed alternative transition. Methods X and Y as a means of avoiding potential disputes and minimizing the administrative cost of implementing the change from a cost of sales or sales base to a cost input base. Either of the proposed methods would have eliminated the major portion of potential equitable adjustments arising from compliance with the Standard.

Numerous comments regarding the equity, administrative complexity, and costs of both X and Y were received. Some commentators asserted that Y was more equitable in that both CAS-covered and non-CAS covered work would be treated alike, on the basis on which the work was negotiated. Others felt X was more equitable in that there would be less impact on non-CAS covered work. Some commentators expressed the view that neither X nor Y was equitable in that both methods effectively repriced existing contracts by impacting, "squeezing down" the cost input rate on new contracts, and both methods would result in a deferral of recovery of G&A expenses.

While some commentators found one method less administratively complex than the other method, other commentators saw little difference in the administrative cost and effort required by either method. Most commentators expressed the view that either X or Y would require some additional administrative effort and the generation of data not currently produced.

A number of alternative transition methods were suggested including:

- (1) An option to use either X or Y,
- (2) An option to use X or Y or switch over immediately,
- (3) Neither X nor Y, but use equitable price adjustment,
- (4) The use of a combination method involving the actual cost of sales and cost input rates for a period and some type of suspense account to prevent an over-recovery of G&A expenses.

In addition, commentators proposed a number of variations of each of these basic alternatives. The Board is persuaded, after reviewing all of the comments received on transition methods, that a variation of one of those methods favored by many industry associations and several defense contractors offers substantial promise for avoiding potential disputes and for minimizing the impact of shifting from a cost of sales or sales base to a cost input base. This transition method is set forth in § 410.50(e) and Appendix A of the Standard. Business units required by the Standard to

change from their present allocation base to a cost input base are not required to use this transition method; rather, a business unit has the option of choosing this transition method or proceeding with an immediate change-over to a cost input base and seeking adjustment under the equitable adjustment provision of the contract clause.

Use of the optional transition method will, in the Board's opinion, avoid the need to use the equitable adjustment provision of the contract clause to reprice prime contracts and subcontracts of business units using this technique. The Board believes that this procedure is appropriate for this Cost Accounting Standard.

It is the Board's view, however, that for most Standards the impact of changes in cost accounting practices required by new Cost Accounting Standards will be accommodated by price adjustments for covered prime contracts and subcontracts through the equitable adjustment provisions of the contract clause.

For any business unit which chooses not to use the transition method set forth at § 410.50(e) and Appendix A, the contractual provision requiring appropriate equitable adjustment of the prices of affected prime contracts and subcontracts will, of course, be implemented with consequent adjustment of the price of such contracts and subcontracts.

The optional transition method provided in § 410.50(e) and Appendix A permits a business unit whose disclosed or established cost accounting practice was to use a cost of sales or sales base—and which is performing work on final cost objectives which came into existence prior to the date the business unit must first allocate its cost in compliance with the requirements of this Standard—to allocate the G&A expense pool to these cost objectives using a cost of sales or sales base. These final cost objectives often include:

- (1) Government contracts which contain the CAS clause;
- (2) Government contracts which do not contain the CAS clause;
- (3) Contracts other than Government contracts, or customer orders awarded, prior to the date the business unit must first allocate its cost in compliance with the requirements of this Standard; and
- (4) Production not specifically identified with contracts or customer orders under production or work orders existing prior to the date on which a business unit must first allocate its cost in compliance with this Standard and which are limited in time or quantity.

Production under standing or unlimited work orders, continuous flow processes and the like, not identified with contracts or customer orders, are

to be treated as final cost objectives awarded after the date on which a business unit must first allocate its cost in compliance with the requirements of this Standard.

The business unit will allocate its G&A expense pool to those final cost objectives which arise on or after the date on which a business unit must first allocate costs in compliance with the requirements of this Standard using a cost input base calculated in compliance with § 410.50(d).

A business unit will use the transition method until all pre-existing final cost objectives using the cost of sales or sales base are completed. At that time the business unit will be using and will continue to use a cost input base selected in accordance with the requirements of § 410.50(d) to allocate the G&A expense pool to all CAS-covered contracts.

In order to prevent possible windfalls and to provide equity to both parties to applied to the inventory suspense account must be established. The amount of the inventory suspense account shall be the beginning inventory of contracts subject to the CAS clause of the cost accounting period in which a business unit must first allocate costs in accordance with the requirements of this Standard. The G&A expense allocation rate to be applied to the inventory suspense account is the cost of sales rate for that first accounting cost period.

The suspense account will be amortized in any cost accounting period subsequent to the last cost accounting period in which final cost objectives negotiated by using a cost of sales or sales base are still being performed and in which the amount of the ending inventory of contracts subject to the CAS clause for that cost accounting period is less than the amount of the inventory suspense account. The G&A expense pool of that cost accounting period shall be reduced by the difference between the inventory suspense account and the ending inventory of contracts subject to the CAS clause of that cost accounting period times the cost of sales rate applicable to the inventory suspense account.

The Standard must be followed after the start of a contractor's next fiscal year after January 1, 1977. This long lead time provides both the Government and contractors an opportunity to prepare appropriate administrative procedures for using this transition method.

3. DEFINITION OF G&A EXPENSE

G&A Expense. Some commentators expressed the view that the definition was consistent with their current practice; others were concerned that the definition of G&A expense was narrower than those definitions currently in use, and the result might be exces-

sive fragmentation of existing G&A expense pools to remove insignificant items.

Board research indicates that while accountants are in agreement about the general character of G&A expenses, practice has resulted in the cost of a variety of functions and expenses being included in the G&A expense pool. As a result, from the early stages of this project onward, the Board has seen a need to provide a definition of G&A expense in order to bring some uniformity to this area of accounting.

Commentators expressed concern about problems involving the classification of those persons and functions of top level management that are concerned with both the overall planning and administration of a business unit and the direction of a particular function. Some commentators suggested that top level management people could keep time records, and split their costs between the G&A expense pool and the administration of the function which they are directing. While this may be appropriate in some circumstances, the Board believes the determination of the content of the G&A expense pool and the identification and classification of expenses in a particular circumstance must be based on judgment giving consideration to the characteristics of the individual business units. Similarly, the distinction between those expenses which are other indirect costs, including manufacturing overhead and those which are G&A expenses must be based on the individual circumstances using the guidelines provided in the Standard and the definition.

The definition has been revised to provide guidance for making those decisions. The definition now requires that for an expense to be classified as G&A expense, it must be incurred for the management and administration of the business unit as a whole. Further, the definition specifically excludes from G&A expense those management expenses whose beneficial or causal relationship to cost objectives can be more directly measured by a base other than a cost input base representing the total activity of a business unit during a cost accounting period.

Commentators indicated concern and expressed some confusion regarding the interaction of the definition of G&A expense and the requirements of § 410.40(d). Commentators were uncertain as to if and when expenses which do not meet the definition of G&A expenses contained in the Standard should be removed from the G&A expense pool. The Board has revised § 410.40(d) to clearly express the Board's intent that those expenses which do not meet the definition of a G&A expense and whose beneficial or causal relationship to business unit

cost objectives is best measured by a base other than a cost input base representing the total activity of a business unit during a cost accounting period should be removed from the G&A expense pool.

Materiality. With respect to the questions about materiality, the Board has several times expressed its belief that the administration of Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of cost. See, for example, the March 1973 "Statement of Operating Policies, Procedures and Objectives." The Board has considered the comments concerning the potential problems that could arise without a clearer statement of materiality related to the composition of the G&A expense pool. The Board believes in this instance a significance test will be particularly useful and the Standard has been appropriately modified (§ 410.50(c)).

Accounting for Specific Items of Expense in the G&A Expense Pool. Commentators also expressed concern about the treatment of specific items of expense that are sometimes found in the G&A expense pool. In particular, commentators expressed concern over the treatment of selling and marketing costs, independent research and development (IR&D) costs and bidding and proposal (B&P) costs. Commentators questioned whether under the Standard these costs were G&A expenses to be included in the G&A expense pool.

The Board recognizes that at the present time selling costs (marketing or selling costs) may constitute a significant amount of cost and are accounted for in a variety of ways. Some account for selling costs in a separate cost pool while others include selling costs as part of the G&A expense pool.

Contractors who have included selling costs in a cost pool separate and apart from the G&A expense pool may continue that practice or may change and include selling costs in their G&A expense pool. Further, contractors who will have to change the allocation base used for the G&A expense pool and who have in the past included selling costs as part of the G&A expense pool may account for selling costs by establishing a separate cost pool for the selling costs and using the allocation base they previously used for their G&A expense pool. Where selling costs are accounted for in a cost pool separate and apart from the G&A expense pool and are allocated using a different allocation base, they shall become part of the cost input base used to allocate the G&A expense pool. Also, the Board notes that the current ASPR provision related to the accounting for IR&D and B&P cost requires that generally the allocation of these costs shall be on the same basis as the con-

tractor's allocation of his G&A expense pool, although these expenses are not termed G&A expenses. Under the provisions of this Standard, business units which have included IR&D and B&P costs in their G&A expense pool may continue to do so. Those business units which choose to use the optional transition method in § 410.50(e) and in which the IR&D and B&P costs remain in the G&A expense pool will account for these costs as follows:

(a) During the transition period, those business units which were using a cost of sales or sales base will continue to use that base to allocate the G&A expense pool to final cost objectives which were in existence as of the date the business unit must first allocate its costs in accordance with the requirements of this Cost Accounting Standard.

(b) During the transition period and subsequent to that time, the G&A expense pool would be allocated to new contracts subject to the CAS clause using a cost input base as required by § 410.50(d).

As a result of the current ASPR provision, a business unit which is required under this proposed Standard to change the allocation base used for its G&A expense pool could, because of the ASPR requirements, also be required to change the allocation base for IR&D and B&P. For those contractors who include IR&D and B&P in their G&A expense pool, this change in the business unit's method of accounting for IR&D and B&P costs, however, would be subject to the transition provision of the proposed Standard, and would only affect allocation of these costs to contracts awarded on or after the date on which a business unit must first allocate its costs in accordance with the requirements of this Standard.

Commentators expressed the view that since IR&D, B&P costs, and selling cost could become part of the allocation base for the G&A expense pool it might lead to the concept that these costs are final cost objectives themselves and should receive an individual allocation of G&A expense. As was stated in the Prefatory Comments to the September 9, 1975 publication, the Board is currently working on projects involving IR&D, B&P and selling costs. The Board at this time does not require changing the accounting for these costs. However, where these expenses are treated separately and apart from the G&A expense pool they shall become part of the allocation base used to allocate the G&A expense pool to final cost objectives and are not to be treated as individual cost objectives in and of themselves.

The illustrations concerning the accounting for costs which are removed from the G&A expense pool and the

accounting for IR&D and B&P costs and selling costs have been clarified in response to comments received.

Expenses Transferred from the G&A Expense Pool. Commentators expressed the view that those items which will be taken out of the G&A expense pool and transferred to the benefiting segment for which they were incurred, are not really G&A expenses of the segment but are G&A-type expenses. These expenses come out of the pool and are transferred in what might be described as a purification of the G&A expense pool before it is allocated. The Board agrees with this position, but does not believe an amendment of the Standard is necessary.

4. USE OF MEMORANDUM RECORDS

Some commentators urged that the Standard specifically permit the use of memorandum records for the allocation of G&A expenses to final cost objectives. The Board notes that even in the absence of this Standard, many contractors now use memorandum records to perform the allocation of G&A expenses for purposes of Government contracts, because in their formal records they do not make an allocation of G&A expenses to contracts or they do so on a different basis. The Board sees no need to disturb the practice of using memorandum records for the allocation of G&A expenses to final cost objectives.

5. ALLOCATION OF HOME OFFICE EXPENSES TO FINAL COST OBJECTIVES

Commentators expressed concern about the handling of home office expenses which are received by a segment as residual expenses under CAS 403 or as a lump sum which is not designated as a particular type of expense. The Standard now provides explicitly that individual handling of various types of home office expenses would be required only where a separate allocation of expenses is received from a home office, and where the amount of the allocated expense is significant.

Other commentators suggested that in given circumstances a different allocation base than the allocation base used for the allocation of home office expense to the segment may be appropriate for the allocation of home office expense to final cost objectives of the segment. The Standard does not require that the same base be used for the allocation of home office expenses to final cost objectives of the segment as was used for the allocation of home office expenses to the segment. The Standard requires establishment of a beneficial or causal relationship between the cost objectives and the expense wherever separate and significant allocations of home office expenses are received by a seg-

ment. It may be appropriate to use a different allocation base for the allocation of home office expenses received by a segment than the allocation base used to allocate home office expenses to the segment.

A number of commentators stated that allocations of home office expenses, either in total or part, are the type of expenses which should be accounted for as period expenses and should not be inventoried nor should these allocations be part of a cost input base for the allocation of the G&A expense pool as they are not part of the activity being managed. The Standard provides that certain allocations of home office expenses are always to be included in the G&A expense pool. Allocations of certain other types of home office expenses, where they are separately received and significant in amount, may or may not be included in the segment's G&A expense pool. The Standard provides that these costs shall be allocated to cost objectives of the segment based on the beneficial or causal relationship between the cost objectives and the expense. As such, where a beneficial or causal relationship between these expenses and cost objectives of the segment can be established, these expenses shall be included in cost objectives other than the segment's G&A expense pool. Where a beneficial or causal relationship for the expenses is not identifiable with other cost objectives of the segment then the expense would be included in the G&A expense pool.

The total cost of a final cost objective is made up of a variety of costs and expenses incurred in different manners and at different times. The functions and services represented by the allocation of home office expense is recognized, for contracting purposes, as part of the total cost of final cost objectives. As such, these costs are not unlike the other costs incurred in the effort to produce the final cost objectives. These costs shall become part of the appropriate cost input base selected to allocate the G&A expense pool. The illustrations have been revised to clarify that a segment must receive the home office expenses as a separate allocation if the requirements of § 410.50(g)(2) are to be applicable.

6. ALLOCATION OF G&A EXPENSES TO SPECIAL CONTRACTS

Commentators suggested that the special allocation provision be stated in terms of class of contracts or types of situations. If the G&A expense pool meets the requirements of the Standard, the existence of a need for special allocation to a class of contracts or type of situation would indicate that the allocation base being used is not representative of the total activity of

the business unit during a typical cost accounting period. The Standard is designed to provide consistent accounting treatment for all contracts, except for a particular contract or other final cost objective, which is an exception to a business unit's normal operation.

The cost input allocation base for G&A expense is a broad measure which is normally representative of the total activity of a business unit during a cost accounting period. Thus, for a given final cost objective to qualify for special treatment, the difference in its beneficial or causal relationship to G&A expense as compared with the relationship of other final cost objectives to G&A expenses should be one which is apparent and capable of being supported. The provision of the Standard calls for the exercise of judgment; nonetheless, the Board believes a materiality criterion based on a measure of significantly different benefits is proper for use in evaluating and establishing a separate and exceptional allocation to a given final cost objective.

7. MISCELLANEOUS

Some commentators stated that the Standard should provide for the allocation of G&A expenses to intermediate cost objectives, such as service centers and other overhead pools. Their position was based on the concept that in various types of full-cost responsibility accounting systems, all costs are allocated to cost objectives for more accurate costing and control purposes. A few commentators stated that for certain management expenses within the G&A expense pool they are able to determine a discrete beneficial or causal relationship between these expenses and the cost objectives of the business unit. Therefore, these expenses are allocated on a separate allocation base to the cost objectives of the business unit.

Where a beneficial or causal relationship between certain management expenses and business unit cost objectives can be determined using an allocation base other than the base used for the G&A expense pool, then by definition, these management expenses are not G&A expenses and should be excluded from the G&A pool. Where a beneficial or causal relationship other than one based on a broad measure of total activity can be determined, generally the resulting allocation represents improved contract costing. However, for those expenses which are in the G&A expense pool, the Board's research indicates that the beneficial or causal relationship between these expenses and business unit activities of a cost accounting period is such that if they are allocated to intermediate cost objectives the allocation to final cost objectives could be significantly distorted.

Some commentators took the posi-

tion that G&A expenses should not be allocated to stock or product inventory items. Other commentators suggested that the cost input of stock or product inventory items should be included in the G&A allocation base only in the cost accounting period when these items are used. The Board has taken the position that work on stock or product inventory items represents part of the productive activity of the business unit for a cost accounting period, and therefore, these items should receive an allocation of G&A expenses.

The Board has recognized the administrative difficulties that can arise as a result of inventorying G&A expenses on these items for contract costing purposes and at the same time complying with requirements of generally accepted accounting principles for financial reporting. The Board has concluded that a practical solution to this circumstance is provided by the accounting treatments set forth in the Standard. A contractor can include G&A expense with the inventory cost of these items for contract costing purposes and provide his own procedure for complying with generally accepted accounting principles. Alternatively, contractors who do not include G&A expenses in the inventory cost of these items in order to conform with generally accepted accounting principles, are permitted to apply G&A expenses using the G&A rate of the period in which the items are issued.

In either situation, the cost of stock or product inventory items is to be included in the computation of the allocation base in the year produced. The Board believes this procedure will provide the appropriate determination of the G&A rate for each year, and the difference in the G&A rate applicable to final cost objectives by using the G&A rate of the year in which the items are issued rather than manufactured will not be significant.

The illustration dealing with the timing of inclusion of stock or product inventory cost input in the allocation base has been revised to make clear that stock or product inventory items cost input is to be included in the year in which the cost input is incurred.

Commentators suggested that a transition provision be provided for other types of changes, e.g., changing from a value-added cost input base to a total cost input base, or removing an item of expense from the G&A expense pool, required for compliance with the Standard. The Board recognizes that a variety of changes may occur as individual business units take action necessary to comply with the Standard. The Board believes that the equitable adjustment provision of the CAS contract clause provides the best means of handling the variety of changes which may take place.

Commentators suggested that some

type of exemption threshold for this Standard should be adopted. It was suggested that the threshold could be based on either total sales to the Government by a business unit or corporate entity or Government business stated as a percentage of total business. The Board is currently studying the question of whether an exemption from its regulation could be appropriately based on the proportion of total business which a contractor does with the Government. Pending the results of that study, the Board does not believe that a percentage-of-sales exemption in individual Standards is appropriate.

Cost-Benefit. Section 719(g) 50 U.S.C. App. 2168(g), as amended provides "In promulgating such standards and major rules and regulations for the implementation of such standards, the Board shall take into account, and shall report to the Congress in the transmittal required by Section 719(h)(3) hereof, the probable costs of implementation, including inflationary effects, if any, compared to the probable benefits, including advantages and improvements in the pricing, administration and settlement of contracts."

In a draft of the proposed Standard that was distributed for comment, the Board specifically requested commentators to provide data on the administrative costs of compliance with that proposal. In the second publication of the proposed Standard, the Board made the same request for data to indicate the administrative costs of compliance with Alternative X or Alternative Y. Of the 165 comments received, only two comments on the draft proposal and one comment on the second publication provided quantitative data. Many comments received indicated that there would be some administrative costs incurred in complying with this Standard. As indicated above, a number of the potential administrative problems described in the comments have been reduced or eliminated by changes to the Standard being promulgated today. Moreover, the practices of many contractors already conform with all or some of the provisions of this Standard.

Commentators indicated that part of the increased administrative cost is attributed to the transition to a cost input allocation base for those business units currently using a cost of sales allocation base. Another part of the increased administrative cost for these same business units is attributed to the accounting for the G&A expense allocated to ending inventory. The Board recognizes that these administrative costs will arise in some cases.

Among the benefits which the Board believes will be derived from use of this Standard No. 410 are a more equitable treatment of all costs incurred during a period, in terms of the G&A

expense pool allocation to final cost objectives; improved measurement of the cost of final cost objectives; a reduction in disputes through the establishment of criteria for evaluation and selection of the allocation base for the G&A expense pool; increase in the likelihood of achieving objectivity in the allocation of G&A expenses to final cost objectives; and an increase in comparability of cost data, among contractors in similar circumstances.

The Board concludes that the costs anticipated for administrative compliance with this Standard when reasonably managed in light of the purposes to be served are outweighed by the probable benefits expected to be derived from its use.

As required by section 719(g) 50 U.S.C. App. 2168(g), as amended, the Board has evaluated the potential inflationary effect of this Standard. The Board has concluded that any inflationary effect of this Standard will be insignificant.

Effective Date. The availability of the transition method to contractors who choose to use it requires especial care in complying with the effective date and application provisions of the Standard. The following comments are offered to illustrate those provisions. The comments assume that the contractor has a January 1 fiscal year; contractors with different fiscal years would of course apply the requirements of the Standard using different dates appropriate to their own fiscal year. For those contractors using a cost of sales base, having a fiscal year beginning on January 1, and electing to use the transition method provided in Appendix A, all contracts entered into prior to January 1, 1978, would be accounted for using the contractor's cost of sales base in accordance with the cost accounting practice previously disclosed or established. Contracts entered on or after January 1, 1978, should be accounted for using a cost input base in accordance with the requirement of § 410.50(d). The transition period would begin January 1, 1978, and continue until all contracts entered into prior to January 1, 1978 are completed. This situation is illustrated in Appendix A, Illustration 1.

Under certain circumstances, a contractor who has been using a cost of sales base must be presumed, during the time between the effective date of this Standard and the date when it becomes applicable to him, to have elected to use the transition method provided in § 410.50(e). These circumstances arise when (1) the contractor proposes to receive an award of a contract priced by use of a cost of sales base for the entire contract and (2) the period of performance specified or anticipated for the contract extends beyond the date when the Standard becomes applicable to the contractor. Contracting agencies should take ap-

propriate action to advise the contractor that consistent with the concepts of Part 401, Cost Accounting Standard—Consistency in Estimating, Accumulating and Reporting Costs, his decision to price the proposal entirely by use of a cost of sales base is deemed an election to operate under the transition method prescribed in § 410.50(e) when this Standard becomes applicable to him.

Those contractors using a cost of sales base, having a January 1 fiscal year, and electing to proceed with a complete change-over to a cost input base on January 1, 1978, would have to be careful to comply with Standard 401 in making proposals for those contracts which will span part or all of the period October 1, 1976, through December 31, 1977, and cost accounting periods beginning January 1, 1978, and thereafter. The proposal should indicate that the cost of sales base will be followed until the date when the requirements of this Standard must be followed; at that later time, the practice required by this Standard, a cost input base, should be proposed to be used as the contractor's practice for the remaining life of the contract.

To illustrate, assume a contractor having a January 1 fiscal year currently allocates G&A expense using a cost of sales base. When the contractor makes a proposal for a contract which will be entered into after October 1, 1976, and prior to January 1, 1978, his proposal must recognize that his G&A expense pool will be allocated by using a cost of sales base from the date of the contract through December 31, 1977, and by using a cost input base thereafter.

The Board expects that this Standard will become effective on October 1, 1978.

There is also being published today an amendment to Part 400, Definitions, to incorporate in that part terms defined in § 410.30(a) of this Cost Accounting Standard.

PREAMBLE B

Preamble to document published 6-8-78

The document published on June 8, 1978 at 43 FR 24819, revised § 410.70. This amendment was part of a publication which added § 331.30(b)(3). Only the portion of the preamble which describes the revision to § 410.70 is printed here. The remainder of the preamble appears as preamble K of the supplement to Part 331.

* * * * *

In the FEDERAL REGISTER of February 16, 1977 (42 FR 9391), the Board proposed to amend section .10, General Applicability, of standards 401 through 409 to conform these sections to the general applicability section as it appears in standard 410 et seq. No comments were received on this proposed amendment. The Board considers this change to be appropriate and

is amending standards 401 through 409 as set forth below.

PREAMBLES TO COST ACCOUNTING STANDARD 411, ACCOUNTING FOR ACQUISITION COSTS OF MATERIAL

PREAMBLE A

Preamble to Original Publication, 5-5-75

The following is the preamble to the original publication of Part 411, 40 FR 19425, May 5, 1975.

The Standard on Accounting for Acquisition Costs of Material being published today is one of a series being promulgated by the Cost Accounting Standards Board (CASB) pursuant to section 719 of the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. App. 2168) which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

Preliminary work on the development of this Standard resulted from the absence of a requirement in agency regulations that the same costing method be used for similar categories of material within the same business unit and that the method be consistently applied. The Board undertook research with a view that a Cost Accounting Standard on this subject might improve cost assignment and cost measurement in accounting for acquisition costs of material.

Early research included an extensive review of available literature and a review of decisions of boards of contract appeals and courts.

A preliminary analysis of material accounting concepts was made and a number of issues were identified; comments on this analysis were obtained from interested persons. After evaluation of all of the issues, the Board developed and circulated preliminary research drafts of Standards which were widely distributed for informal comment and to ascertain the cost impact of adoption of the Standard as proposed. Suggestions and comments were received from 70 respondents; these comments were considered in developing a revised Standard which was published in the FEDERAL REGISTER of November 26, 1974, with an invitation for interested parties to submit written views and comments to the Board. The Board supplemented that FEDERAL REGISTER publication by sending copies of the FEDERAL REGISTER material directly to organizations and individuals who had provided the Board with comments on the earlier proposal or had otherwise expressed an interest in the proposal.

Responses were received from 86 sources including individual companies, Government agencies, professional associations, industry associations, public accounting firms, universities,

and others. All of these comments have been considered by the Board and those addressing areas of particular significance are discussed below, together with explanations of the changes made in the Cost Accounting Standard being promulgated from the proposal published in the FEDERAL REGISTER on November 26, 1974.

The Board takes this opportunity to express its appreciation for the helpful suggestions and criticisms which have been received, and for the time devoted to assisting the Board in this endeavor by the many companies and individuals involved.

1. *Need for a standard.* Many comments were received questioning the need for a Standard in this area. Suggestions were received that because Disclosure Statements at present deal with this subject matter, the Board should accept them in place of a Standard. Other commentators contended that Standard 402, Consistency in Allocating Costs Incurred for the Same Purpose (4 CFR Part 402), dealt with any problems encompassed by this Standard. Some commentators argued that current practices concerning material costs used on Government contracts are well defined, of long duration, and are continually monitored by the Government. Others contended that inventory costing methods are covered by generally accepted accounting principles (GAAP) and, for this reason the Board should not issue a Standard on this subject.

With respect to the makeup of the draft Standard itself, some commentators said it was too broad, while others said it was too detailed and procedural. Some commentators stated that any Standard in this area should deal with direct materials only and should not contain any reference to indirect materials.

The Board has considered the arguments raised above as well as other facets of this particular subject matter. After studying this matter further, the Board has concluded that a Standard dealing specifically with accounting for the acquisition costs of material is needed to complement the Disclosure Statement and Cost Accounting Standard Contract Clause requirements, and to provide consistency in the application of material costing methods. Further, the Board believes that issuance of a Standard may be entirely appropriate even if the Standard does no more than establish as a Cost Accounting Standard the currently prevailing procurement regulations dealing with the allocation of costs to cost objectives. Accordingly, the Board is promulgating today a Standard, appropriately revised in light of the comments received, dealing with Accounting for Acquisition Costs of Material.

2. *Inventory costing methods.* The draft Standard published in the FEDERAL REGISTER on November 26, 1974,

provided for the use of three inventory costing methods and asked commentators to identify any other methods they believed should be acceptable, for contract costing purposes, along with a justification and criteria for the use of such methods. Many commentators expressed the view that the last-in, first-out (LIFO) inventory costing method, under which the recent costs of material are allocated to cost objectives and the older costs are allocated to material remaining in inventory, should be permitted. Some commentators noted that LIFO should be allowed because it is acceptable to the Internal Revenue Service and the Securities and Exchange Commission, and because it is a recognized method for valuing inventory under generally accepted accounting principles and it is acceptable for other purposes. Other commentators expressed the view that the LIFO method results in a better matching of current costs with current revenues thereby reducing the "inventory profits" that develop during inflationary periods.

The purpose of this Standard is to provide for better allocation and measurement of material costs as they relate to specific contracts. The accounting practices used to achieve this purpose should be justified on the basis of their effectiveness for such allocation and measurement. They should not be justified solely on the basis that they are practices acceptable for tax and financial reporting purposes. Further, generally accepted accounting principles do not specify the details of cost allocations to particular contracts but are concerned with reporting the financial results of operations of the company as a whole.

The Board realizes LIFO is considered by some as a partial answer to accounting for the impact of inflation. The Board has noted, however, that most of the companies that recommended that the LIFO method be permitted for contract costing purposes charge almost all of their material to contracts at the time the material is acquired or produced. The direct allocation of the costs of materials to contracts tends to counter the effects of inflation since the current cost of the material is charged against the contract. Moreover, few of these companies use LIFO for material that is issued to contracts from inventory.

The Board believes that accounting for the impact of inflation should be the subject of a separate Standard. The Cost Accounting Standards Board is currently conducting research into this subject.

The Board did not include LIFO as a permitted inventory costing method in the draft Standard because contractors which currently follow LIFO for Government contracts use it in a manner which does not permit systematic and rational identification of the

cost of material issues to specific cost objectives. The Board believes such identification is essential in cost accounting for Government contracts. Accordingly, while the Board has included the LIFO inventory costing method as a permitted method in the Standard being promulgated today, it has also included a requirement that the costing method used be applied in a manner which results in systematic and rational costing of issues of material to specific cost objectives. The costing of such issues to cost objectives must be reasonably current; it would not appear rational to hold in abeyance for months, pending a LIFO determination, the cost of materials issued to a Government contract.

3. *Direct charging of material.* The proposed Standard included a provision whereby the cost of a category of material could be allocated directly to a cost objective provided the cost objective is specifically identified on the purchase order at the time of purchase or on the work order at the time of production of material and provided there is no established material inventory account for that category of material. Some commentators felt that contractors should be permitted to allocate the cost of material directly to a contract without the identification requirement. A greater number of contractors supported the identification requirement provided by the Board. These commentators felt that if identification with the end use was feasible, direct allocation should be permitted.

Most commentators objected to the prohibition of direct allocation if a material inventory account existed. They complained that this requirement forced the contractors to stock material at their own expense. They said this requirement would discourage purchase of material in economical lots. Commentators also pointed out that this requirement would make off-site shipments uneconomical, and would adversely affect contractors' compliance with requirements in other Standards concerning their price proposals.

The Cost Accounting Standards Board favors the direct identification of costs where possible. The Board stated in its "Statement of Operating Policies, Procedures and Objectives" (March 1973):

As an ideal, each item of cost should be assigned to the cost objective which was intended to benefit from the resource represented by the cost or, alternatively, which caused the incurrence of the cost. To approach this goal, the Board believes in the desirability of direct identification of costs with final cost objectives to the extent practical. The Board recognizes the need for care in application of the concept of direct identification of costs with final cost objectives * * *.

In furtherance of this objective, the Board has concluded that the specific identification of the end use of a category of material at the time of purchase or production should remain a requirement for the direct allocation of the cost of material. The Board is persuaded, however, that the existence of a material inventory account should not prohibit the direct allocation of the cost of material, and the Standard being promulgated has been revised to delete that prohibition. If contractors have previously established material inventory records for categories of material, however, the Standard does not require any change in this practice.

4. *Cost of material.* The draft Standard provided that material costs should be the acquisition cost of material adjusted to the extent practical by extra charges paid or discounts and credits received. Many commentators objected to this provision since they said that it is not in accordance with the practices currently followed by most companies. They argued that they charge many of the types of adjustment items referred to above to an indirect cost account and distribute those costs to all material on a base that they say is now acceptable to the Government. They also allege that there would be considerable work involved in identifying these kinds of additional charges with the individual purchases of material and to then spread the charges against the categories of material being purchased.

The Board intended this requirement to define broadly the net acquisition cost of material. This provision has been retained in the Standard being promulgated. A section has been added to the Standard stating that where it is not practical for a contractor to handle charges and credits as set out above, the contractor may provide for the consistent inclusion of such charges or credits in an appropriate indirect cost pool.

5. *Definitions.* Many comments were received on several of the definitions included in the draft Standard. Most commentators raised questions about the definitions of "Category of Material" and "Material Inventory Account."

Some commentators concluded that "Category of Material" would include items such as lubricants, paper, ink, towels, and items of that type. The Board intended that material such as this could be handled as provided under §411.40(c) of the promulgated Standard which permits the cost of material to be allocated, under certain conditions, to an indirect cost pool for distribution to cost objectives.

Other commentators felt that the requirement that a category of material be comprised of identical or interchangeable units would be unduly restrictive. Their contention was that different, individual items of material

would have to be considered as separate categories of material. The Board intended its definition to be read in this way. It was not meant that all sheet steel, for example, should be considered as a single category of material. Most contractors would maintain separate inventory records of different sizes and thicknesses of sheet steel. Each of these would be a category of material.

Many of the comments concerning the definition of "Material Inventory Account" indicated that commentators assumed the Board was talking only about general ledger or subsidiary ledger accounts. Such is not the case. The Board was referring to any record used for accumulating the cost and quantity of material for subsequent issue to one or more cost objectives. The records the Board had in mind could include card files, computer data, bin tags, or other forms of detailed information used in the company's system of accounting for receipt and issue of material recorded as an asset.

Many commentators objected to the inclusion of the word "quantity" and the word "cost" in the definition of material inventory account. Some said they maintained records of either cost or quantity only. It was not the Board's intention that each record must show both cost and quantity. The word "quantity" has been deleted from the definition. The records referred to are those used to accumulate the cost of materials for allocation to specific cost objectives.

The Board has concluded that the definition of "Category of Material" as presented in the draft Standard published on November 26, 1974, should be retained. The reference to "Material Inventory Account" has been deleted and the term "Material Inventory Record" substituted. Several words in this definition have been changed to make it more clear that the Board is referring to any records maintained in support of general ledger or subsidiary ledger financial accounts.

6. *Need for written policies.* Many commentators said that a requirement for written policies should be deleted from this Standard. They contended that such a requirement was not in accordance with their understanding of what Cost Accounting Standards should cover. They felt the Board was becoming too deeply involved in procedural details with such a requirement.

Contractors who have submitted Disclosure Statements felt that such submission should exempt them from a requirement for written policies. They contended that in responding to the Disclosure Statement, they were, in effect, setting forth their written policies and practices.

During the Board's development of the Disclosure Statement, many contractors suggested that a Disclosure

Statement such as the Board had designed was not justified because they said they had accounting manuals and similar written documents which set forth their accounting practices. They contended further that these manuals and similar written documents were available to Government auditors and provided sufficient information concerning the contractor's accounting practices. Although these manuals could not be used to fulfill the disclosure requirement, the Board recognizes that these are the kinds of documents that should contain written policies that are needed to permit effective implementation of this Standard. The Board also notes that many companies which are subject to Cost Accounting Standards are not required to file Disclosure Statements.

Some commentators questioned whether there would be a need for written policies for each category of material. Certainly the Board does not intend that this be the case. It is expected that contractors will have written policies establishing criteria which would apply to all of their material transactions.

Other commentators concluded that the written policies were listed as a requirement by the Board solely for the Government's use in determining compliance with the Standard. The Board feels that written policies and practices are beneficial as evidenced by the many companies which have them.

7. *Applicability of standard to indirect material.* The draft Standard provided a means by which a category of material used solely in performing indirect functions or which is not a significant element of production costs could be handled through an indirect cost pool rather than accumulated in a material inventory record. There was a further requirement that when quantities of such material were not consumed in a cost accounting period and were estimated to be significant in total costs, the cost of such material was to be established as an asset at the end of the period.

Many commentators stated that the Standard should not deal with indirect materials, while a few questioned the use of an indirect cost pool for allocating the cost of such material. Other commentators stated that many contractors generally do not maintain inventory records of such material and that the provision set forth in the first sentence of the preceding paragraph was necessary, otherwise the Standard might present major problems for contractors. Most of those commenting on this point recommended the retention of this provision.

Many commentators disagreed with the requirement to establish remaining material of this type as an asset at the end of the period. Some commentators felt that this requirement contradicted the first part of the provi-

sion. They argued that if the material was not a significant element of production cost and thereby was permitted to be allocated to an indirect cost pool, it did not seem logical to require that any amounts of such material should be established as an asset at the end of the period. They stated that if this situation occurred, then presumably the material should not have been charged to cost objectives through an indirect cost pool.

These commentators apparently misinterpreted the Board's intention. The draft Standard referred to the value of unconsumed material to be set up as an asset, not the amount charged to an indirect cost pool during the cost accounting period. The provision deals with significant amounts of unconsumed material of this type remaining at the end of the period.

Another commentator stated that the expensing of indirect supplies has long been a generally accepted practice and, if consistently applied, would not result in inequities in contract costing as long as unconsumed amounts do not fluctuate significantly from year to year. Other commentators were concerned that the use of the word "significant" would generate endless disputes with Government auditors since such a determination is subjective and no definition of that word was included in the Standard.

After considering all the comments the Board has received on this point, it has decided to retain the provision allowing the use of an indirect cost pool for allocation of the cost of material of the type described in this provision of the Standard. The Board is also persuaded that when quantities of such indirect material are not consumed in a cost accounting period and the excess of the ending inventory over the beginning inventory is estimated to be significant in relation to the total cost included in the indirect cost pool, the cost of such unconsumed material is to be established as an asset at the end of the period. The setting up of this material as an asset is to be accomplished by reducing the indirect cost pool by a corresponding amount.

On numerous occasions the Board has stated that it agrees that the administration of its rules, regulations, and Standards should be reasonable and not seek to deal with insignificant amounts of cost. Because of this, the Board does not believe it essential to define the term "significant" as used in this provision of the Standard. Generally accepted accounting principles, as stated in the American Institute of Certified Public Accountant's Accounting Research Bulletin No. 43, recognize that the term "inventory" includes goods to be consumed directly or indirectly in operations, such as supplies. The aforementioned requirement has therefore been retained in the Standard being promulgated.

8. *Transfers of material.* The draft Standard contained a requirement that a transfer of the cost of material from one cost objective to another was to be made at the same cost that was allocated to the initial cost objective or at the current market value. Many commentators objected to this provision on the grounds that it would be extremely difficult to identify the cost that was allocated to the initial cost objective. They contended that this requirement would also generate disagreements with Government auditors as to whether or not initial cost information was, in fact, available. Also, some commentators felt that determination of current market value would be a difficult and time consuming chore.

While not agreeing or disagreeing with the commentators' statements, the Board has concluded that the transfer of material is of sufficient significance to warrant consideration as a subject for a separate Standard. The Board has initiated a research project to consider what factors affect the cost of transfers between cost objectives and between organizations. For this reason, the provision concerning cost of transfers of material between cost objectives has been deleted from this Standard.

9. *Periodic vs. perpetual inventory accounting.* The published draft Standard contained a provision permitting either periodic or perpetual inventory accounting procedures. This was coupled with a requirement that the period for periodic inventory accounting should not be longer than one quarter of a year. It was further stated that these provisions were not intended to establish a requirement regarding the taking of physical inventories.

Many commentators stated that this provision appeared to contain contradictory statements since the periodic inventory accounting method normally requires a physical inventory when the inventory value is established. They further said that as they understand that provision, they would be required to take physical inventories quarterly, which they felt was unnecessarily frequent.

The Board was referring to the period involved for the establishment of costs of material issues, not to the taking of physical inventories. It is the Board's intention that costing of material issues should be on a current basis. To achieve this goal, the Board has inserted a requirement in the Standard that the inventory costing method used is to be applied in a manner which results in systematic and rational costing of issues of material to specific cost objectives.

10. *Costs and benefits.* Few comments were received on the subject of implementation costs of the Standard. This Standard has, for most contractors, almost no cost. It does require

written policies; most contractors already have such policies. A few contractors, however, may have to establish or modify inventory policies; for these contractors there may be minimal costs.

The Board believes that this Standard will result in improved understanding of the requirements involved in accounting for acquisition costs of material during the negotiation and audit of contracts and these potential benefits will outweigh any costs of implementation.

11. *Other comments.* The published draft Standard contained a provision excepting small quantities of material used for purposes such as prototype and developmental work from the definition of an established material inventory account. While only a few commentators offered comments on this provision, in view of the revisions being made to the Standard as set out above, this provision has been deleted from the Standard.

A number of commentators raised questions concerning the potential conflict between requirements of this Standard and those set out in Standard 407, Use of Standard Costs for Direct Material and Direct Labor (4 CFR Part 407). The Board recognizes the nature of the potential conflict described by the commentators, but feels that an inventory costing method using standard costs in accordance with the requirements of Standard 407 would meet the inventory costing requirements of this Standard.

Section 411.10, *General applicability*, has been shortened and simplified from the material under this section appearing in earlier promulgated Cost Accounting Standards. The earlier material was a restatement of the statutory requirements of Pub. L. 91-379. The Board believed it was helpful to repeat this material to assist users of the Standards. However, the Board has from time to time provided for certain exemptions from the requirements to follow Cost Accounting Standards, and these exemptions were not recognized in the "applicability" sections of earlier Standards. The Board believes that the shortened material in § 411.10, referring users to the Board's detailed regulations, will provide users with helpful information on general applicability.

There is also being published today an amendment to Part 400, Definitions, to incorporate in that part terms defined in § 411.30(a) of this Cost Accounting Standard.

PREAMBLES TO COST ACCOUNTING STANDARD
412, COMPOSITION AND MEASUREMENT OF
PENSION COST

PREAMBLE A

Original Publication, 9-24-75

The following is the preamble to the original publication of Part 412, 40 FR 43873, Sept. 24, 1975.

The Cost Accounting Standard on Composition and Measurement of Pension Cost is one of a series being promulgated by the Cost Accounting Standards Board pursuant to section 715 of the Defense Production Act of 1950, as amended, Pub. L. 91-379, 50 U.S.C. app. 2168, which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts. This Standard establishes the components of pension cost, the bases for measuring such cost, and the criteria for assigning pension costs to cost accounting periods.

As part of the Board's early research relating to the subject of pension costs, it developed an Issues Paper in August 1973, and a preliminary draft Standard in September 1974. Both the Issues Paper and preliminary Standard were sent to a large cross-section of companies, Government agencies, industry and professional associations, actuaries, and other interested individuals. The Board received responses to these research papers which were useful in identifying the key issues involved in pension cost accounting and in developing a proposed Standard which was published in the FEDERAL REGISTER of May 5, 1975, with an invitation to interested parties to submit written views and comments to the Board. The Board also supplemented the invitation in the FEDERAL REGISTER by sending copies of the proposed Standard to several hundred organizations and individuals who had provided the Board with comments on the preliminary proposal or who had otherwise expressed interest in the subject of the Standard.

The Board received 80 sets of written comments from companies, Government agencies, professional associations, industry associations, public accounting firms, universities, actuaries and others in response to the FEDERAL REGISTER proposal. All of these comments have been carefully considered by the Board. The Board's views on each of the major issues discussed by commentators are outlined below, together with explanations of the changes made in the Cost Accounting Standard being promulgated.

The Board wishes to take this opportunity to express its appreciation for the helpful suggestions and constructive criticisms it has received, and for the time devoted to assisting the Board in this endeavor by the many organizations and individuals involved.

(1) RELATIONSHIP TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 AND TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The Board received a variety of comments relative to the relationship between the proposed Standard, the Em-

ployee Retirement Income Security Act of 1974 (ERISA), and generally accepted accounting principles set forth in "Accounting for the Cost of Pension Plans," Opinion No. 8 by the Accounting Principles Board (APB-8). Some stated that, with the enactment of ERISA, Congress has expressed its will relative to pensions and a Cost Accounting Standard on pension costs which is different than ERISA is unnecessary. Others stated that APB-8 is a viable and proven document which provides sufficient guidance for both financial accounting and cost accounting purposes. Others stated that the combination of ERISA and APB-8 provides all the guidance needed for cost accounting purposes. Still others stated that a Standard should be deferred until the Federal regulations required by ERISA have been promulgated, and/or the Financial Accounting Standards Board (FASB) completes its reevaluation of APB-8.

The purpose of the Board in promulgating this Standard is to establish the accounting bases for measuring the proper amount of pension cost to be assigned to cost accounting periods for subsequent allocation to negotiated Government contracts.

ERISA establishes, among other things, minimum funding standards for pension plans and provisions affecting deductibility of pension costs for tax purposes. Although there is some commonality between the funding provisions of ERISA and the provisions of the Standard, ERISA does not provide for the measurement of pension costs for assignment among cost accounting periods or for the subsequent allocation of such costs to contracts. Accordingly, the Standard contains requirements, not contained in ERISA, to accomplish these purposes. Nevertheless, on the basis of its research, the Board is confident that the Standard being promulgated is compatible with the requirements of ERISA, i.e., compliance with the provisions of the Standard does not violate the provisions of ERISA, although certain provisions of the Standard are more restrictive than is permitted by ERISA.

APB-8 provides criteria for accounting for the cost of pension plans for financial accounting purposes. The Board believes that certain of these criteria are not appropriate for Government contract costing purposes. For example, a fundamental concept of APB-8 is that the annual pension cost to be charged to expense for financial accounting purposes is not necessarily determined by the funding of a pension plan. The Board believes that a requirement of law for annual minimum funding of pension costs on an irrevocable basis, is strong evidence that an obligation for at least such period.

The Board is aware of the FASB's projects to establish financial accounting and reporting Standards for employee benefit plans and to reevaluate APB-8, as well as the need for the cognizant Government agencies to develop regulations relative to ERISA. It is our understanding that the FASB reevaluation of APB-8 is not likely to result in a Standard that would be applicable before the end of calendar year 1976. The Board believes, however, that the issuance of a Cost Accounting Standard is needed promptly for contract costing purposes.

For example, there does not now exist any authoritative guidance which sets forth the components of pension cost that are properly includable and excludable for contract costing purposes. In addition, there are no existing criteria to resolve how the components of pension cost, once determined, shall be measured and assigned to cost accounting periods. The need for such measurement and assignment criteria for contracts is particularly critical because of the long-range projections used in computing pension cost and because the many techniques available for measuring and assigning such cost have significant impacts thereon. The significant amounts involved in annual pension cost calculations, the changes in the mix of contractors' Government and commercial business, and the settlement of individual contracts long before actual pension costs can be determined create a special need to provide criteria relative to the assignment of pension costs among cost accounting periods and the allocation of such costs to the cost objectives of the periods.

In developing the accompanying Cost Accounting Standard, the Board has attempted to stay within the general constraints of APB-8 and the funding provisions of ERISA. The Board recognizes that in the FASB's reconsideration of APB-8, the FASB could make significant changes in the manner in which pension costs are to be treated for financial accounting purposes and that the FASB's project on financial accounting and reporting for employee benefit plans may influence the conclusions reached in the reevaluation of APB-8. However, any such changes would be directed to external financial reporting and would not necessarily impact contract costing. The Board is also aware that Federal regulations which may be issued could conflict with a provision of this Standard. The Board maintains constant liaison with the FASB with regard to the two Boards' respective responsibilities for developing Standards. It also maintains liaison with the legislative and regulatory bodies responsible for developing and administering ERISA. The Board will review whatever pronouncements these

bodies may issue and will make whatever revisions to the Standard it deems appropriate for contract costing purposes.

(2) NEED FOR TWO STANDARDS RELATIVE TO PENSION COST

Several commentators suggested that this Standard should deal not only with the composition and measurement of pension cost, but also with actuarial gains and losses¹ and the allocation of pension costs. The Board believes that the development of a separate Standard covering the latter two areas is advisable. First, the development of a single Standard would result in an extremely large and complex Standard that could create many problems in implementation and administration. For example, the Issues Paper developed by the Board set forth a total of 50 distinct accounting issues requiring resolution; the Standard being promulgated covers only 24 of these issues. In addition, the Board believes that the subjects covered by the two Standards are separable; a Standard can be issued relative to the composition and measurement of pension cost without creating a concurrent need for a Standard relative to the adjustment and allocation of such costs. Moreover, in computing actuarial gains and losses, it is necessary to determine how fund assets should be valued. APB-8 does not cover this aspect of pension cost accounting. In its project on accounting for pension funds, the FASB is endeavoring to specify the manner in which assets should be valued. The Board intends, as part of its continuing liaison with the FASB on this matter, to exchange research so that any possible differences in concept or approach could be minimized or eliminated entirely.

(3) TREATMENT OF ACTUARIAL GAINS AND LOSSES

The FEDERAL REGISTER proposal noted that an adjustment for actuarial gains or losses is a component of pension cost. Several commentators ex-

pressed concern over the Board's intent. Some commentators interpreted the proposed Standard as requiring that actuarial gains and losses be spread over a number of years. Other commentators believed that the proposed Standard required the immediate recognition of actuarial gains and losses.

The Board emphasizes that the Standard does not delineate how actuarial gains and losses shall be accounted for at this time. The Standard being promulgated neither requires nor prohibits immediate recognition of gains and losses or the spreading of such gains and losses to future years. Therefore, actuarial gains and losses should be accounted for in accordance with pertinent laws and regulations, and should be consistently applied. Section 412.50(a)(5) has been amended to clarify this concept.

(4) ACTUARIAL COST METHODS²

Many commentators expressed their concern over the section of the FEDERAL REGISTER proposal which limited acceptable actuarial cost methods to the accrued benefit cost method³ or to a projected benefit cost method⁴ which separately identifies unfunded actuarial liabilities⁵ and actuarial gains and losses. This section, in effect, ruled out the use of an aggregate⁶ cost method for measuring pension costs for negotiated Government contracts. Most of these commentators noted that ERISA and APB-8 permit these methods to be used.

The Board's primary reason for prohibiting the use of an aggregate cost method in the proposed Standard was because such a method does not disclose actuarial gains and losses. Any method that does not disclose actuarial gains and losses impairs the ability to determine whether actuarial assumptions⁷ are reasonable. Actuarial assumptions are significant underlying factors for determining the amount of pension costs to be assigned among cost accounting periods. It is only

when such assumptions are visible that a determination can be made that they are reasonable. The most appropriate means for determining such reasonableness is to compare assumed events with actual events.

Also, because most aggregate cost methods do not develop unfunded actuarial liabilities, the Government cannot ascertain the funding status of a plan, i.e., whether it is excessively funded at any point in time. Consequently, the Government could be making larger reimbursements than is required to defray its fair share of pension costs incurred by contractors. Many of the comments received acknowledge that most aggregate cost methods do not disclose overfunded situations.

Nevertheless, the Board is impressed by certain of the views of commentators who advocate the use of an aggregate methods. The Board recognizes that aggregate methods are widely used and that they generally spread pension costs evenly and within the periods established in the Standard for amortizing unfunded actuarial liabilities. The Board also notes that commentators stated that a required change in actuarial cost methods may result in substantial actuarial fees and, in some cases, could result in contractors violating current labor commitments.

The Board's solution to this problem was provided generally in several of the comments received. First, several commentators who recognized that an aggregate cost method does not disclose the funding status of a plan, suggested that contractors using such a cost method develop an alternative computation to determine such status. They pointed out that such a computation is required under the full funding limitation of ERISA and is often required by the IRS when it believes a plan may be overfunded.

Other commentators suggested that contractors who use an aggregate cost method provide supplemental information identifying actuarial gains and losses that have occurred and the

¹"The effect on pension cost resulting from differences between actuarial assumptions and actual experience."

²"A technique which uses actuarial assumptions to measure the present value of future pension benefits and pension fund administrative expenses, and which assigns the cost of such benefits and expenses to cost accounting periods."

³"An actuarial cost method under which units of benefit are assigned to each cost accounting period and are valued as they accrue — that is, based on the services performed by each employee in the period involved. The measure of normal cost under this method for each cost accounting period is the present value of the units of benefit deemed to be credited to the employees for service in that period. The measure of the actuarial liability at a plan's inception date is the present value of the units of benefit credited to employees for service prior to that date. (This method is also known as the Unit Credit cost method.)"

⁴"Any of the several actuarial cost methods which distribute the estimated total cost of all of the employees' prospective benefits over a period of years, usually their working careers."

⁵"Pension cost attributable, under the actuarial cost method in use, to years prior to the date of a particular actuarial valuation. As of such date, the actuarial liability represents the excess of the present value of the future benefits and administrative expenses over the present value of future contributions for the normal cost for all plan participants and beneficiaries. The excess of the actuarial liability over the value of the assets of a pension plan is the Unfunded Actuarial Liability."

⁶"As used herein, an aggregate cost method is any actuarial cost method which spreads the entire cost of future pension benefits over the average future service lives of the current work force and which does not develop actuarial gains or losses."

⁷"A prediction of future conditions affecting pension cost; for example, mortality rate, employee turnover, compensation levels, pension fund earnings, changes in values of pension fund assets."

extent to which such gains and losses have been amortized through subsequent pension contributions or offset by gains and losses in subsequent accounting periods. These commentators informed us that the incremental costs of providing such additional information would be relatively minor.

Accordingly, the Board has added a section, (§ 412.50(b)(2)) which permits a contractor to use any projected benefit cost method if the contractor (1) makes an alternative computation (under a projected benefit cost method which separately discloses unfunded actuarial liabilities and actuarial gains and losses) to disclose the funding status of the plan and reduce pension cost as indicated by such computation, (2) provides supplemental information relative to actuarial gains and losses and gains or losses resulting from changed actuarial assumptions, and (3) uses that method in developing costs for financial accounting purposes.

The third requirement was added because the Board has tried unsuccessfully to ascertain criteria for determining the circumstances under which an aggregate cost method is a preferable method for assigning costs to cost accounting periods for Government contracting purposes.

Finally, to assure that the aggregate cost method used spreads pension costs within the time frames set forth in this Standard for other projected benefit cost methods, § 412.50(b)(2) requires that such aggregate cost methods spread the cost of future pension benefits over the average remaining working lives of the work force.

(5) ACTUARIAL ASSUMPTIONS

A large number of commentators were concerned with the manner in which the FEDERAL REGISTER proposal dealt with actuarial assumptions. They were particularly concerned with that provision of the proposed Standard which stated that when an actuarial assumption differs significantly from historical experience, the contractor shall provide evidence supporting its conclusion that such experience is no longer appropriate. Most commentators who objected to this provision in the Standard interpreted it as requiring separate gain and loss analyses for each assumption each time an actuarial valuation is performed. They cited the large cost of performing such analyses and noted that ERISA merely requires that actuarial assumptions be reasonable "in the aggregate."

Although the Board believes that the basis and rationale for each assumption should be made visible by contractors, it believes that the test of

reasonableness of such assumptions should be applied to the end result. It is not the intent of the Board to require a separate gain or loss analysis for each assumption each time an actuarial valuation is made. Rather, the intent is that contractors not use an undocumented composite factor to represent all assumptions used in measuring pension costs, as this practice would inhibit any evaluation of the reasonableness of individual assumptions as applied to future periods. Such evaluations may be necessary when assumptions, taken in the aggregate, are found to be unreasonable, as discussed below.

Once individual actuarial assumptions have been set forth by contractors, the Board believes that the validity of these assumptions can be evaluated by the overall results obtained. Therefore, the Standard provides that the validity of the assumptions used may be evaluated in the aggregate. However, if an actuarial valuation discloses that the assumptions were not reasonable in the aggregate, the Standard requires that the contractor shall identify the major causes for the resultant actuarial gains and losses and set forth the bases and rationale used for either retaining or revising each such assumption.

In order to recognize the long-term nature of pension plans, the Standard provides in § 412.50(b)(5) that actuarial assumptions should reflect long-term trends, rather than short-term fluctuations. Also, the Standard does not specify how often determinations of actuarial gains and losses should be made. ERISA provisions require that such determinations be made not less frequently than once every three years except that more frequent determinations may be prescribed by regulation in particular cases, i.e., for plans which have sustained substantial gains or losses for several periods in succession. The Board believes that the ERISA requirements with respect to the frequency of determinations for gains and losses is equally appropriate for compliance with the provisions of the Standard at this time.

In addition to the foregoing, several commentators stated that the Standard should provide that the judgment of enrolled actuaries, as set forth in ERISA, should be determinate with respect to assumptions as well as other actuarial determinations. The Board recognizes the importance of the functions performed by enrolled actuaries with respect to actuarial determinations. However, contract terms are not imposed on actuaries; rather, it is the contractors who are parties to contracts with the Government and must

bear the responsibility for compliance with the terms thereof.

(6) CALCULATIONS OF NORMAL COST⁸

The FEDERAL REGISTER proposal provided that the calculations of normal cost should be the sum of the calculations for the individual employees in the plan, except that homogeneous groupings and averages could be used if the results substantially agree with the results based on individual employee calculations. A number of commentators objected to this provision. They said that it would appear to require that two calculations be made in order to show that the use of groupings and averages gives results that agree with the results based on individual employee calculations. Some commentators stated that this requirement is unrealistic because actuaries frequently use aggregate calculations and that such aggregations can be tested against individual company or industry-wide experience. Other commentators stated that this provision would result in a single calculation for determining the assumed entry age of planned participants.

The comments received indicate that there are divergent opinions as to how normal costs shall be calculated under projected benefit cost methods. Nevertheless, the Board concludes that the methods commonly used would not materially affect the results of normal cost calculations. Accordingly, the requirement to compute normal costs on an individual basis for projected benefit cost methods has been deleted from the Standard.

The proposed Standard provided also that the calculation of normal cost shall be based on a percentage of payroll. Many commentators stated that this requirement does not recognize the fact that many pension benefits are not related to salaries. In order to accommodate these views, the Board has revised the Standard (§ 412.50(b)(3)) to provide that the calculation of normal cost shall be based on a percentage of payroll for plans where the pension benefit is a function of salaries and wages and be based on employee service for plans where the pension benefit is not related to salaries and wages.

(7) PAY-AS-YOU-GO PENSION METHODS⁹

Several commentators apparently assumed that the FEDERAL REGISTER proposal prohibited the recognition of pension costs of plans that provide benefits on a pay-as-you-go basis. One commentator stated that the Standard prohibited the recognition of the costs of pay-as-you-go plans which are not qualified for Federal income tax purposes.

⁸The annual cost attributable, under the actuarial cost method in use, to years subsequent to a particular valuation date."

⁹A method of recognizing pension cost only when benefits are paid to retired employees or their beneficiaries."

The Board's view, as expressed in the FEDERAL REGISTER proposal, is not to prohibit recognizing the cost of pension benefits provided on a pay-as-you-go basis. Rather, the Board's intent is to specify how the cost of such benefits shall be measured and assigned among cost accounting periods. Moreover, the accounting treatment to be afforded to the costs of pay-as-you-go plans is not dependent on the Federal income tax status of the plan.

Accordingly, the Board has revised the provisions of the Standard relative to pay-as-you-go methods (§ 412.50(b)(4)) and has added an illustration (§ 412.60(b)(2)) to clarify its intent.

(8) UNALLOWABLE PENSION COSTS

The FEDERAL REGISTER proposal provided that the pension costs applicable to prior years that were disallowed in accordance with then-existing Government contractual provisions should be separately identified and eliminated from any unfunded actuarial liability being amortized pursuant to the provisions of the Standard. Several commentators stated that this provision is not equitable because ERISA requires that such amounts be funded.

The Board recognizes that all elements comprising an unfunded actuarial liability, including unallowable costs included therein, are required to be amortized pursuant to the funding provisions of ERISA. However, ERISA does not deal with contract costing and therefore does not deal with unallowable contract costs. The Board believes that for contract costing purposes, pension costs which were assignable to prior periods and which were specifically determined to be unallowable under then-existing contractual provisions should not be assignable to periods subsequent to the effective date of this Standard. It should be noted that the treatment of amounts funded in excess of the pension cost for a cost accounting period is separately covered in § 412.50(c)(1).

(9) AMORTIZATION OF UNFUNDED ACTUARIAL LIABILITIES

The FEDERAL REGISTER proposal included a provision requiring contractors to establish and consistently follow a policy for selecting specific amortization periods for any unfunded actuarial liabilities. The proposed Standard stated that such policy should give consideration to the size and nature of unfunded actuarial liabilities. Several commentators stated that they did not believe that the size and nature of such liabilities should govern the choice of amortization periods. The Board's intent was to permit contractors to establish different amortization periods for different types and sizes of unfunded actuarial liabilities. The Board still believes that contractors should be permitted to estab-

lish such different amortization periods. Accordingly, the Standard has been revised (§ 412.50(a)(3)) to clarify that such determinations are permissive rather than mandatory.

(10) INTEREST RESULTING FROM DELAYED FUNDING OF PENSION PLANS

The FEDERAL REGISTER proposal provided that if any portion of pension cost computed for a cost accounting period is not funded by the time established by the funding provisions of the plan, an interest equivalent on the amount not funded shall not be a component of pension cost of any other cost accounting period. Several commentators stated that this provision is inequitable because, in order for a pension plan to be viable, an amount equivalent to interest should be added to pension costs to compensate the fund for interest that would have been earned if the cost had been funded in a timely manner. Some commentators added that APB-8 requires that interest equivalents be added to pension accruals under such circumstances. Still others understood the proposed Standard to say that such interest equivalent is not a cost; they therefore disagreed with the proposed Standard.

The Board agrees that an interest equivalent should be recognized in order to determine whether the plan is properly funded. However, the Board believes that interest cost resulting from the delayed funding of a pension plan is a consequence of an investment decision and is, therefore, an investment cost rather than a component of pension cost. The interest was caused by a decision of management to use its funds for other purposes; in effect, management borrowed from the pension trust fund.

Several commentators stated that they compute pension cost at the beginning of a cost accounting period and add interest at the valuation rate to the normal cost to the date of funding. They questioned whether the Standard would prohibit this practice. The Standard being promulgated does not prohibit this practice: *Provided*, That funding is made by the end of the cost accounting period. Accordingly, the Board has amended § 412.50(a)(7) to state that if any portion of the cost computed for a cost accounting period is not funded in that period an amount equivalent to interest computed on that portion beyond the end of that period shall not be a component of pension cost of the current or any future cost accounting period.

(11) ASSIGNMENT OF PENSION COST

Certain commentators expressed their disagreement with the sections of the FEDERAL REGISTER proposal dealing with the assignment of pension costs among cost accounting peri-

ods. The concept set forth in the proposal related in the assignment of costs to the validity of the liability for such costs. Commentators referred to the concept set forth in APB-8 that the accrual of pension expenses and the funding of pensions are not necessarily related. They stated that cost should be assigned to cost accounting periods irrespective of whether or when funded.

The Board believes that assigning pension costs to cost accounting periods on a cash basis is inappropriate from an accounting viewpoint and could lead to the improper assignment of pension costs among periods. The Board believes also that the concept which states that funding is unrelated to pension accruals is not appropriate for contract costing because, under such a concept, pension costs could be assigned to cost accounting periods and never be funded; yet such costs would be reimbursed by the Government.

The underlying concept of the Standard is that when a valid liability exists, the corresponding costs may be accrued irrespective of when the liability is liquidated. If the liability (to the pension fund or, for pay-as-you-go plans, to retirees) is not valid, it cannot be accrued; in order for it to be allocated to cost objectives of the current period, it must be liquidated (funded) in that period or within a reasonable period of time thereafter. In order to clarify its intent with regard to the allocation of pension costs to cost objectives of individual cost accounting periods, the Board has revised the wording of § 412.40(c) of the Standard.

In the FEDERAL REGISTER proposal, the Board noted that the requirement to fund a pension cost pursuant to ERISA made the liability valid and therefore made the cost assignable to the current period. Several commentators stated that ERISA permits such costs to be waived and funded over a 15-year period. They reasoned that under such circumstances it is no longer appropriate to assign such pension cost in the year for which such costs were computed. The Board believes that if the financial position of a contractor is such that it requests and obtains such a waiver there is doubt as to validity of the liability and therefore of the cost incurred. Accordingly, it has amended the Standard to provide, in § 412.50(c)(3), that if a contractor receives such a waiver the pension costs shall be assigned to the cost accounting periods in which the funding of such cost takes place.

(12) INSURED PLANS

Several commentators stated that the section of the FEDERAL REGISTER proposal dealing with insured plans was confusing. They stated that the

definition of a "separate insurance account" set forth in the proposed Standard conflicted with this section. Commentators stated that this section would seem to eliminate from the major requirements of this Standard various forms of insured plans such as deposit administration and immediate participation guarantee contracts.

The Board's intent with regard to insured plans is to treat defined-benefit plans¹⁰ funded exclusively by the purchase of individual or group permanent insurance contracts as defined-contribution plans.¹¹ The Board's view relative to such plans is consistent with ERISA whose minimum funding requirements are not applicable to these plans. All other insured pension plans are subject to the provisions of this Standard. The Board has revised § 412.50(a)(8) accordingly and has eliminated the definition of separate insurance account.

(13) DEFINITIONS

The Board has received a significant number of comments relative to the definitions used in the Standard. Some commentators stated that the Board should use the definitions contained in ERISA. Others stated that the Board should use the APB-8 definitions. Still others recommended that the Board should establish a single glossary of actuarial terms.

The Board recognizes that a major problem in the field of pension accounting has been the use of various terms which have the same meaning. For example, the term "prior service costs" used in APB-8, "past service costs" used in ASPR, "accrued liability" used in ERISA, and "supplemental liability" used by many actuaries have virtually the same meaning. In researching the definitions currently in use, the Board noted that one factor seemed to prevail: The glossaries in use were tailor-made for the particular documents which applied to the terms. For example, the definitions in APB-8 were written in the context of the way in which the words were intended for use in that Opinion. Similarly, the definitions used in ERISA were fashioned to be in consonance with the specific provision of the Act. The Board's primary objective in developing the definitions in this Standard is similar; the definitions should help provide a clear understanding of the concept used therein, while at the same time maintaining consistency with the thrust of the definitions used in APB-8 and ERISA.

The Board received some additional comments with regard to specific definitions set forth in the FEDERAL REGIS-

TER proposal. One commentator expressed confusion at the terms "accrued pension liability" and "unfunded accrued pension liability" because the word "accrued" has a specific meaning in an accounting sense which is different than that intended in the Standard. The Board believes that this comment has merit and, accordingly, the Standard has been revised to use the terms "actuarial liability" and "unfunded actuarial liability."

Other commentators requested elaboration of the definition of a pension plan. Specifically, they questioned whether the definition is applicable to execute compensation plans, excess benefit plans, and other plans that may not be "qualified" for Federal income tax purposes. The Standard provides the accounting treatment for the cost of all pension plans which fall within the definition of a pension plan. Such accounting treatment is not contingent on the manner in which IRS may categorize plans for income tax purposes.

Several additional commentators questioned that portion of the definition of a pension plan which states that benefits shall be paid for life or be payable for life at the option of the employee. They questioned whether a life income settlement for an employee would fall within the meaning of this definition. The Board believes that such a settlement is, in effect, equivalent to a payment for life and thus falls within the intent of the definition.

(14) COSTS AND BENEFITS

The anticipated benefits of this Standard are improved cost measurement and increased consistency and uniformity in accounting for pension costs and assigning such costs to cost accounting periods, leading to increased assurance that the measured and assigned costs will be allocated to the proper cost objectives, including Government contracts.

When the preliminary draft Standard on pension cost was submitted to a wide cross-section of companies and individuals, the recipients were specifically asked to comment on the costs of implementing the Standard. The overwhelming majority of the respondents stated that the incremental costs of implementation should be small. In commenting on the proposed Standard published in the FEDERAL REGISTER, several respondents stated that the prohibition against use of an aggregate projected benefit cost method and the requirement to make annual gain or loss analyses of each actuarial assumption would involve additional

administration costs of any significance. Since the Board has essentially eliminated these problem areas in the Standard, it believes that increased administrative costs occasioned by this Standard will be minimal. In summary, the Board believes that the benefits to be derived from this Standard clearly outweigh the costs of implementation.

The Board expects that this Standard will become effective on January 1, 1976.

There is also being published today an Amendment to Part 400, Definitions, to incorporate in that part terms defined in § 412.30(a) of this Cost Accounting Standard.

Part 412—Cost Accounting Standard for Composition and Measurement of Pension Cost is added to read as follows:

PREAMBLES TO COST ACCOUNTING STANDARD 413, ADJUSTMENT AND ALLOCATION OF PENSION COST.

PREAMBLE A

Preamble to Original Publication, 6-2-76

The following is the preamble to the original publication of Part 413, 42 FR 37191, July 20, 1977.

The cost Accounting Standard on Adjustment and Allocation of Pension Cost is one of a series being promulgated by the Cost Accounting Standards Board pursuant to section 719 of the Defense Production Act of 1950, as amended, Pub. L. 91-379, 50 U.S.C. app. 2168, which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

This Standard is the second Standard dealing with pension costs. The first Standard, 4 CFR Part 412, establishes requirements covering the composition of pension cost and the bases to be used for measuring such cost. The Standard being promulgated today establishes the basis for assigning actuarial gains and losses to cost accounting periods and for allocating pension cost to segments of an organization.

As part of the Board's early research relating to the subject of pension cost, it submitted an issues paper to a large cross-section of companies, Government agencies, industry and professional associations, actuaries, and other interested individuals. On June 18, 1976, this staff draft Standard was sent to those interested parties who had expressed a desire to assist the Board in its research efforts. The responses to the staff draft Standard were considered in developing a pro-

¹⁰A pension plan in which the benefits to be paid or the basis for determining such benefits are established in advance and the contributions are intended to provide the stated benefits."

¹¹A pension plan in which the contributions to be made are established in advance and the benefits are determined thereby.

posed Standard which was published in the FEDERAL REGISTER of February 3, 1977, with an invitation to readers to submit written views and comments to the Board. The Board also supplemented the invitation in the FEDERAL REGISTER by sending copies of the proposed Standard to over 1,000 organizations and individuals.

The Board received 67 sets of written comments from companies, Government agencies, professional associations, industry associations, public accounting firms, actuaries, universities, and others in response to the FEDERAL REGISTER proposal. All of these comments have been carefully considered by the Board. The Board's views on each of the major issues discussed by commentators are outlined below, together with explanations of the changes made to the proposed Cost Accounting Standard.

The Board wishes to take this opportunity to express its appreciation for the helpful suggestions and constructive criticisms it has received, and for the time devoted to assisting the Board in this endeavor by the many organizations and individuals involved.

(1) *Relationship to the Employee Retirement Income Security Act of 1974 and to the Financial Accounting Standards Board.* The Board received a number of comments relative to the relationship between the proposed Standard and the Employee Retirement Income Security Act of 1974 (ERISA). Many of the respondents stated that the proposed Standard contained requirements which are either inconsistent with, more restrictive than, or in conflict with the provisions of ERISA.

The purpose of the Board in promulgating its Standards on pension cost is to establish the criteria for measuring the proper amount of pension cost to be assigned to cost accounting periods for subsequent allocation to negotiated Government contracts. ERISA establishes, among other things, minimum funding Standards for pension plans and provisions affecting deductibility of pension cost for tax purposes. Although there is some commonality between the funding provisions of ERISA and the Standard being promulgated today, ERISA does not provide for the measurement of pension costs for assignment among cost accounting periods or for the subsequent allocation of such costs to contracts.

Notwithstanding the differences in objectives between the proposed Standard and ERISA, the Board believes that compliance with the provisions of the Standard being promulgated today will not violate any provision of ERISA. The Internal Revenue Service confirmed the Board's view on this matter.

One commentator expressed concern over the issuance of a Cost Accounting Standard at this time in view of the

active involvement by the Financial Accounting Standards Board in refining the accounting and reporting for both pension plans and employer pension costs. The Board is aware that the FASB may issue a Standard which could be different from the Standard being promulgated today. The Board maintains constant liaison with the FASB with regard to the two Boards' respective responsibilities for developing Standards. It also maintains liaison with the legislative and regulatory bodies responsible for developing and administering ERISA. The Board will review whatever pronouncements these bodies may issue and will consider whether revisions to this Standard are appropriate.

(2) *Definitions.* The Board has received a number of comments relative to the definitions used in the proposed Standard. Some commentators were concerned that the Board is developing still another glossary of actuarial terms. One of the problems in the field of pension accounting has been the words used to express concepts use. Different meanings have been ascribed to the same terms; different terms have been used to describe the same circumstances; and some terms have inferred meanings which have not been present and have not been intended. Thus, the Board's objective in developing the definitions in this Standard is to help provide a clear understanding of the concepts used therein.

With regard to the specific definitions used in the proposed Standard, the most common problem related to the term "segment." Some commentators construed the term to mean any group of employees performing work for the Government. The definition used in the proposed Standard is the same as that set forth in 4 CFR Part 400. As defined, a segment is an organizational unit which reports directly to a home office of that organization. The designation of organizational units as segments is the responsibility of the contractor; the proposed Standard does not change such designations.

(3) *Assignment of Actuarial Gains and Losses to Cost Accounting Periods.* Section 413.50(a)(2) of the proposed Standard required that for contractors using an immediate-gain actuarial cost method, actuarial gains and losses shall be amortized over a 15-year period. Several commentators stated that immediate recognition of actuarial gains and losses should be required when there are "abnormal forfeitures" (i.e., exceptionally large termination gains). Some commentators expressed a desire for a 10-15-year amortization period; some desired a 10-20-year period; others merely wanted sufficient flexibility to permit them to use whatever amortization period they deem appropriate.

The 15-year amortization period is the same as that set forth in the mini-

mum funding provisions of ERISA. It is also consistent with Opinion No. 8 of the Accounting Principles Board (APB-8) covering the accounting for the cost of pension plans. The Board believes that the amortization period set forth in ERISA is a reasonable basis for adjusting past pension cost accruals without creating significant distortions to current year's accruals. The Board is opposed to the use of various amortization periods because it would be contrary to the Board's objective of attaining greater consistency and uniformity in the measurement of pension cost and the assignment of such costs to cost accounting periods.

The Board believes also that there is no valid basis for immediate recognition of gains or losses simply because they are exceptionally large. Recognizing gains and losses in the current year generally is not appropriate because the gains or losses are often an adjustment of costs of a number of years. In this regard, the Board notes that APB-8 states also that gains and losses should be recognized immediately only if they arise from a single occurrence not directly related to the operation of the pension plan such as the closing of a plant. The Standard is consistent with this concept. Accordingly the 15-year amortization period has been retained in the Standard being promulgated today.

(4) *Annual calculation of actuarial gains and losses.* A number of commentators objected to the requirement in § 413.40(a) of the proposed Standard that actuarial gains and losses be developed annually. They pointed out that this provision, in effect, requires an annual actuarial valuation. They stated that such a requirement may impose a burden on small contractors, is contrary to ERISA which requires a valuation no less frequently than once every three years, and will result in increased administrative costs.

The Board's primary reason for requiring annual calculations of actuarial gains and losses is to assure that the proper cost is assigned to each cost accounting period. Postponing such calculations may well obscure large fluctuations in pension costs which should be recognized on a timely basis. Because many contracts begin and end within a two or three-year period, such postponements can result in incorrect costs being allocated to these contracts. The Board notes that the overwhelming majority of contractors perform annual actuarial valuations.

In addition, it should be noted that annual actuarial valuations need not be made for all pension plans. Section 412.40(a)(2) of 4 CFR Part 412 provides that for defined-contribution pension plans, the pension cost for a cost accounting period is the net contribution required to be paid for that period. Similarly, § 412.50(a) of 4 CFR Part 412 provides that multiemployer plans, certain insured plans, and cer-

tain plans applicable to colleges and universities shall be considered to be defined-contribution pension plans. Accordingly, the requirement to develop actuarial gains and losses annually is not applicable to these plans.

With regard to small contractors, the Board notes that it has not received a single comment from a small contractor stating that the requirement for an annual actuarial valuation for certain pension plans will result in a financial hardship to the contractor. Every comment it has received on this point has come from a major contractor. As for increased actuarial fees, the Board was informed by several actuaries that the difference between the cost of three annual valuations and the cost of a single, three-year valuation is relatively small.

In view of these considerations, the Board has retained the requirement for annual development of actuarial gains and losses.

(5) *Valuation of pension fund assets.* A substantial number of commentators objected to the provision of § 413.50(b)(2) of the proposed Standard which required that the value of pension fund assets be within 80 to 120 percent of the market value of such assets. Some commentators stated that such an approach could have a significant impact on pension cost in a year in which there is a large market fluctuation. Many of these seemed particularly concerned that a substantial drop in the market value of fund assets would cause an increase in pension costs. Other commentators stated that such a requirement is inconsistent with the fundamental requirement of the proposed Standard which stated that the method in use should minimize the effect of short-term market fluctuations. Some suggested various modifications to the proposed Standard to minimize the possible impact of this provision. For example, it was suggested that the average market value of the fund on several dates be used to determine whether an adjustment is required, or that no adjustment should be required unless the value of the fund is outside of the corridor for a period of several years. Some commentators were of the opinion that the corridor approach was reasonable and should be used except in cases where certain asset valuation methods are used; the most common method cited was the 5-year moving average. Several commentators noted that ERISA requires that, for minimum funding purposes, assets shall be valued on a basis which gives consideration to fair market values. They suggested that this provision obviates a need for a corridor.

The Board notes that there is no opposition to the concept that the actuarial value of pension fund assets should take into account the market value of such assets. It recognizes that there are numerous asset valuation

methods which take into account market value in varying degrees. In order to achieve an acceptable relationship between the actuarial value of pension fund assets and their market values, the Board could have restricted the use of any of these market valuation methods. In the absence of such restrictions, however, the Board believes some limits must be provided to assure that the actuarial value of fund assets on a given date gives adequate recognition to their market value. The Board reiterates its often stated concept that assignment of costs to the proper period is of paramount importance in determining contract costs. Total reliance on valuation methods which fail to produce actuarial values within the specified corridor is not acceptable for contract costing purposes. For the same reasons, the Board does not accept the suggested modifications to the use of a single asset valuation date because these modifications could defeat the objective of assuring that the value of the fund bears an appropriate relationship to current market values.

The Board notes that the requirement to adjust pension fund assets to within a certain range of market value is not a new concept with this Standard. The Armed Services Procurement Regulations (ASPR) has for many years required that appreciation in equity securities be recognized to the extent that 80 percent of their market value exceeds their adjusted book value. The requirement for upward adjustments of pension fund assets in the Standard being promulgated today is thus similar to the existing ASPR provision. No known problems with this provision for upward adjustments have come to the attention of the Board. Early research in connection with the pension cost Standards did, however, indicate widespread dissatisfaction with the existing ASPR provisions because they did not permit adjustment of pension fund assets below cost. The Standard being promulgated today will correct this apparent inequity.

The Board notes also that many of the commentators apparently did not realize that the adjustment to pension fund assets required pursuant to § 413.50(b) would result in an actuarial gain or loss subject to the 15-year amortization period specified in § 413.50(a)(2). It should be recognized that the 15-year amortization period minimizes the effect of short-term market fluctuations in two ways. First, the cost impact of the actuarial gain or loss for any year is spread over 15 years. Secondly, in computing a single year's pension cost, there could be adjustments resulting from market fluctuations in as many as 15 prior years. If, as can be expected, some of these adjustments will be increases to the year's pension costs while others will be decreases, the effect of market fluctua-

tuations on a year's pension cost will be further minimized. Accordingly, § 413.50(b)(2), in conjunction with § 413.50(a)(2), is considered to assure adequate recognition of the market value of pension fund assets while at the same time assuring that the effect of short-term market fluctuations is minimized.

In summary, the Board continues of the view that wide latitude should be provided for selecting an asset valuation method, but that such latitude should be coupled with the requirement that the assets valued under the method selected fall within a range of the market value of such assets. The requirement that assets be valued at least at 80 percent of market value is consistent with the present provision of ASPR. The requirement that assets be valued at no more than 120 percent of market value is a needed and equitable change to the ASPR concept. These requirements are not expected to result in severe pension cost fluctuations which concerned some of the commentators. Under the circumstances the Board has not adopted those recommendations aimed at deleting or revising the requirement that pension fund assets be valued within 80 to 120 percent of market value.

(6) *Valuation of bonds in a pension fund.* Several commentators expressed their disagreement with the provision of § 413.60(b) of the proposed Standard which required that, in establishing the corridor, market values must be used for all assets, including bonds. They stated that the use of amortized amounts will, over time, produce values less susceptible to short-term market fluctuations than will be produced by the use of market values. They noted also that, for minimum funding purposes, ERISA permits bonds to be valued at cost less amortization. The Board's research shows that assets of a pension fund are acquired for investment purposes and may be liquidated whenever pension fund managers believe that the proceeds therefrom can generate more income elsewhere. The Board's research shows also that the frequent turnover of pension fund assets is the rule rather than the exception. Therefore, the Board continues of the view, that in establishing the corridor, all assets should be valued on the basis of market and no change has been made to § 413.60(b) to provide otherwise. However, the Standard permits a contractor to use amortized values for bonds as a part of the asset valuation method.

(7) *Allocation of pension cost to segments of an organization.* Section 413.40(c) of the proposed Standard provided that pension costs for a segment may always be developed by separate computation. It further provided that composite pension costs for two or more segments may be computed and allocated by means of an alloca-

tion base "unless distortions are created." Section 433.50(c)(2) provided that "unless an equitable allocation of pension costs to segments can be made by means of an allocation base." Separate pension costs for the segment shall be calculated under certain specified conditions.

Some commentators were opposed to a requirement to calculate separate pension costs for a segment under any conditions. Others thought that the proposed Standard was unclear as to when separate segment pension cost calculations were required. A number of commentators concluded that separate calculations would have to be made in any event in order to prove that the use of an allocation base is acceptable. A number of these stated that such separate calculations would be costly.

Normally, pension costs are "central payments or accruals" as that term is used in 4 CFR Part 403. Therefore, where pension costs can be computed for an individual segment, 4 CFR Part 403 would ordinarily require that the amount so computed be the amount allocated to such segment. The calculation of individual segment costs is, in effect, a direct allocation which is not only consistent with CAS 403 but is also consistent with the Board's cost allocation concepts as set forth in the Board's Restatement of Objections, Policies and Concepts (May 1977). Under the circumstances, the Board does not agree with those commentators who are of the view that computation of separate segments pension costs should never be required. Nevertheless, the Board recognizes that the calculation of separate segments pension costs cannot be made without some additional cost and effort. Consistent with its long-standing concepts on materiality, the Board believes that the calculation of separate segment pension cost should be mandatory only when such separate calculations produce materially different results than would result from the use of an allocation base. Therefore the Board sought to provide, in the proposed Standard, criteria to determine when separate calculations would be required.

It is evident that many reviewers of the proposed Standard were uncertain as to when separate segment pension cost calculations would be required and when an allocation base could be used. Accordingly, § 413.40(c) has been revised to clearly state that a separate calculation of pension cost for a segment is required only when the conditions set forth in § 413.50(c) (2) and (3) are present. Appropriate changes have also been made in these paragraphs.

The Board recognizes whether separate segment pension cost calculations are required depends in the final analysis on what is considered to be "material" for the purposes of § 413.50(c) (2)

and (3). The proposed Standard provided that separate segment costs are to be computed for a segment which had "significant" termination gains; "significantly" different than average benefits, eligibility criteria, or age distribution; or "significantly" different actuarial assumptions.

The concern of many commentators that they would have to make separate segment pension cost calculations in order to prove that the use of a base is acceptable apparently stemmed in part from uncertainty as to what was meant by "significant." The Board is one record as stating that Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of costs. The Board has previously published in its Statement of Operating Policies, Procedures and Objectives certain criteria to be considered in determining whether a transaction or a decision about an accounting practice is material. Such criteria have also been proposed for inclusion in the Board's regulations. It is intended that these criteria be considered in determining whether separate segment pension cost calculations are required.

To clarify that the Board's existing materiality criteria apply in this instance, § 413.50(c) (2) and (3) in the Standard being promulgated today use the words "material" or "materially" in lieu of the words "significant" or "significantly" contained in the proposed Standard. More importantly, a statement has been added to § 413.50(c)(2) to state that separate pension cost calculations are required when the listed conditions are present only if "such conditions materially affect the amount of pension costs allocated to the segment." The Board believes that, in most cases, it will be obvious to the contracting parties whether the presence of one or more of these conditions for a segment will materially affect the pension cost for that segment. In cases where the impact is not obviously known, the Board contemplates that the contracting parties will rely on summary estimates as a basis for determining whether separate calculations are required. The Board believes that over time, the need for such summary estimates will diminish. The Board emphasizes that separate calculations are not routinely required, even though no two segments are likely to be identical with respect to the actuarial factors set forth in the Standard. The Board intends that separate segment calculations will be required only in those instances where they would result in a materially different pension cost allocation to a segment.

Several commentators noted that there are pension plans covering several segments that are almost completely devoted to performing work for the Government. Others noted that they

had segments which perform a relatively negligible amount of Government work. In either case, according to these commentators, even significant differences in pension cost factors among segments covered by the plan would not materially affect the amount of pension costs allocated to Government contracts. Accordingly, they recommended that the provisions of the Standard relative to separate computations for a segment not be applicable to such segments.

One of the Board's primary objectives in the Standard being promulgated today is to allocate the proper amount of pension costs to each segment. This objective is appropriate, irrespective of the mix of Government and commercial work of a segment or among all segments covered by a pension plan. Even if several segments are entirely devoted to performing work for the Government, the allocation of pension costs among such segment could materially affect the amount of pension costs that are allocated to particular types of contracts in a cost accounting period. The Board recognizes, however, that if a relatively immaterial amount of a segment's work is performed for the Government, any revised allocation of pension cost for that segment would probably have little or no effect on the costs allocated to Government contracts. In such a case, the Board urges the contracting parties give due consideration to the Board's views on materiality.

(8) *Allocation bases.* The proposed Standard required in § 413.50(c)(1) that contractors who compute a composite pension cost for two or more segments must allocate such costs on a base consisting either of the salary and wages of the participants or the number of participants, except where the contracting parties agree to the use of a different base. A number of commentators stated that in certain cases a better beneficial or causal relationship can be obtained by the use of other than the specified bases. The most commonly listed practice was the use of one base to allocate normal cost and another base to allocate unfunded actuarial liabilities. The Board recognizes that in many cases the use of other bases or a combination of bases would provide an equitable means for allocating pension costs to segments. The Board believes that it should not preclude the use of any appropriate base. Therefore, § 413.50(c)(1) of the Standard being promulgated today has been revised to provide that the base to be used for allocating composite pension costs shall be representative of the factors on which the pension benefits are based.

The Board still believes, however, that under certain circumstances, a specific base provides the best means for allocating pension cost. Accordingly, § 413.50(c)(1) still requires the use

of salaries and wages as an allocation base where costs are calculated as a percentage of salaries and wages, and the use of a base consisting of the number of employees where costs are calculated as an amount per employee.

(9) *Allocation of pension fund assets to segments.* When pension cost must be separately calculated for a segment, it will generally be necessary to allocate pension fund assets to such segments. Section 413.50(c)(5)(iii) of the proposed Standard provided that if contractors used different actuarial cost methods in prior years, the allocation of assets must be based on actuarial liabilities developed under the Accrued Benefit actuarial cost method. Several commentators noted that this provision could result in an allocation of assets to segments which is inconsistent with the bases used to accumulate the assets. The Board agrees with this observation. Accordingly, § 413.50(c)(5) of the Standard being promulgated today provides that the allocation of assets shall be made in a manner consistent with the actuarial cost method or methods used to give rise to such assets. It should be noted, however, that such an allocation is permitted only when contributions, disbursements, income, and expenditures made by, or in behalf, of a segment are not readily determinable.

Several commentators suggested that the Standard should be clarified with regard to whether the value of the assets to be allocated shall be the cost of the assets, the actuarial value of the assets, or the market value of the assets. Accordingly, the Board has provided in § 413.50(c)(5)(ii) of the Standard that the allocation shall be the actuarial value of the assets.

Several other commentators expressed concern that the Standard would require that specific assets be allocated to segments. The Board never intended an allocation of specific assets; rather, it intended that there be an initial allocation of assets for accounting purposes only. All of the assets of a pension fund remain available to provide benefit payments for participants in any segment. To clarify this point, § 413.50(c)(5) of the Standard being promulgated today has been revised to state that there shall be an initial allocation of a share in the undivided pension fund assets.

During the course of the Board's research several contractors and actuaries questioned whether the proposed asset allocation requirements prohibited contractors from establishing a separate fund for a segment. The Board does not intend such a prohibition in the Standard being promulgated today.

(10) *Pension costs of inactive participants.* The proposed Standard provided in § 413.50(c)(7) that inactive pension plan participants shall be considered as constituting a separate seg-

ment. This provision was included on the basis of research indicating that the accumulation of pension costs applicable to inactive employees would facilitate the allocation of such costs. However, a large number of commentators objected to this provision, stating that it would be much simpler and less costly to merely assign inactive participants to segments. The Board continues to believe that in certain cases the use of a separate segment to accumulate costs applicable to inactive employees will facilitate cost allocation. It recognizes, however, that in other cases assignment of inactive employees to active segments will ease administrative problems. The Board believes that either technique should result in an equitable allocation of pension cost. Accordingly, the Standard being promulgated today specifically provides in § 413.50(c)(9) for the use of either technique.

Section 413.50(c)(10) of the proposed Standard required that the pension cost calculated for the segment created for inactive participant shall be allocated to the active segments on the basis of the pension cost calculated for those segments. Several commentators pointed out that such a basis may be inappropriate in some cases. The Board concurs and has revised § 413.50(c)(9) of the Standard to permit more flexibility in selecting an allocation base under such circumstances.

(11) *Other cost allocation matters.* Several commentators questioned whether contractors must always allocate assets, and continue developing fund data for a segment simply for the purpose of amortizing an identified one-time actuarial gain or loss attributable to a segment. If an equitable allocation of pension cost can be achieved without allocating assets, it is not necessary to do so. For example, in the case of a one-time termination gain or loss, a contractor could isolate this gain or loss from the other composite actuarial gains or losses and separately credit or charge the former gain or loss over the next fifteen years to the segment from which it arose. The contractor could then continue using the composite cost allocation method (except for such separate adjustment) so long as there is no further unusual experience for that segment. The Board has amended the illustration in § 413.60(c)(1) of the Standard to embody this concept.

Section 413.50(c)(1) of the proposed Standard contained a requirement that costs shall be calculated on a segment basis under circumstances where (1) a pension plan for a segment was, or becomes, merged with that of another segment, and (2) the ratio of assets to actuarial liabilities for each of the merged plans are significantly different from one another after apportioning the benefits in effect after the

merger. In illustrating this point in § 413.36(c)(3), it was indicated that this provision is applicable to mergers which occurred prior to the effective date of the Standard. Several commentators expressed concern over the provision, stating that retroactivity was inequitable. They stated that it would be difficult and expensive to analyze prior years' pension cost, especially in cases where the mergers arose many years ago. The Board believes that these comments have merit. Accordingly, the Standard being promulgated today specifically provides in § 413.50(c)(4) that a requirement for separate segment pension cost calculations for mergers shall have prospective impact only and that pension costs need not be adjusted for prior years. Section 413.60(c)(5) has also been revised.

One commentator noted that its segments performing Government work had different pension cost factors than did the other segments of the company. However, the commentator noted that these factors were homogeneous for the segments performing Government work. The commentator asked whether the Standard requires a separate cost calculation for each segment under such circumstances. The contractor can make a composite calculation for the Government segments and allocate the cost to these segments by means of an allocation base. The contractor can, of course, do this for the other segments. To highlight this point the Board has added an illustration in § 413.60(c)(4) of the Standard.

Two commentators asked whether a difference between the amount of pension cost required to be funded under ERISA, and the sum of the pension costs developed for all segments could be allocated to the various segments. The board recognizes that it is theoretically possible for the sum of all pension costs calculated for segments of an organization to be materially less than the minimum amount required to be funded pursuant to ERISA. However, such a difference may not be assigned to the period for which funding is required. The Board has previously emphasized that the amount of pension cost assignable to a cost accounting period is not necessarily the same as the amount funded for that period. If the amount required to be funded exceeds the amount calculated, the excess amount funded is subject to the provisions of 4 CFR Part 412 (§ 412.50(c)(1)) which states that "Amounts funded in excess of the pension cost computed for a cost accounting period pursuant to the provisions of this Standard shall be applied to pension costs of future cost accounting periods."

(12) *Closing of a segment.* The proposed Standard contained a requirement in § 413.50(c)(13) that when a

segment is closed and a significant number of employees are terminated, the contractor shall calculate a gain or loss from the plan applicable to that segment, irrespective of whether the pension plan is terminated. A number of commentators expressed their concern over this provision. Some questioned whether the "net gain or loss" was an actuarial gain or loss and, if so, how it related to other sections of the Standard. Other commentators presumed that this section dealt with the termination of a plan; they stated that, in such an event, the provisions of ERISA and regulations of the Pension Benefit Guarantee Corporation would prevail. They suggested that this section of the Standard be made applicable only to pension plans that are being continued.

As a general rule, the Standard being promulgated today is based on the concept that material actuarial gains and losses applicable to a segment will be taken into account in future cost accounting periods in determining the costs for the segment. However, a problem arises in cases where a segment is closed. Because there are no future periods in which to adjust previously-determined pension costs applicable to that segment, a means must be developed to provide a basis for adjusting such costs. This adjustment is not an actuarial gain or loss as defined in the Standard. To clarify its intent, the Board has revised § 413.50(c)(12) of the Standard and the related illustration in § 413.60(c)(8). The Standard now states that when a segment is closed, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment.

The Board recognizes that, in some cases, the closing of a segment could be associated with a termination of a plan. Several commentators noted that, in such a case, the actuarial liability for that segment could be greatly influenced by regulations developed pursuant to the provisions of ERISA. The Standard specifically permits the effect of such regulations to be considered in determining the actuarial liability for the segment.

It should be noted that the provisions of this section are appropriate whenever a segment performing a material amount of Government business is closed, irrespective of whether the closing is caused by the completion of a contract or an organizational change, or whether the closing results in a complete or partial termination of the plan. The board emphasizes that the purpose of this provision is to serve as a basis for recognizing and adjusting pension costs previously allocated to the segment being terminated. Such a requirement is independent of whether employees are terminated from the plan.

(13) *Application to defined-contribution and certain other plans.* A number of commentators questioned whether the provisions of the proposed Standard are applicable to defined-contribution and multiemployer pension plans. The Board notes that Standard 412 specifically provides that, for a defined contribution pension plan, the pension cost for a cost accounting period is the net contribution required to be made for that period. Standard 412 provides also that a multiemployer pension plan established pursuant to the terms of a collective bargaining agreement shall be considered to be a defined-contribution pension plan for purposes of this Standard. Thus, the only provisions of this Standard that are applicable to these plans are those dealing with the allocation of costs to segments.

Specific questions were raised with regard to the applicability of the asset valuation requirements to insured plans. Section 413.50(b)(4) of the proposed Standard provided that the asset valuation requirements therein are not applicable to insured plans whose funds are commingled with those of the insurance company. Several commentators stated that this provision was unclear; they questioned whether group deposit administration annuity contracts, immediate participation guarantee contracts, or separate accounts deposit administration contracts are subject to the asset valuation provisions of the Standard. The Board intends that such contracts be subject to these provisions of the Standard. However, the asset valuation provisions do not apply to contracts under which insurance companies guarantee a rate of return. The Board believes that, in such circumstances, the recognition of unrealized appreciation or depreciation on pension fund assets does not alter the basic contractual agreement entered into between the plan sponsor and the insurance company. Section 413.50(b)(4) of the Standard has been revised to clarify this point.

(14) *Costs and benefits.* The anticipated benefits of this Standard are increased consistency and uniformity in measuring actuarial gains and losses and assigning them to cost accounting periods, and better allocation of pension costs to segments of an organization. The Board believes that such improved measurements and allocations will result in more equitable allocation of pension costs to cost objectives, including Government contracts. By providing criteria for controversial aspects of pension cost accounting, the Standard is also expected to reduce disagreements among contracting parties.

In its research leading to the development of this Standard, the Board noted a number of disagreements between contracting parties relating to

the disposition of termination gains attributable to segments performing Government contracts. The Board believes that the Standard will diminish, if not eliminate, such disagreements.

On May 19, 1977, the Comptroller General of the United States issued a report to the Congress entitled "Contractor Pension Plan Costs: More Control Could Save the Department of Defense Millions." The General Accounting Office selected, at random, nine Department of Defense prime contractors and examined the pension costs of these contractors. The report states that a substantial amount of questionable pension plan costs were, or may be, charged to Government contracts. The report attributes much of the questionable pension costs to the inequitable allocation of pension plan costs between Government and commercial business. The report states that the Standard being promulgated today deals with, and should correct, many of the problems cited. The following are examples of these problems and the provision of the Standard which deals with them.

(a) A contractor, which calculates pension cost by segment, does not equitably allocate assets to these segments each year; the amounts allocated do not recognize net annual capital contributions by the segments nor the segments shares in the capital growth of pension fund investments. Section 413.50(c) (5), (6) and (7) deals with this subject.

(b) The pension fund of a contractor which acquired a commercial subsidiary is in a surplus position. As a result, pension contributions are not being made for either the Government segments or the commercial subsidiary. Because the surplus was accumulated mainly through Government reimbursements that exceeded the amounts required, the Government's proportional share of the surplus has been diluted by the annual pension plan costs of the commercial subsidiary. Section 413.50(c)(3) deals with this subject.

(c) One contractor used corporate-wide assumptions to calculate pension cost. However, the Government-oriented segments had much higher employee termination rates than did the other segments. The cost to the Government would have been much less if separate pension cost calculations were made for the Government-oriented segments, using the appropriate termination assumptions. Section 413.50(c)(2) deals with this subject.

The Board recognizes that the implementation of this Standard may result in some increased administrative costs by defense contractors. The Board's research shows that any incremental administrative costs incurred will be predominantly related to increased actuarial fees. After discussing with actuaries the nature and scope of increased actuarial work required, the Board is confident that the increased administrative costs required to implement the proposed Standard are relatively small and do not approach the

benefits that will be achieved by the proposed Standard.

As required by 719(g) of the Defense Production Act of 1950, as amended, the Board has evaluated the potential inflationary effect of this Standard. The Standard may cause a shift of pension costs from earlier periods to later periods or vice versa. It may also cause a shift of pension costs among various portions of a contractor's business. In the long run, however, total pension costs will not increase or decrease as a result of this Standard. As already noted, increased administrative costs attributable to the Standard are expected to be minimal. Accordingly, the Board concludes that this Standard will have no inflationary effect.

(15) *Effective date.* At the time of promulgation of each previous Standard, the Board followed the policy of reserving the effective date of the Standard, pending the expiration of 60 calendar days of continuous session of the Congress following the date on which the Standard was transmitted. Section 413.80 of the Standard being promulgated today specifies the effective date. The date is included at this time to afford contractors and contracting agencies the earliest possible notification so that they can begin to make implementation plans. In the event any subsequent event makes it necessary to rescind or amend that date, such action will be taken by appropriate notice in the FEDERAL REGISTER.

**PREAMBLES TO COST ACCOUNTING STANDARD
414, COST OF MONEY AS AN ELEMENT OF
THE COST OF FACILITIES CAPITAL**

PREAMBLE A

Preamble to Original Publication, 6-2-76

The following is the preamble to the original publication of Part 414, 41 FR 22244, June 2, 1976.

The Standard on Cost of Money as an Element of the Cost of Facilities Capital being published today is one of a series being promulgated by the Cost Accounting Standards Board (Board) pursuant to section 719 of the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. App. 2168), which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts.

Performance under negotiated contracts usually requires the use of facilities which represent significant contractor investments. Accounting principles applicable to financial reporting do not provide for any explicit recognition of the cost of capital committed to facilities. The Board has long been interested in identifying, as a contract cost, a part of the contrac-

tor's total cost of capital. The Board distributed three research papers dealing with the cost of capital in connection with negotiated contracts. These mailings were in June 1974, April 1975, and December 1975. The responses received to all three of those research mailings were useful in the development of the proposal published by the Board on March 5, 1976 (41 FR 9562).

The Board supplemented that March 5 FEDERAL REGISTER request for comments by sending copies of the FEDERAL REGISTER material directly to organizations and individuals who were expected to be interested. The Board has received 82 comments on the March 5 proposal. All of these comments have been carefully considered. The Board appreciates the helpful suggestions and criticisms which have been furnished.

The comments below summarize the major issues discussed by respondents and the significant changes which have been made from the March 5 version of the proposed Standard.

A. GENERAL COMMENTS

(1) *Impact on Contract Prices.* Commentators who represented contractors and the accounting profession tended to favor the proposal, while those who represented some Government agencies were opposed. Government representatives were joined by some other commentators who expressed the belief that the cost of money as an element of the cost of capital committed to facilities should remain, explicit or otherwise, a consideration in determining contract profit compensation, rather than be treated as an element of cost. The Board's early research into the broad question of measurement of the costs related to capital commitment included a number of inquiries about the propriety of a change in the basic concepts of contract cost to include this element.

The cost to be measured, even though imputed, is real and is relevant for contract costing. The Board is persuaded that there has not been adequate agreement on techniques for measuring it. A Cost Accounting Standard is, therefore, appropriate.

Some commentators have expressed concern that contract profit levels may be reduced when this new element of contract cost is recognized, and that there will thus be no real financial benefit from the issuance of the Standard. Such comments are based on a misunderstanding of the Board's mission. The Standard is intended to improve contract cost measurement and understanding by the contracting parties and to provide for greater uniformity by specifying techniques appropriate to types of circumstances actually encountered. Capital asset commitment varies widely among contracts. The Board has developed a

technique that takes explicit account of such differences in capital intensity. The procurement agencies are now considering their pricing policies and the Board expects the agencies in doing this to give appropriate recognition to this Standard.

(2) *Exclusion of Working Capital.* As the Board pointed out in its publication on March 5, 1976, its staff has investigated the problems related to measurement of the costs related to investments in operating, or working, capital. Most commentators, while generally favoring the Board's proposal as to the cost of facilities capital, urged that the final promulgation include explicit cost recognition based on the contractor's investment in working capital. The Board is not prepared at this time to make determinations on all the issues related to working capital. The economic impact of contractor investment in facilities is, by itself, important enough to warrant recognition as a contract cost without delay. The Board will seek to resolve the problems related to measurement of the contract cost attributable to the investment in working capital.

(3) *Withdrawal of Proposed CAS No. 413.* A number of commentators expressed regret that the Board had withdrawn its proposed Cost Accounting Standard No. 413 on Adjustment of Historical Depreciation Costs for Inflation, which was published on October 9, 1975. As the Board pointed out in its March 5, 1976 publication, inflation has an impact on interest rates. Research shows that over time there is a strong correlation between interest rates and the rate of change of the price level. The interest rates which were available for measuring the cost of capital would unavoidably include some allowance for inflation. Although a number of respondents denied any overlap, the promulgation of both CAS No. 413 and CAS No. 414 as proposed would have resulted in some duplication of coverage.

The accounting profession continues to consider various approaches to the financial reporting problems related to inflation. The Board will continue to observe the various efforts within the profession, and will consider the usefulness for contract costing purposes of each new statement of generally accepted accounting principles related to inflation.

Should the Board consider it appropriate at some future time to measure the impact of inflation in some other way for contracts, it will, of course, reconsider the rate as well as the method selected for measurement of the cost of money as an element of the cost of facilities capital.

B. CONTENT OF THE STANDARD

(1) *The Renegotiation Board Rate.* The Board's March 5 publication specified the use of the semiannual inter-

est rate established in accordance with Pub. L. 92-41 to serve as a cost of money rate for determining the imputed cost of capital committed to facilities. That law requires that the "rate shall be determined by the Secretary of the Treasury, taking into consideration current private commercial rates of interest for new loans maturing in approximately five years." (section 2, 85 Stat. 97).

Some commentators have pointed out that the interest rate specified under Pub. L. 92-41 was, during 1973-1974, less than the actually experienced rate of general inflation, and thus could not have realistically reflected the rate of inflation. The rate includes provision for the expected impacts of future inflation. In the future as in the past, inflationary expectation may indeed be less than the rate of inflation subsequently experienced; but at times it may also be greater.

Obviously the single interest rate specified under Pub. L. 92-41 and used as a cost of money rate in this Standard will rarely be the precise borrowing rate of any particular contractor.

(2) *Allocation of Facilities.* For contract costing purposes, the cost of capital committed to facilities must be related to contracts. The following three subsections deal with the techniques proposed to establish this relationship.

Simplified Procedure: The Standard being promulgated today is based on allocation to negotiated contracts of an appropriate share of the total cost of money which can be identified with the facilities employees in a business unit. This allocation is made by first identifying the total facilities capital associated with each indirect cost pool. The imputed interest cost is then assigned to contracts on the basis of the same measures used to allocate other costs from those indirect cost pools.

Interested parties almost universally accepted this basic approach. A few have expressed concern, however, that the proposed procedure might entail more effort than would be warranted by the improved precision obtained as compared with a much simpler procedure to approximate the desired allocation.

The March 5 proposal included a provision for a simple allocation technique, based on the established procedure for distribution of G&A expenses. This alternative was to be used "only where the contracting parties agree that the results are not likely to differ materially from those which would be produced under the procedure (otherwise described in the proposed Standard)."

Critics of the proposal suggest that the only way the two parties could agree to use the alternative simple procedure would be to recreate the detail of an allocation using the "regular" method as a comparison. But if the "regular" method must thereby be

applied in any case, then there would be no reason to pursue the alternative. The Board has confidence in the reasonableness of the contracting parties in finding ways to achieve the purpose of this Standard. Where the total amount of facilities capital is minor in relation to the estimated incurred cost, for example, the parties could be expected to agree in advance to use the simpler alternative procedure. Similarly, if the contractor has a variety of service centers and other indirect cost pools, which are generally used to serve all productive activities, and which do not individually involve significant facility investments, the alternative procedure could be expected to provide significant administrative convenience, and should probably be used. The situation would be different if a relatively significant portion of the total facilities investment were identified with a service center which is obviously not used with the same intensity for all final cost objectives of the contractor; the imputed cost related to such an investment should be assigned on the basis of the use of the facilities rather than on the basis of some overall allocation procedure.

The instructions in the Standard have been modified slightly to clarify the available flexibility. The Board expects that administrative convenience and the likelihood of significant distortion will be considered in decisions about the use of the simplified alternative procedure permitted.

Basic Allocation Technique. Some commentators criticized the complexity of the regular procedure provided in the March 5 publication. The instructions called for the identification of assets to pools "on any reasonable basis that approximates the actual absorption of depreciation and the related costs of such facilities. The basis of allocation of undistributed assets in each business unit between, for example, the engineering overhead pool and the manufacturing overhead pool, should be related to the manner in which the expenses generated by these assets are absorbed in the two overhead rates. The choice of the basis for allocation is up to the contractor within the limits stated above." Those critics who feel that the instructions require too much detailed analysis in the case of elaborate overhead distribution systems seem not to have understood the intent of the quoted portion. Consolidation and simplification to a limited number of pools and allocation bases is justified in the typical situation where there are many service centers. Minor editorial changes have been made in the instructions, but the Board has not seen the need for any major change in this regard.

Application to Process Cost Systems. The Standard provides a means for allocating the imputed cost to final cost objectives by developing facilities cap-

ital cost factors for indirect cost pools. To determine the cost of money applicable to a given final cost objective, these factors must be multiplied by the corresponding allocation base units identified with the final cost objective. A few commentators questioned the technique for applying this procedure for process cost systems.

In a process cost system all the production costs, including overhead costs, are usually accumulated in cost pools associated with "process cost centers" and are then allocated to final cost objectives or products by means of an individual cost center "charging rate." The procedures outlined in this Standard for developing facilities capital cost of money factors for overhead and G&A expense pools are equally applicable to "process cost centers" in case of a process cost system. However, difficulties may arise in computing the appropriate amount of cost of money applicable to each cost objective or product. The difficulties will emerge where the cost records of individual contracts or other final cost objectives do not, as a matter of course, identify any amount of allocation base units related to these final cost objectives in the various "process cost centers." In those circumstances it is anticipated that the contracting parties could agree upon one of several possible acceptable courses of action. Thus it should not be difficult to develop an acceptable allocation basis using statistical methods where appropriate. In addition, the "alternative method," described in instructions to Form CASB-CMF, could be applied in suitable circumstances.

(3) *Inclusion in "Cost Input":* A few commentators questioned whether the imputed cost of capital committed to facilities should be included in the cost input typically to be used as the basis for distribution of G&A expenses under the terms of Cost Accounting Standard No. 410. This element of contract cost is indeed a part of total cost. The term "cost input" is defined as "the cost, except G&A expenses, which for contract costing purposes is allocable to the production of goods and services during a cost accounting period." In principle, the cost of capital committed to facilities, other than those facilities identified with the G&A expense pool, should be included in the total cost input base.

The Board believes that as a practical matter the allocation of the cost of money for the cost accounting period (See Col. 5 Form CASB-CMF) would not be materially affected by the inclusion or exclusion of cost of money from "cost input." The cost of money for the business unit as a whole would not change. However, to the extent that cost input is used as an allocation base some difference in the allocation to individual contracts can be antici-

pated. As indicated earlier, however, this difference generally should be immaterial.

In view of the amount of cost accounting data that may be affected by the introduction of cost of money as an element of contract cost and the idiosyncracies of the systems designed to handle that data, the Board believes that administrative expediency should not be ignored. Therefore, at this time it does not prescribe whether this element of cost should be included in or excluded from the cost input allocation base. Although the imputed cost of capital committed to facilities should be included in the total cost input allocation base whenever practicable, exclusion of this element will be acceptable whenever the contractor chooses such exclusion on the basis of reasonable administrative convenience. The illustration in Appendix B is prepared showing the inclusion of this cost and also, as an alternative, showing the exclusion of this element of cost from the measure used as an allocation base for G&A expenses.

C. ADMINISTRATION

(1) *Accounting Records.* The Board's March 5 proposal included the acknowledgement that the imputed cost to be recognized has not been treated under the generally accepted accounting principles applicable to external financial reporting. Even so, several commentators felt the need to point out to the Board that the proposal would involve a cost not currently recognized in published corporate financial reports.

The Board has often emphasized that memorandum records, not necessarily a part of the contractor's formal accounting system, can furnish adequate accounting support for contract purposes, where these purposes differ from those for which the accounting system was developed. The imputed cost to be recognized under this Standard is no exception. The Standard provides the techniques by which this cost will be measured, starting with data already in the accounting records.

(2) *Preparation of Estimates.* The March 5 proposal included the provisions that "where the cost of money must be determined on a prospective basis the cost of money rate shall be based on the most recent available rate published * * *." Some commentators urged that the Standard make more clear the relationship of the published rate to the rate to be used in estimates. Some urged that the published rate be required, and others asked for the publication of official forecasts, which should be used for estimates.

Other commentators pointed out that the determination of the cost of money applicable to a proposed con-

tract requires estimation of a number of asset values and allocation rates. They asked that the Board provide clear instructions as to prospective application.

The Board has never undertaken to advise the contracting parties as to techniques for estimating or for agreeing upon specific amounts of estimated costs. In the case of the imputed cost of capital committed to facilities, as for other elements of cost, the clear determination of the procedure by which "actual" cost will later be measured can eliminate confusion as to the nature of the estimate. The parties may, of course, use any techniques which seem appropriate for agreeing on the numeric values to be included in contract cost estimates.

(3) *Compliance with Standard No. 401.* The Board has earlier promulgated a Standard (4 CFR Part 401) which requires that the practices used in pricing a proposal (estimating) shall be consistent with the cost accounting practices used in accumulating and reporting costs. One of the essential features of that Standard is the requirement that any significant element of cost in the estimate can be compared with the corresponding actual cost. A number of commentators have expressed concern about the applicability of that Standard to an imputed cost.

For the purposes of complying with Standard No. 401 the Board believes that any reasonable estimating technique which establishes the cost of money as a separate amount is acceptable. It is not necessary in estimating to follow precisely the procedures, including Form CASB-CMF, incorporated in the Standard.

D. APPLICABILITY

(1) *Use Rates.* Contractors are sometimes compensated for the use of facilities by means of "use rates" authorized under Government procurement policies. These rates may cover various elements of ownership costs, including depreciation. The March 5 publication contained a proposed exemption for situations where such use charges were included in contract costs. A number of commentators criticized that proposed exemption.

The Board does not intend to interfere with the process of establishing "use rates" nor is it prepared to define at this time the factors that should be taken into account when they are formulated. The Board believes that the cost of money is a valid economic cost, and that it is as relevant to a contractor employing a use rate as it is to one using depreciation. Existing schedules of use rates have presumably included appropriate consideration of all elements of the total cost to be considered in developing such rates. The proposed exemption for those covered by

use charges is accordingly retained.

(2) *Existing Covered Contracts.* Many commentators urged revision of § 414.70 of the March 5 proposal to delete the exemption of contracts and subcontracts entered into prior to the effective date of the Standard. Such contracts were negotiated under the provisions of Government procurement regulations. In all such regulations, any interest costs incurred by the contractor have been specifically designated as unallowable costs. Furthermore, none of these regulations has recognized any imputed cost of capital committed to facilities. The agreement of the parties, embodied in such prior contracts, has necessarily been reached in light of the cost principles existing at the time the contracts were entered into. The Board therefore concludes that this Standard should not be applied to existing contracts and the Board has consequently retained the exemption in § 414.70.

E. BENEFITS AND COSTS

With respect to Cost Accounting Standards, the Board's primary goal is to issue clearly stated Standards to achieve (1) an increased degree of uniformity in accounting practices among Government contractors and (2) consistency in accounting treatment of costs by individual Government contractors. Increased uniformity and consistency are desirable to the extent that they improve understanding and communication.

Contract costs currently do not include any measurement of the cost of money, which is undeniably a cost related to contract performance. The result is that contract cost measurements have made no distinction between contracts with equal amounts of total incurred cost but with vast differences in amounts of facilities investment.

This Standard need have no impact in the aggregate prices paid by the Government but will reflect specific identifiable cost of money as an element of the cost of facilities capital in individual negotiated contracts. Previously, these costs presumably were reflected in nonidentifiable amounts in the profits or fees included in the total contract prices. By reflecting specific costs of money attributable to contractor investments in facilities, this Standard will provide for greater consistency in negotiating total contract prices. The Board understands that procurement agencies expect to take this Standard into account in their current reconsideration of pricing policies. The Standard also will assist the procurement agencies to discriminate more effectively between contracts in which the cost of money is significant and those in which it is not.

The Nation's mobilization base depends on its facilities. These may be

more effectively modernized because of the explicit cost recognition provided by this Standard, which will help to eliminate the existing disincentives which have hampered contractor investments in facilities. Also, to the extent that the Standard results in investment in cost-reducing equipment, the Government will be able to procure goods and services at lower prices.

Some commentators have suggested that the Board's issuance of Cost Accounting Standard No. 409 caused the need for recognition of this element of cost of facilities capital, and that the Standard being promulgated should be judged in that context. The Board does not agree. The Standard on depreciation was justified by the need for improved criteria with respect to depreciation expense identified with contract performance. Some critics of that Standard argued, in effect, that it should not have been promulgated because, even though it would improve depreciation accounting, there were economic costs not yet being recognized, and that improper depreciation could be justified as an acceptable technique for meeting the economic need. The Board was not and is not persuaded by such reasoning.

The Board has considered the administrative costs related to implementation of this Standard. The most significant potential problems mentioned by commentators were related to features of the proposal which have been modified in response to those comments. The Standard as promulgated today is not expected to involve any significant administrative difficulty, either for contractors or for the Government.

In summary, the Board finds that the benefits of this Standard, which are significant, outweigh the costs, including any inflationary impact.

F. MISCELLANEOUS

The Board expects that this Standard will become effective on October 1, 1976.

There is also being published today an amendment to Part 400, *Definitions*, to incorporate in that part terms defined in § 414.30(a) of this Cost Accounting Standard.

PREAMBLES TO COST ACCOUNTING STANDARD 415, ACCOUNTING FOR THE COST OF DEFERRED COMPENSATION

PREAMBLE A

Preamble to Original Publication, 7-30-76

The following is the preamble to the original publication of Part 415, 41 FR 31797, July 30, 1976.

The Standard on Accounting for the Cost of Deferred Compensation being published today is one of a series being promulgated by the Cost Accounting Standards Board pursuant to

section 719 of the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. App. 2168), which provides for the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts. This Standard provides criteria for the measurement of the cost of deferred compensation and the assignment of such cost to cost accounting periods.

Early research included an extensive review of available literature, the Disclosure Statements filed with the Board, and decisions of boards of contract appeals. This information was then supplemented by visits and mail solicitations to contractors in order to elicit more specific data concerning company deferred compensation plans.

In May 1975, a questionnaire/issues paper was sent to a wide mailing list soliciting responses to several basic issues identified in the Board's early research. Seventy responses to the questionnaire/issues paper were received from interested parties, the majority of whom were companies that had deferred compensation plans. Based on the responses received, a preliminary draft Standard was developed in December 1975 and sent to a large cross section of companies, Government agencies, industry and professional associations, and other interested individuals. The Board received 53 responses to the draft Standard.

After several changes were made to the draft Standard, based on consideration of the comments made by respondents, a proposed Standard was published in the FEDERAL REGISTER of April 7, 1976, with an invitation to interested parties to submit written views and comments to the Board.

The Board received 34 sets of written comments from companies, Government agencies, professional associations, industry associations, public accounting firms and others in response to the FEDERAL REGISTER proposal. All of these comments have been carefully considered by the Board. The Board's views on each of the major issues discussed by the commentators are outlined in the following sections, together with explanations of the changes made in the Cost Accounting Standard being promulgated.

The Board wishes to take this opportunity to express its appreciation for the helpful suggestions it has received and the time devoted to assisting the Board in this endeavor by the many organizations and individuals involved.

RELATIONSHIP OF STANDARD TO CURRENT PROCUREMENT REGULATIONS

Under current procurement regulations, deferred compensation is allocable as a cost of Government contracts only to the extent that such costs are deductible for the same fiscal year for

Federal income tax purposes. A few commentators expressed concern that the proposed Standard would require the assignment of the cost of deferred compensation to a cost accounting period that would be different than that determined under the Internal Revenue Code for Federal income tax purposes.

Under the Internal Revenue Code, a deduction for tax purposes for the cost of many incentive or bonus type plans is not permitted until the deferred compensation is paid to the recipient. Under the Standard, however, the cost of deferred compensation is assignable as a contract cost in the period the contractor incurs an obligation to pay such cost which, for many deferred compensation plans, will be the period in which the award is made. (See § 415.40(a).)

The Board has recognized that contract costing often deals with the same expenditures as are of interest in income tax accounting. Except for differences in tax rates, shifts of income or expense from one year to another generally do not have a significant effect on total tax paid over a period of time. Similar shifts of cost, however, from one year to another could have a decided impact on the costs chargeable to Government contracts. This impact occurs because the mix of Government and commercial contracts often changes significantly from period to period. Therefore, the Board believes that application of the criteria provided in the Standard to assign the cost of deferred compensation on an accrual basis of accounting is needed to better assure that such cost of deferred compensation will be assigned to appropriate cost accounting periods.

ALLOCABILITY AND ALLOWABILITY OF CONTRACT COSTS

Several Government agency commentators pointed out that under present procurement regulations deferred compensation is not allowable until the period in which paid. These commentators also noted that the cost of stock options, under present procurement regulations, is unallowable. Although these commentators generally recognized that the provisions of the Standard involve allocability, they questioned whether the Standard would encroach on the allowability prerogatives of the procurement agencies.

The Board believes that recognition of the cost accounting concept that all costs incurred in carrying on the activities of an enterprise are allocable to the cost objectives of the enterprise is essential to the maintenance of sound and consistent contract cost accounting. Cost Accounting Standards should result in determination of costs which are allocable to contracts and

other cost objectives. The use of Cost Accounting Standards, however, has no direct bearing on allowability determinations.

DEFINITION

A commentator was concerned that the proposed Standard may apply to the cost of some pension plans that are subject to Accounting Principles Board Opinion No. 8, Accounting for the Cost of Pension Plans, and that different measures of cost might result for the same plan from application of the proposed Standard and from application of APB Opinion No. 8. The commentator questioned whether an amount paid to an employee after retirement for a specified period of time, e.g., 10 years, would fall under the definition of deferred compensation as used in this Standard. If a payment for a specified period of time after retirement is, in effect, equivalent to a life income settlement, this payment falls within the definition of a pension plan as provided in Cost Accounting Standard 412, Composition and Measurement of Pension Cost. If the payment is not a life income settlement, it is not a pension plan and the award is covered under the definition of deferred compensation. The Board does not believe that the Standard being promulgated today applies to any pension plan covered under APB Opinion No. 8.

DETERMINATION OF OBLIGATION

One of the criteria contained in the Standard for determining whether a contractor has incurred an obligation for the cost of deferred compensation is whether or not there is reasonable probability that certain required conditions precedent will occur before an employee is entitled to receive the benefits (see § 415.50(a)(5)). The proposed Standard stated that, in determining whether certain events are likely to occur, one of the factors to be considered was the reasonableness of the time interval between the award and the expected occurrence of the event. A few commentators suggested that the proposed Standard specify the length of time that would be reasonable. The Board does not believe that a particular time period can be specified to cover all circumstances. Each category of award must be analyzed on a case-by-case basis because there are several factors involved in determining whether employees should be entitled to receive the benefits of an award. Among the factors that should be considered, in addition to the time interval, are the employer's experience with similar awards and other restrictive terms which may be involved in the terms of the award.

Since there are numerous factors to be considered, the Board has deleted from § 415.50(a)(5) of the Standard

mention of two specific factors in order not to give undue weight to these factors. In addition, the Board has added § 415.50(a)(6) to make clear with respect to stock options, that an obligation is deemed to have been incurred only if there is a reasonable probability that the option ultimately will be exercised.

FUTURE SERVICE REQUIREMENTS

Section 415.50(a)(3) provides, as a condition for the assignment of deferred compensation, that the amount of future payment be capable of being measured with reasonable accuracy. In this connection, several commentators suggested that this provision should override the provision for prorating the cost if future service is required. The commentators stated that the service to be rendered after the period of award does not influence the basis for the award. These commentators believe that if there is a strong likelihood that the recipients of the awards would remain with the company for the periods of future service then the costs should be charged in the year of award.

The Board does not agree that the reasonable accuracy of measuring the cost should override the appropriate assignment of the cost to the periods of current and future service based on the facts and circumstances of the award. The Board believes that, where future service is required, such compensation related to the service rendered in those future periods and therefore the related cost should be assigned to those periods. In this regard, the Board believes that the concepts embodied in Accounting Principles Board Opinion No. 12 Omnibus Opinion, are appropriate for contract costing. This Opinion states that "If elements of both current and future service are present [for deferred compensation awards], only the portion applicable to the current service should be accrued." To make certain that this concept is clearly understood to be incorporated in the Standard being promulgated, a provision has been added to § 415.50(a).

VARIABLE INTEREST RATE

Several commentators expressed concern over a provision in the proposed Standard which stated that if the interest rate included in the award is not fixed at the date of award, the interest was to be assignable only to the periods in which the interest was paid. A few of these commentators stated that generally accepted accounting principles require that the estimated amount to be paid should be assigned in a systematic and rational manner. The commentators stated that, if the amount of interest is known in each period, it should be assigned in each such period.

The Board agrees that the variable interests amounts should be assigned to periods in a systematic and rational manner provided that the terms of the plan specify the basis under which variable interest amounts will be derived and the interest applied in each period is determinable at that time. Consequently, the Standard being promulgated today has been revised to provide in § 415.50(d)(2), that variable interest included in awards shall be assigned in the same period as the principal of the award, provided that the rate is based on a specified index and is determinable in each applicable period. The Standard also provides that since the interest rate used at the time of the award is likely to vary from the actual rates in future periods, adjustments shall be made in any future period in which the variation in rates materially affects the cost of deferred compensation.

Section 415.50(d)(3) was added to the Standard to provide for those situations in which the interest rate was not based on a specified index or not determinable in each applicable year. In these situations, the present value of the principal amount of the award is assignable in the year of award and the interest cost is assignable to the period or periods in which the payments are made.

FORFEITURES

Two commentators stated that the forfeiture provision should be expanded to recognize that losses on the initial payment for irrevocably funded plans, as well as earnings, may occur within the framework of such a plan. The Board had intended that both gains and losses be recognized and has changed the provision to clarify this point (see § 415.50 (d)(7)).

Another commentator stated that the forfeiture provision should not include interest to the date of the forfeiture. The commentator stated that it seems inequitable to require that the value of the forfeiture be determined at a level which was not fully allowable as a cost during the accounting periods affected. The Board does not share the view that including interest in the credit for forfeitures is inequitable. The interest factor represents the time cost of money which the contractor should pay to the Government for having been provided with funds. The forfeiture is calculated to be the present value of the future benefit at the time of forfeiture and thus is equivalent in present value terms to the amount of deferred compensation that was originally assigned. However, as stated in the Standard, the failure of the recipient to voluntarily exercise a stock option is not considered a forfeiture.

The Standard has been amended to provide that if a recipient of an award

of stock options voluntarily fails to exercise such options, such failure does not constitute a forfeiture. (See § 415.50(e)(6).)

STOCK AND STOCK OPTIONS

A few commentators cited the requirement of § 415.50(a)(3) of the proposed Standard which provides that the amount of the future payment must be capable of reasonable estimation, and expressed their opinion that the value of award of contractor stock that is to be distributed in a future period or periods should not be assigned to any period prior to payment because the amount of payment to the employee cannot be reasonably estimated before that time.

The Board believes that the compensation cost of stock or stock option plans should be measured by the quoted market price of the stock at the measurement date less the amount, if any, that the employee is required to pay. Further, the measurement date for both stock awards and stock option plans should be the first date on which are known both the number of shares to be distributed and the option price, if any. These views are embodied in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, which already must be followed by contractors for financial reporting.

If the market price of the stock on the date of distribution is used, the Government, in effect, would be sharing in financial risk-taking with the contractor. Subsequent fluctuations of the price of the stock should not influence the measurement of the award. However, the Board recognized that the proposed Standard was not consistent with respect to the measurement of the cost of stock and stock option. Consequently, § 415.50(e)(1) has been changed to provide for the measurement of the cost of stock to be at the measurement date rather than the time an obligation was deemed to have been incurred.

In order to further clarify the Board's intent, § 415.50(e) had been revised to provide that the measurement of the award of stock, stock options, or other assets as set forth in the Standard shall be deemed to be a reasonable measure of the amount of the future payment.

Two commentators stated that the cost of stock options should be based on the value of the options on the date they are exercised. Similar to the reasoning expressed above, the Board does not believe that it would be appropriate to base the cost of stock options on the value prevailing at the date of exercise. Stock options which are awarded at a value which equals the market value of the stock would involve no cost under the provisions of the Standard. However, if the award of stock options were based on their

value at the date exercised, a cost of the award would have to be recognized by the Government even though the contractor could purchase an appropriate number of shares at the time of the award to defray any cost resulting from future increases in the market value of the stock. The Board believes, therefore, that stock options should be measured at the date on which both the option price and the number of shares are established (see § 415.50(e)(1)).

Several commentators suggested that the requirement for prorating the cost of stock options over the period of future service and taking the present value of the prorated cost should be eliminated because the price of the stock is the present value of the stock price. The Board agrees with these commentators. Consequently, the requirement for discounting the cost of stock options has been eliminated from the Standard.

TRANSITION PROVISION

Several commentators suggested that a transition provision be included in the Standard to amortize costs of deferred compensation accumulated in periods prior to the promulgation of the Standard, but not previously charged to contract costs. Several of these commentators suggested various methods to amortize the recovery of all prior deferred compensation on an accelerated basis. Among the methods suggested was to charge all such prior costs in the period that the Standard became effective or to charge such costs over the remaining work life of the employee or five years, whichever is shorter. However, one commentator recommended that the Board use a suspense account, as used in Cost Accounting Standard 408, Accounting for Cost of Compensated Personal Absence. The use of a suspense account would delay recognition of the cost of deferred compensation awarded before the effective date of the Standard.

The procurement regulations for costs of deferred compensation awarded prior to the effective date of the Standard generally provide that such costs will be allocable in the period in which they are paid to recipients. The Standard being promulgated today would not disturb the contractual provisions applicable to such prior awards. The provisions of this Standard are applicable only to new awards of deferred compensation made on or after the date that the Standard becomes applicable to each contractor. The Board recognizes that there will be a minor budgetary increase required by the Government agencies until the prior deferred compensation awards are paid. However, for the majority of deferred compensation plans, the awards previously made will be paid out over a relatively short period

of time, e.g., five years. Consequently, the Board believes that a transition provision is not necessary for the Standard being promulgated today.

OTHER CHANGES

The first illustration (§ 415.60(a)) was changed to reflect the change in the provision regarding interest rates that are not fixed at the date of award. Other changes of a minor nature were made to various sections of the Standard for clarification.

COSTS AND BENEFITS

Section 719(g) of the Defense Production Act of 1950, as amended, provides "In promulgating such standards and major rules and regulations for the implementation of such standards, the Board shall take into account, and shall report to the Congress in the transmittal required by section 719(h)(3) hereof, the probable costs of implementation, including inflationary effects, if any, compared to the probable benefits, including advantages and improvements in the pricing, administration and settlement of contracts."

Comments received in response to the FEDERAL REGISTER publication, as well as information obtained from contractors prior thereto, indicated that there would be minimal administrative costs entailed in complying with the Standard. One Government agency stated that additional administrative burden would be placed on the Government as a result of the conversion from a cash basis to the accrual method of accounting. The Board believes that any such additional administrative costs due to this conversion will be minimal. The Governmental agencies have always had the responsibility for reviewing the reasonableness of deferred compensation plans and evaluating the payments to assure that such payments coincide with the principal and interest provisions of the plan. The Board believes the main additional administrative cost involved is in reviewing the present value calculation and determining if the contractor has incurred a valid obligation at the time the award is made.

Among the benefits which the Board believes will be derived from the use of this Standard is the assignment of the costs of deferred compensation to proper periods. Under the present regulations, the assignment of much of these costs is essentially on a cash basis. As a consequence, deferred compensation costs may have been incurred in much earlier periods than the periods in which they were recognized as incurred costs; in many cases, several years after the service has been rendered by the employee. Giving full consideration to all the relevant factors discussed herein, the Board believes the benefits to be derived from this Standard clearly outweigh any costs of implementation.

As required by section 719(g), the Board has evaluated the potential inflationary effect of this Standard. The Standard requires the use of present value techniques for the assignment of cost and incorporates a forfeiture provision with interest. The use of these techniques recognizes the time cost of money. In the long run, the cost to the Government should be essentially the same as that which would be incurred under a cash basis of accounting. For a majority of deferred compensation plans, moreover, the awards previously made will be paid out over a relatively short period of time, e.g., five years. The Board has concluded that there will be only a minor budgetary increase on the Government agencies until the prior deferred compensation awards are paid. Overall, however, any inflationary effect of this Standard will be minimal.

The Board expects that this Standard will become effective January 1, 1977.

There is also being published today an Amendment to Part 400, Definitions, to incorporate in that part terms defined in § 415.30 of this Cost Accounting Standard.

PREAMBLE B

Preamble to Revision of Section, 7-30-76 and 1-8-78

The following is the preamble to the revision of § 415.80, published at 42 FR 18857, Apr. 11, 1977 and correctly reprinted at 43 FR 24821, June 8, 1978.

On July 30, 1976, a Cost Accounting Standard entitled Accounting for the Cost of Deferred Compensation was published in the FEDERAL REGISTER (41 FR 31797 et seq.). The effective date of the Standard was reserved in the July 30 publication. This final rule establishes the effective date.

PREAMBLES TO COST ACCOUNTING STANDARD 416, ACCOUNTING FOR INSURANCE COSTS

PREAMBLE A

Preamble to Original Publication, 9-20-78

The following is the preamble to the original publication of Part 416, 43 FR 42239, Sept. 20, 1978.

(1) BACKGROUND

Work on a potential standard on accounting for insurance costs was initiated for a number of reasons; these included (1) differences between armed services procurement regulation (ASPR) provisions governing self-insurance and Financial Accounting Standards Board (FASB) statement No. 5, (2) Armed Services Board of Contract Appeals (ASBCA) cases or other disputes related to insurance accounting, and (3) knowledge of unresolved problems obtained by discus-

sions with contractors and audit agencies.

A statement of issues related to accounting for insurance and a preliminary draft standard were developed by the staff and circulated to contractors, agencies, and others. Responses to these staff papers and to the FEDERAL REGISTER publications of October 5, 1977, and May 15, 1978, and information obtained in subsequent meetings with respondents and other interested persons were considered in developing the standard which is being promulgated today. Twenty-nine comments were received in response to the most recent FEDERAL REGISTER publication. All comments have been considered by the Board and those addressing areas of significance are discussed below, together with explanations of the changes made in the cost accounting standard being promulgated today from the proposal published in the FEDERAL REGISTER of May 15, 1978.

Ten respondents said that the proposed standard was acceptable as written, or they suggested only minor word changes.

The Board wishes to take this opportunity to express its appreciation for the helpful suggestions and constructive criticisms it has received, and for the time devoted to assisting the Board in this endeavor by the many organizations and individuals involved.

(2) COVERAGE OF STANDARD

One respondent said that the standard should be limited in its application to significant problem areas rather than treating all insurance and insurance-related costs in a general fashion. As stated in the prefatory remarks which accompanied the May 15, 1978, FEDERAL REGISTER publication, in its research, the Board did not find that accounting practices depended upon the type of risk or insurance. Therefore this standard, applicable to the major problems, is also appropriate for all other insurance.

One respondent suggested that the standard deal with the subject of premiums paid to "captive" insurers. The Board reiterates its belief, which it stated in the May 15, 1978, FEDERAL REGISTER publication, that the technique for accounting for premium costs should not be influenced by questions of the reasonableness of the amounts paid. Consequently, no change in this regard has been made in the May 15, 1978, proposal.

(3) SELF-INSURANCE AS A COST

Three respondents suggested that the proposed standard failed to properly distinguish between self-insurance and the absence of insurance. The Board recognizes that there may indeed be differences in the amount of planning involved, but there is no difference in the principle applicable to

cost measurement. "Absence of insurance" is in fact one kind of self-insurance. The respondents said that a contractor who does not purchase insurance or set up a funded reserve to cover possible losses does not incur a cost and that, in such situations, actual losses are a part of entrepreneurial risk taking and should come directly from profit. For the reasons set forth below the Board does not agree.

A contractor who acquires assets is exposed to two types of risks—static risks and dynamic risks. Static risks are the risks which are inherent in the ownership of the assets; dynamic risks result from the decision to utilize the assets for the production of specific goods or services. Static risks are the same for all owners of similar assets in similar circumstances; e.g., the risk that property of a given type in a given location will be destroyed or damaged. Consequently, they are normally predictable by mathematical methods and can be insured against. Dynamic risks are a function of managerial judgment, e.g., whether a proposed product can be produced for a profit. Dynamic risks are not normally predictable or insurable; they generate a profit or loss, depending on management's ability to forecast costs and markets; they are the true entrepreneurial risks. Static risks, because they can be measured, predicted, and quantified, are properly subject to treatment as costs rather than as entrepreneurial risks.

From a cost accounting standpoint, the decision to purchase insurance or self-insure is not one of cost versus no-cost. Rather, it is one of certainty versus uncertainty. A contractor who self-insures will be subject to cost variations in any short time period as compared to one who purchases insurance, but in the long run their costs should be substantially the same and their product or service must be priced to cover the same long-term cost.

Whether a contractor should be required to make deposits in a fund to provide for replacement of assets in the event of loss is not a consideration in determining the costs of self-insurance.

(4) ACCOUNTING FOR SELF-INSURANCE

When the business entity purchases insurance coverage from an underwriter, the cost to the business—for the static risk—is the premium. When the business entity does not purchase insurance, the best method of assignment of cost to current activities is a matter of possible disagreement.

A contractor who self-insures can recognize the cost of self-insurance for product pricing purposes in either of two ways:

(1) By recognizing actual losses as

they occur and allocating them to the products of some time period, usually the cost accounting period in which the loss occurred; or (2) by estimating the long-term average loss per time period and allocating it to the products of each time period. The second method is conceptually preferable in that it allocates the costs of all losses to the products of all time periods without regard to the particular chance distribution of actual losses among time periods.

The proposals which were published in the October 5, 1977, and May 15, 1978, FEDERAL REGISTER included criteria for selecting between the two approaches to recognizing the cost of self-insurance. A charge which would represent the projected average loss was required except in those situations where the actual losses in a cost accounting period could be expected to serve as a good representative of the long-term average loss for that period. The recognition of actual losses, rather than the use of a predetermined charge, would be expected where many units are exposed to loss and the maximum loss related to any one unit would be relatively small. Examples are the losses falling within the deductible portion of the automobile collision coverage for a fleet of vehicles, the deductible portions of property and casualty coverage where the size of the deductible is nominal in relation to the total exposure to risk for that coverage, and the worker's compensation claims of a large work force. There would be little point in calculating a special self-insurance charge in such circumstances.

The Board has decided to retain the requirement for the use of a self-insurance charge, as contained in the FEDERAL REGISTER proposal. A reasonable assignment of cost should be made to products of each period in which there is exposure to the risk. The cost of each loss should be allocated to all work accomplished in the facility where it occurred (and successor facilities over the life of the enterprise, not just to the work of the day, month, or year in which the loss happened to occur. This can be accomplished by charging each period with a self-insurance charge which is equal to the projected average loss.

The standard also retains the provision of the FEDERAL REGISTER proposals which permitted the recognition of actual losses in those limited circumstances, as described above, in which the actual losses in any cost accounting period may be expected not to differ significantly from the projected average loss for that period.

Several respondents were concerned as to the possible consequences if a self-insurance charge were to be made, and, subsequently, actual losses differed substantially from the projected average loss. The self-insurance charge

is, of necessity, and estimate. If the estimate is made in a reasonable and supportable manner, then the fact that actual losses depart significantly in either direction from the projected average loss is not a basis for adjusting the costs of that cost accounting period. However, the standard provides that contractor's actual loss experience shall be reviewed regularly and that self-insurance charges for subsequent periods shall reflect experience, as would premiums for purchased insurance. Similarly, if the situation were one in which it had been determined that actual losses were to be used because they were not expected to differ significantly from the projected average loss, and actual losses did, in fact, differ significantly, the actual losses would be nonetheless the measure of the cost.

(5) LIMITATION ON SELF-INSURANCE CHARGE

The proposals which were published in the FEDERAL REGISTER provided that the self-insurance charge plus insurance administration expenses could be equal to, but could not exceed, the cost of comparable purchased insurance plus the associated administration expenses. Several respondents saw this as a question of allowability. It is, however, not a limit on allowability; it permits the cost of comparable purchased insurance to be used as one means of estimating the projected average loss. The provision is intended to avoid the necessity of employing actuaries to perform computations which other actuaries have already performed for the insurance company in setting the premium. The standard has been modified to express this intention more clearly.

Other respondents were concerned that a company which calculated a self-insurance charge based on, say, a 5-year moving average of its own loss experience would encounter problems if it were to incur a large loss; this would raise its average above the cost of comparable purchased insurance and thereby preclude the recovery of the excess over time. Again, the Board intended the limitation to apply only where the cost of comparable purchased insurance is used as a convenient method of estimating the projected average loss. The standard specifically requires that the contractor's own loss experience be reviewed regularly and that self-insurance charges for future periods reflect such experience in the same manner as would purchased insurance. It should be noted that the cost of future insurance premiums would also be expected to reflect, to some degree, the unfavorable loss experience of the contractor.

Several respondents were concerned that the standard would require them to obtain quotations for insurance pre-

miums for comparison with proposed self-insurance charges, and they questioned the feasibility of obtaining such quotations. The standard only requires such a quotation if the self-insurance charge is to be estimated thereby; it would not be required if, for example, the charge were to be based only on a projection of the contractor's own experience.

(6) TERMINOLOGY

Several respondents suggested that, in the definition of "actual cash value," the phrase "replacement cost less depreciation" could lead to confusion because the type of depreciation intended thereby was not clear. The phrase was intended to imply replacement of the destroyed asset with one in the same physical condition. The definition has been modified to make this intention clearer.

One respondent suggested that the provisions of § 416.50(a)(1)(v) relative to "insurance coverage on retired lives" should be applicable to all types of insurance, rather than being limited to life insurance. The Board intended that this phrase provide for all types of insurance for retired persons. The term "retired lives" has accordingly been replaced by the term "retired persons."

Two respondents asked that the standard define or prescribe criteria for determining when a loss is considered to be "catastrophic" for purposes of home-office reinsurance agreements; they were concerned about after-the-fact disagreement as to whether a particular loss was "catastrophic" and thereby to be allocated in part to the home office, or "noncatastrophic" and to be absorbed entirely by the segment. The Board believes that what constitutes "catastrophic loss" depends on the individual circumstances of each contractor. The determination should be made at the time the internal loss-sharing policy is established and should be revised, as necessary, for changes in future circumstances. Obviously, a catastrophic loss would be one which would be very large in relation to the average loss per occurrence for that exposure, and losses of that magnitude would be expected to occur infrequently.

(7) PREMIUMS AND REFUNDS

The proposed standard provided that a premium refund or dividend would become an adjustment to the pro rata premium cost for the earliest cost accounting period in which the refund or dividend is actually or constructively received. However, the standard permitted the contractor the option of using estimated net premiums instead. One respondent suggested that the standard permit the shifting of adjustments to prior years for purposes of overhead analysis. This

proposed change would not assure consistent measurement of cost; it has therefore not been adopted.

(8) DIRECT CHARGING OF PREMIUMS

Section 416.50(a)(1)(ii) provides that where insurance is purchased specifically for, and directly allocated to, a single final cost objective, the premiums need not be prorated. One respondent was concerned that if the final cost objective included requirements for two or more customers and the insurance premium were not prorated over the policy period, the cost might be charged only to the earliest units of production. They suggested that the provision be qualified by limiting it to only those final cost objectives which include requirements for a single customer. If the need for the insurance were to be occasioned by only one customer's requirements, the cost should be allocated to only that customer's units regardless of the production sequence. If the requirement is common to all customers' units, it should be allocated to all units.

The accounting principle here is the same as the one for specialized materials, which are charged directly to a final cost objective at the time of acquisition. If costs within a final cost objective, either for materials or for purchased insurance, were to be inappropriately related among the customers whose work is accumulated in the same cost objective, the problem would not be one of allocating costs to that cost objective. Rather it would be a problem of the method of analyzing costs within that final cost objective, a subject not being dealt with here.

(9) DEPOSITS AND RESERVES

Insurance agreements frequently provide for substantial amounts to be held by the insurer for various contingencies. Such amounts may be negotiated in advance or may represent the unrefunded excess of premiums over losses; in either event they are not arrived at by actuarial computations of known risks. The contractor typically retains a significant amount of interest in, and control over, such funds. FASB statement No. 5 provides that amounts which do not represent transfers of risk from the insured to the insurer are deposits and should be accounted for as such. The proposed standard required that anything which would be a deposit under that statement be treated as a deposit for contract costing purposes. In addition, the standard required that "reserves" held by the insurer for the account of the contractor would be regarded as deposits unless they met stated criteria.

These special criteria included a prohibition against recapture of the reserve or fund so long as any beneficiary remained alive. Two commentators

urged that this test be modified. The Board intended to assure that the cost had indeed been incurred, but there was no intention to tie up excess reserves for long periods. The provision has been modified accordingly.

One respondent pointed out that group insurance carriers in recent years have required that premium stabilization reserves be established on medium-size experience-rated programs to smooth the experience so it will be similar to a large group. He said that the contractor has no more right to these reserves than the monthly premium he pays on the policy. He therefore suggested that the reserves required by the insurance carrier should not be required to be treated as deposits unless these reserves are treated as deposits for financial statement purposes. The Board does not agree; such reserves are negotiated amounts and the contractor does in fact have some influence over them. Cost measurement is improved if these amounts are treated as deposits until settled.

Some respondents previously pointed out that where a contractor changes from a pay-as-you-go program for retired persons to a pre-funded program, or initially establishes a pre-funded program, a liability arises to those employees who have already retired. The respondent suggested that the standard provide a transition mechanism to deal with the newly recognized liability. Therefore, the standard which was proposed in the May 15, 1978, FEDERAL REGISTER provided and the standard being promulgated today provides that, for a transition from a pay-as-you-go plan to a terminal-funded plan, or on the initial establishment of a terminal funded plan, the actuarial present value of benefits applicable to employees already retired shall be amortized over a period of 15 years.

Two respondents inquired as to the Board's reason for not providing a similar provision for transitions to fully prefunded level-premium or entry-age-normal plans. The actuarial premium computations for such plans implicitly allow for appropriate amortization of the liability for past service; therefore, an explicit provision for this purpose is unnecessary.

Two respondents asked for some liberalization of the 15-year amortization requirement; one suggested that the period be negotiable depending upon the circumstances which occasioned the change, as for example, when a segment is abolished and many employees take immediate retirement. The 15-year period was chosen to be comparable to the amortization period for actuarial gains and losses contained in CAS 413. To permit the amortization period to be negotiated on a case-by-case basis would reduce uniformity. It might also create an incen-

tive to make such changes at times when one of the parties could be expected to benefit. The Board does not accept the suggestion.

(10) RELATIONSHIP TO OTHER STANDARDS

One respondent was concerned about the relationship of this standard to two other cost accounting standards, CAS No. 412, composition and measurement of pension cost, and CAS No. 415, accounting for costs of deferred compensation. The respondent was concerned especially about health insurance carried for retired employees of a contractor; he felt that there might be confusion as to whether such insurance should be considered a form of deferred compensation, a part of a pension plan, or a part of an insurance program.

The Board believes that these standards provide ample criteria for determining which standard is applicable to any given cost. In particular, the question of whether a benefit, such as insurance provided to retired persons, is an integral part of a pension plan and thereby governed by CAS No. 412 or is a part of an insurance program and thereby governed by CAS No. 416 is a question of fact in each given instance. Moreover, application of either standard to this element would result in substantially the same amounts of allocable cost.

(11) AMOUNT OF A LOSS

The proposal which was published in the October 5, 1977, FEDERAL REGISTER provided, in part, that "the amount of an incurred loss shall be measured by the net book value of property destroyed . . ." A number of respondents disagreed with this provision and suggested that the proper measure of the loss was "fair value," "replacement cost," "replacement cost, net of depreciation," and "replacement cost if replaced and net book value if not replaced." After considering these comments, the Board concluded that the measure of the loss should be the economic value of the asset destroyed, and that this value was best described as "actual cash value"; consequently, the May 15, 1978, FEDERAL REGISTER proposal incorporated "actual cash value."

Three respondents have again asked that the standard recognize replacement cost as the measure of the loss, on the grounds that the asset would probably be replaced with a new asset and that the cost of insurance premiums which would provide for replacement cost coverage would be allowable. The Board believes that the measure of the loss is the economic value of the asset destroyed, and this may bear little relationship to the economic value of the asset which is acquired to replace it. In this connection

it should also be noted that CAS No. 409 requires the treatment of a gain on involuntary conversion of an asset as a recovery of past depreciation or, alternatively, treatment as a reduction in the cost basis of the replacement asset. The Board has, accordingly, retained the use of "actual cash value" as one of the major measures of loss.

Contract audit agencies have reported that contractors sometimes charge the maximum potential loss for contract costing purposes but report a lesser amount for published financial statements; therefore, the proposed standard provided that where the amount of the loss is uncertain, the estimate of the loss shall be the amount includible in published financial statements. Three respondents suggested that this requirement be deleted because the amount reported for financial statement purposes might be too conservative. The Board continues to believe that the guidance contained in FASB statement No. 5 and interpretation No. 14 thereto permits an objective measure of the loss. The Board, therefore, retains the requirement.

One respondent was concerned about whether use of the term "incurred loss" in § 416.50(a)(3) was intended to mean something other than an actual loss. The Board did not so intend; the term "incurred loss" has been eliminated.

Two respondents asked the Board to clarify the references to "publish financial statements" contained in the previously proposed standards. One of these respondents pointed out that not all published financial statements are necessarily prepared in accordance with generally accepted accounting principles; the other pointed out that a loss may be required to be reported in a published financial statement under conditions where it is not accruable therein as a liability. In order to clarify its intent, the Board has replaced the phrase "published financial statements," whenever it appeared in the proposed standard, with the phrase "statements prepared in accordance with generally accepted accounting principles" and the standard now refers to the amount which would be "includible as an accrued liability" in such statements.

(12) PRESENT VALUE OF FUTURE LOSSES

One respondent objected to the requirement for discounting amounts of losses to be paid in the future at a rate different from that contained in existing procurement regulations. As it stated in the prefatory remarks which accompanied the May 15, 1978, FEDERAL REGISTER publication, the Board believes that the additional computational effort involved in using a rate for contract costing different from that required by the various States is not warranted. Where no rate is pre-

scribed by a State, the use of the rate determined by the Secretary of the Treasury pursuant to Pub. L. 92-41, 85 Stat. 97, as required by the standard, is consistent with the Board's requirement in CAS 415 to use that rate in discounting deferred compensation awards.

(13) ALLOCATION OF INSURANCE COSTS FROM A HOME OFFICE TO SEGMENTS

The October 5, 1977, proposal contained criteria for the allocation of insurance costs from a home office to segments. Various respondents questioned the need for such additional guidance on the grounds that the provisions of CAS 403 are adequate for this purpose. The Board concurred in this belief and omitted the related provisions from the May 15, 1978, proposal. Two respondents to that proposal suggested that the provisions of CAS 403 are too general and further guidance is needed to insure that such allocations will reflect significant differences in segment loss experience.

CAS 403 requires that home office expenses shall be allocated on the basis of the beneficial or casual relationship between supporting and receiving activities. Specifically, with respect to central payments or accruals made by a home office on behalf of its segments, CAS 403 requires that these shall be allocated directly to segments to the extent that they can be identified. CAS 403 provides further that payments or accruals which cannot be identified with individual segments are to be allocated by means of an allocation base representative of the factors on which the total payment is based. If there are significant differences in segment loss experience, then these differences would be identifiable and would be required by CAS 403 to be reflected in the allocation of the related home office premium cost or refund. The Board therefore continues to believe that additional guidance for such allocations in this standard is not necessary.

(14) MATERIALITY OF LOSSES AND INSURANCE ADMINISTRATION EXPENSES

The standard permits a contractor to recognize immaterial amounts of self-insured losses and insurance administration expenses as part of other expense categories rather than as "insurance expense." Two respondents were concerned that what is a "material" cost will be the subject of controversy.

The Board recognizes that some contractors may elect to purchase all of their insurance services from an insurance company or outside agencies; such services as claims processing or payment, risk analysis, loss prevention activities, etc. may be billed separately or included in the premium. Other contractors may elect to provide some

or all of these services themselves. The standard recognizes this diversity of practice by stating, in § 416.40, that the amount of the insurance cost is the sum of the projected average loss plus the insurance administration expenses.

Where a contractor purchases substantially all of its insurance services and the cost is included in the premium, the allocation of the costs of such services automatically follows the allocation of the premium. In such situations, if immaterial amounts of in-house costs, such as portions of various individuals' salaries or allocable space costs, are not explicitly recognized as insurance administration expenses, the accuracy of cost allocation is not significantly impaired. On the other hand, if a contractor establishes a claim processing department to process group insurance claims for a large work force, and the costs of such a group are material, then the Board believes that uniformity will be better served by requiring that such costs be allocated in the same manner as the costs of the related insurance. The Board believes that its previous pronouncements on the subject of materiality will provide sufficient guidance.

(15) RENEGOTIATION

One respondent was concerned that contractors will have difficulty in following the standard while reporting to the Renegotiation Board, which is bound by law to allow items in accordance with chapter 1 of the Internal Revenue Code. This concern applies both to the election to account for refunds, dividends, and additional assessments on the basis of estimated net premiums, authorized in § 416.50(a)(1)(vi), and the use of a self-insurance charge in lieu of the recognition of actual losses. In both instances the standard could result in the recognition, as contract cost, of amounts which would not be recognized for tax purposes.

Other cost accounting standards have required the selection of specific cost measurement techniques from among the many which might have been available under the Internal Revenue Code. The respondent suggested that the proposal on insurance is different in that it can result in the use of a method of contract cost accounting which is not permitted for tax accounting purposes.

The Board recognizes that the Renegotiation Board is indeed bound by law to recognize those elements of cost which are identified in the Internal Revenue Code. Measurement of the amounts of such costs to be recognized in any particular period, however, should be done in accordance with the best available accounting techniques. Where this standard recognizes a self-insurance charge in lieu of actual

losses, the Renegotiation Board will also obtain a better measure of contractual profits by following the standard than by following the tax measurement. The Renegotiation Board, as a relevant Federal agency, can arrange for the application of this standard as it has for various others which have required reconciliations between tax reporting and contract costing. No exemption is, therefore, being made for renegotiation.

(16) RECORDS

A contractor who elects to make a self-insurance charge should be expected to provide sufficient documentation to support the amount of the charge. In addition, the standard requires that the contractor's own loss experience be evaluated regularly. Finally, the standard requires the identification of losses to the segment in which they occur. While the cost of losses is already reflected in the contractor's formal accounting records, the data on loss frequency, amount, and location which may be necessary to comply with the proposed standard may not be a normal part of such accounting records. The "records" provision of the standard recognizes both the need for such data and the probable memorandum nature of the records. The requirement to maintain such records was contained in the October 5, 1977, proposal but was inadvertently omitted from the May 15, 1978, FEDERAL REGISTER proposal. It has been reinstated in the standard now being promulgated.

(17) ILLUSTRATIONS

One respondent suggested that the dollar amounts used in illustrations were unrealistic and would serve as guidelines for unrealistic rulings in practice. As the Board has stated on previous occasions, the use of dollar amounts in illustrations is intended to improve the understandability of the illustration. Such dollar amounts are not intended to establish criteria for use in actual situations.

(18) COSTS AND BENEFITS

The Board's objective, with respect to uniformity, is to achieve comparability among entities operating under like circumstances. As applied to the measurement of insurance costs, there should be similar reported costs where there are similar exposures to risk. The Board has recognized the need to provide guidance on the determination of contract charges under self-insurance programs, especially under circumstances where the likelihood is that actual losses in a given period will differ materially from the long-term projected average. This standard will provide for increased uniformity in this field.

Consistency pertains to the use, by any one entity, of cost accounting practices which permit comparability of contract results under similar cir-

cumstances over periods of time. The decision whether to purchase insurance or to self insure is comparable to a make or buy decision. A change in the method of providing for the risks (which risks continue unchanged) is not a change in circumstances of the sort which should destroy comparability over time. This standard provides the basis for consistency in measuring insurance costs even when there are shifts between purchased insurance and self-insurance.

Only three respondents suggested that the implementation costs of the standard would be excessive or would exceed the benefits. One of these foresaw increased administrative costs but did not offer any specifics. The concerns of the others appeared to lie primarily in two areas—the lack of a definition of "materiality" in relation to insurance costs and the lack of specific procedural guidance in estimating a self-insurance charge. They therefore anticipated increased disagreements. The board has provided remarks about materiality in various public pronouncements. The Board believes that these comments are sufficient and that the concerns in this regard are unwarranted.

A self-insurance charge is an estimate, and the Board has consistently refrained from dictating detailed estimating procedures. A contractor must, of necessity, estimate many costs, and the degree of sophistication and complexity of the estimating process is a matter for discussion between the contractor and procurement and audit personnel.

The standard provides for several methods of recognizing the costs of self-insurance. First, the contractor may recognize actual losses in those situations in which the distribution of actual losses may be expected to not differ significantly from the projected average loss. This is a matter which should be readily determinable from the nature of the exposure to risk; this will normally be expected where there are many units exposed to loss and the potential loss per unit is low in relation to the total exposure, as, for example, with worker's compensation, group insurance, and deductible portion of property and casualty insurance which is nominal in relation to the total exposure. In most such cases, contractors already charge actual losses, so no change will be necessary. Second, the contractor may use the premium cost of purchased insurance for comparable coverage as the basis for the self-insurance charge. This method would be appropriate when, for example, the contractor proposed to substantially increase a deductible provision for property and casualty insurance; he might propose to make a self-insurance charge equal to the premium reduction for the decreased coverage. Only in the event that either of

these two methods is appropriate would the contractor have to resort to the third method, that of actuarial review of his own or industry experience to develop a self-insurance charge. Under these circumstances, the board believes that the majority of contractors will already be in compliance with the proposed standard and the costs of compliance for the remainder should not be significant. Therefore, the standard should have no significant inflationary impact.

Four respondents suggested that, if the majority of contractors would not have to change in order to comply with the standard, then the problems were not sufficient to justify the standard. The Board recognizes that, although the insurance problems resolved by this standard are likely to be encountered only by a minority of contractors, when they are encountered they are of substantial importance and their resolution in a uniform and consistent manner will be beneficial in contract costing.

In summary, the Board finds that this standard will increase the uniformity and consistency of measurement of the cost of insurance related to negotiated defense contracts. The standard will eliminate, or materially reduce, the problems listed in the Board's prefatory remarks with the May 15, 1978 publication. The Board finds that the costs of implementation will be slight and that there will be no inflationary impact.

There is also being published today an amendment to Part 400, definitions, to incorporate in that part terms defined in § 416.30(a) of this cost accounting standard.

PREAMBLES TO COST ACCOUNTING STANDARD 417, COST OF MONEY AS AN ELEMENT OF THE COST OF CAPITAL ASSETS UNDER CONSTRUCTION

PREAMBLE A

Preamble to Original Publication, 7-21-80

The following is the preamble to the original publication of Part 417, 45 FR 48574, July 21, 1980.

SUMMARY

The Cost Accounting Standards Board is Promulgating Cost Accounting Standard No. 417, one of the series of Standards being issued pursuant to section 719 of the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. App. 2168).

This Standard provides for the determination of an imputed cost of money to be included in the capitalized cost of acquisition of assets developed, fabricated or constructed for a contractor's own use. Application of this Standard will provide increased uniformity in accounting for the acquisition costs of assets.

EFFECTIVE DATE

December 15, 1980.

SUPPLEMENTARY INFORMATION

(1) BACKGROUND

Cost Accounting Standard (CAS) 417 being promulgated today is based on the same concept as CAS 414, which provides criteria for the measurement and allocation of the cost of money as a part of the cost of tangible and intangible capital assets. CAS 417 provides guidance for the measurement of the cost of money as an element of the cost of capital assets under construction. A proposed Standard on this topic, designated CAS 421, was published in the FEDERAL REGISTER on January 4, 1980. The Board received 36 letters of comment on that proposal and takes this opportunity to express its appreciation for the many helpful suggestions and constructive criticisms that were received.

(2) NEED FOR A STANDARD

Most commentators favored the January 1980 proposal. Those who opposed it did so on the basis that they did not favor Standard No. 414 and do not favor any extension of the principle of that Standard. The Board, in promulgating CAS 414, provided for an important element of contract cost, that of the cost of money related to investment in facilities used in contract performance. Contractor investments committed to facilities not yet in service involve a similar economic cost. The Board believes that this Standard is an appropriate extension of the concept.

(3) PROPOSALS TO AMEND CAS 414

A number of contractors suggested that instead of capitalizing cost of money, it should be treated as a current cost and therefore an amendment should be made to CAS 414 to recognize this cost on current contracts. The Board believes that capitalization of cost of money, in contrast to the immediate recognition of cost of money as a contract cost, will place such costs on the same basis as other construction costs and thus provide for the total cost of new assets to be charged to output of the periods when they are used in the production of goods and services.

(4) CAPITALIZATION OF PAID INTEREST

The proposed Standard No. 421 provided an option to capitalize either cost of money computed in accordance with the provisions of the Standard or the amount capitalized for financial accounting and reporting purposes pursuant to FAS No. 34. This option was offered in order to simplify the record-keeping procedures as it would have enabled the contractor to avoid a duplicate set of records—one for financial accounting and the other for Gov-

ernment contract costing purposes.

A number of Government agencies disagreed with this approach. It was pointed out that no true compatibility exists between FAS No. 34 and the proposed CAS 421 since the former specifically prohibits recognition of any type of imputed interest cost for capitalization purposes. It was also stated that the option to elect between the two methods of capitalization in the proposed CAS 421 would lead to inconsistent capitalization practices among contractors. Furthermore, it was pointed out that paid interest is an unallowable cost under pertinent procurement regulations. One major agency pointed out that if the Standard were to allow the choice as proposed, any contractor making the election to capitalize interest actually paid " * * * will have such costs disallowed when included in depreciation subsequently claimed as a cost under Government contracts." Such disallowance would effectively nullify the option.

In view of these comments by Government procurement agencies the Board has concluded that it would be futile at this time to proceed with the unrestricted option that permits capitalization of the amount capitalized for financial accounting and reporting purposes. The Standard, as promulgated, permits only capitalization of cost of money computed in accordance with the provisions of this Standard, or the amount used for financial reporting where it is not a materially different amount.

(5) ONE-YEAR LIMITATION

The proposed Standard required that in order to capitalize cost of money the construction or fabrication effort must be sustained at least for one year. This provision was based on the belief that administrative costs would typically be higher than the benefits to be expected from capitalization of cost of money for minor projects. Numerous commentators pointed out that irrespective of any administrative costs the cost of money could be quite material on a project lasting less than a year. The Board agrees with this view and has eliminated the restriction on the length of the construction period. The Board expects that contractors will apply the Standard where the benefits to be derived from improved cost measurement and allocation can be expected to outweigh the costs of implementation.

(6) COMPUTATION OF THE "REPRESENTATIVE INVESTMENT AMOUNT"

Some commentators questioned whether there are any constraints imposed on the methods that may be used for determining the "representative investment amount." The Standard specifies in §417.50(a)(ii) [previ-

ously designated as §421.50(e)] only that the method selected should give appropriate consideration to the "rate at which costs of construction are incurred."

The wording in illustrations §417.60 (a) and (b) has been changed to demonstrate more clearly when the use of beginning and ending balances of a cost accounting period is appropriate. If major fluctuations are expected in the rate of cost incurrence, averaging of balances for shorter time periods, such as months, is appropriate.

(7) APPLICABILITY

The proposed Standard was to be applied only to those assets on which construction began after the Standard became applicable. Several commentators pointed out the desirability of immediate application with respect to all assets under construction.

The wording in §417.80 has been changed to extend the coverage to all the assets under construction at the time when the Standard is first applied by the contractor.

(8) COSTS AND BENEFITS

The Board recognizes that there are economic costs related to a contractor's investment in the construction period for assets subject to this Standard. The cost, even though imputed, is real and is relevant for the contract costing. It has heretofore not been a part of contract costing. This Standard provides for its measurement and therefore will improve the quality of cost ascertainment on contracts where the assets are used.

Limitation on the option to use, for contract costing, the amounts capitalized under FAS 34 may impose certain administrative costs for some contractors. The Board is persuaded that these costs, in general, will not be significant, and they are surely outweighed by the benefit of more consistent contract cost measurement which will be derived from the operation of this Standard.

Title 4 CFR Chapter III is amended by adding a new Part 417 to read as follows:

PREAMBLES TO COST ACCOUNTING STANDARD 418, ALLOCATION OF DIRECT AND INDIRECT COSTS

PREAMBLE A

Preamble to Original Publication, 5-15-80

The following is the preamble to the original publication of Part 418, 45 FR 31932, May 15, 1980.

SUMMARY

The Cost Accounting Standards Board is promulgating today Cost Accounting Standard (CAS) 418, Allocation of Direct and Indirect Costs. It is one of a series of Standards the Board is issuing pursuant to Section 719 of

the Defense Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. App. 2168).

CAS 418 requires that costs be consistently classified as direct or indirect, establishes criteria for accumulating indirect costs in indirect cost pools, and sets forth guidance on allocating indirect cost pools. These topics are central to the Board's mission to issue Standards to achieve uniformity and consistency in the cost accounting practices followed by defense contractors in estimating, accumulating and reporting costs of defense contracts.

EFFECTIVE DATE

September 20, 1980.

SUPPLEMENTARY INFORMATION:

(1) BACKGROUND

The present Standard stems from two proposals, published in the *FEDERAL REGISTER* on March 16, 1978 and July 23, 1979.

The March 16, 1978 publication consisted of five proposed Standards:

- CAS 417—Distinguishing Between Direct and Indirect Costs.
- CAS 418—Allocation of Service Center Costs.
- CAS 419—Allocation of Material-Related Overhead Costs.
- CAS 420—Allocation of Manufacturing, Engineering and Comparable Overhead Costs.
- CAS 421—Allocation of Indirect Costs.

The Board received letters from 86 commentators on the March 16, 1978 publication. As a result of the comments and additional research performed at 10 contractor locations, the number of proposed Standards was reduced to three in the July 23, 1979 publication:

- CAS 417—Distinguishing Between Direct and Indirect Costs. (Continued as a separate Standard.)
- CAS 418—Allocation of Indirect Cost Pools. (Consolidated original CAS 418 and original CAS 421.)
- CAS 419—Allocation of Overhead Costs of Productive Functions and Productive Activities. (Consolidated original CAS 419 and original CAS 420.)

The Board received comments from 59 interested parties in response to the July 23, 1979 publication. In addition, representatives of three industry associations supplemented their views orally. After consideration of all views, the Board has determined that it is appropriate to reduce the degree of specificity contained in the July 23, 1979 publication. As a consequence, the Board has been able to consolidate the three proposed Standards into the one Standard being promulgated today.

The Board wishes to take this opportunity to express its appreciation for

the helpful suggestions and constructive criticisms it has received and for the time devoted to assisting the Board in this endeavor by the many organizations and individuals involved.

The following sections of these prefatory comments present the Board's views on the major issues raised by the commentators in response to the July 23, 1979 publication, and explains how these views are expressed in the current Standard.

(2) POTENTIAL IMPACT ON CONTRACTOR ACCOUNTING SYSTEMS

Based on staff research and the comments received on prior proposals, the Board recognizes that this Standard may have a pervasive impact on contractor accounting systems. Because of this, the Board here and in the Standard is emphasizing the necessity to evaluate any perceived need for change in cost accounting practices in terms of materiality. The need to evaluate the materiality of a change in cost accounting practice applies to all provisions of the Standard. It is not limited to those particular provisions of the Standard in which materiality is mentioned for emphasis.

In resolving questions of materiality, the Board refers the parties to the criteria found in 4 CFR 331.71. These criteria take into consideration a variety of factors including the absolute dollar amount of costs involved, whether the costs are direct or indirect, the relationship of the costs to a particular contract, and the impact on Government funding. The Board is persuaded by the comments received on prior proposals that the use of these criteria will lead to an appropriate implementation of this Standard.

Some commentators urged the Board to define materiality in terms of the net effect on the cost of the totality of Government contracts in relation to the costs of implementing any accounting change pursuant to the Standard. The Board's materiality criteria recognize the need to consider the impact of cost accounting changes on the costs of individual contracts. To reduce the probable impact on the number of pools or changes in allocation bases required under the Standard however, the Board urges the parties to give special consideration to the net effect without ignoring any of the criteria specified in § 331.71(a). The Board notes that a change which has the same directional impact on most Government contracts will be more material than one in which the directional impacts on the costs of various Government contracts are mixed.

Commentators were particularly concerned that the proposed Standards would require them to establish separate indirect cost pools or the change their allocation bases even where the allocation results would be substantially the same. The Board in-

tends that the creation of additional indirect cost pools or change of allocation base will be required only if the changes will result in materially different allocations of cost.

In those circumstances in which a change in cost accounting practice is not required because of the present immateriality of impact, the Board notes that the impact may become material if circumstances should change. In this case acceptance of the existing system based on the immateriality of the impact would no longer pertain and the other criteria in the Standard would be applied to determine the appropriate accounting in the changed circumstances.

(3) DEFINITION OF DIRECT COST

The Standard being promulgated today includes the Board's definition of direct cost (§ 418.30(a)(2)). The Board originally issued the definition in 1972 as part of CAS 402, Consistency in Allocating Costs Incurred for the Same Purpose. Direct cost is defined as "any cost which is specifically identified with a particular final cost objective."

Commentators have criticized the definition on conceptual grounds and on the basis that it is contrary to common understanding of the term. They contend that a proper approach would recognize that all cost objectives have direct costs. Despite these criticisms, they indicate that no practical problems have resulted from the present definition.

The definition in CAS 402 was needed because of the type of consistency the Board requires in that Standard; that is, consistency in the allocation of direct and indirect costs with respect to final cost objectives. To broaden the definition of direct cost to say that all cost objectives have direct costs, would require a substantial change in CAS 402 in order to continue to achieve the purposes of that Standard.

Furthermore, the existing definition of direct cost facilitates description of allocation bases for the purposes of the Standard being promulgated today, as well as for other Standards. A change in the definition of direct costs as recommended by the commentators would necessitate a series of new definitions or lengthy descriptions of the types of direct cost which may be used for making up bases for allocating various indirect cost pools.

The Board believes that the present definition of direct cost serves useful purposes and has not created any problems. The Board, therefore, has decided to retain the present definition.

(4) NEED FOR WRITTEN POLICIES

The purpose of proposed Standard 417 was to distinguish between direct and indirect costs. Criteria were estab-

lished for direct costs. Generally, costs not meeting those criteria were to be classified as indirect.

Many commentators objected to the proposed Standard. They claimed that the criteria were too restrictive and would have required the reclassification from direct to indirect of many costs that have a close relationship to final cost objectives.

The Board has considered the statements made by the commentators and has studied other information it has developed. The Board has concluded that more flexibility should be allowed concerning the classification of costs as direct than was permitted by proposed CAS 417. That proposed Standard has been eliminated, and a requirement has been added to CAS 418 (§§ 418.40(a) and 418.50(a)(1)) for a written statement, in which each contractor must set forth his policies and practices for classifying costs as direct or indirect. The degree of detail that the statement should contain is a matter for decision by the contracting parties.

(5) AVERAGE AND PRE-ESTABLISHED DIRECT LABOR RATES

Proposed CAS 417 provided in § 417.50(b) that: "The amount of cost to be allocated as a direct cost to final cost objectives may be determined on the basis of an average cost of the resources used or applied whenever the resources are interchangeable." Several commentators believe that the requirement that resources be "interchangeable" before their costs could be averaged was too strict. They said that "interchangeable" would be interpreted to mean "identical." The principal concern was with average and pre-established direct labor rates. The commentators said that few labor resources are identical or even "productively interchangeable," and that consequently the interchangeability criterion would cause the creation of many more labor rates.

The Board believes there is no conceptual difference between average and pre-established direct labor rates and labor-rate standards, which are governed by CAS 407. Use of Standard Costs for Direct Material and Direct Labor. Retention of interchangeability as the sole criterion for average and pre-established direct labor rates would impose stricter criteria for those rates than CAS 407 imposes for labor-rate standards. Accordingly, the Board decided to apply the same criteria to average and pre-established direct labor rates that are used in CAS 407 for labor-rate standards. The Standard now permits (§ 418.50(a)(2)(B)) two kinds of groupings in addition to those based on the principle of interchangeability. Average or pre-established direct labor rates may be set for a group of employees who (i) are interchangeable

with respect to functions performed, (ii) produce homogeneous output, or (iii) form an integral team. The Board believes that these changes will avoid the problems foreseen by the commentators, and will be consistent with CAS 407.

(6) BLANKET COSTS

Blanket costs are labor or material costs accumulated in intermediate cost objectives and reallocated to final cost objectives as direct costs. Many commentators objected to § 417.50(c) of the proposed CAS 417, which would have permitted such costs to be classified as direct only if they were allocated from an intermediate cost objective by a measure of resource consumption or a measure of output. Commentators said that this was too restrictive. They claimed that, since most bases used to distribute blanket costs are surrogates for rather than direct measures of resource consumption, proposed CAS 417 would have required most blanket costs to be classified as indirect costs.

The Board has considered the statements made by the commentators and has removed the requirement that blanket costs in order to be classified as direct costs be allocated on the basis of direct measures of consumption or output.

(7) 5 PERCENT MATERIALITY TEST

A number of commentators expressed concern that the requirements of the proposed CAS 418 and 419 would lead to unnecessary proliferation of indirect cost pools. The proposed Standards would have required that a separate pool be created only where a material difference in cost allocation would result. The Board had proposed a 5 percent materiality test for this purpose. This provision drew a large number of responses. Most commentators expressed serious reservations about the practicality of such a test.

The 5 percent materiality test was included in the proposed CAS 419 for the express purpose of alleviating the concern expressed by many commentators about unnecessary proliferation of overhead pools. Many of the same commentators suggested that rather than specifying an arbitrary percentage, the Standard should rely on the materiality provision already included in the Board's rules and regulations. The Standard being promulgated today refers to § 331.71 which sets forth the materiality criteria for use in the application of all Standards.

(8) HOMOGENEOUS INDIRECT COST POOLS

Some commentators stated that the requirement of the proposed § 418.50(a)(1) for a homogeneous indirect cost pool could result in unnecessary proliferation of indirect cost pools. A number of commentators also characterized the requirements of the

proposed § 418.50(a)(2) as being redundant or in conflict with the requirements of the proposed § 418.50(a)(1). The Board has revised the proposed § 418.50(a)(2) to parallel the language in proposed § 418.50(a)(1) to preclude any conflict between the two paragraphs. The Board continues to believe that the requirement for homogeneous pools based on the concept of beneficial or causal relationship is essential. The Board has emphasized in the revised § 418.50(b)(2) that a pool also is deemed to be homogeneous if the separate allocation of the costs of the dissimilar activities would not result in material differences. The Board has provided reference to its guidance on materiality contained in § 331.71.

Some commentators stated that the proposed § 418.50(a)(3), which dealt with dissimilar use of resources, was too detailed a prescription and as such would lead to unnecessary proliferation of indirect cost pools. The Board was persuaded that the coverage of this level of detail is not necessary in the single revised Standard and accordingly has removed this requirement.

(9) HIERARCHY OF ALLOCATION BASES

The proposed CAS 418 provided, in § 418.50(b), a list of alternative allocation measures. The proposal would have required the use of the "best available" representation of resource consumption. Commentators questioned the need for an expressed preference and suggested a free choice among the allocation bases listed.

The Board believes that the establishment of the hierarchy is essential to assure that the basic concept of cost allocations as expressed by the Board in its statements of policy and in other Standards promulgated to date is achieved. The Board, however, made revisions to the Standard to lessen the concerns expressed by commentators. First, instead of the "best available representation of resource consumption," the Board has substituted therefor, in § 418.50(e), the phrase "an appropriate measure of resource consumption." The Board also provided that the determination of which allocation measures to be used must be made on the basis of the individual circumstances, including the availability and quality of the data on which the potential measures are based.

(10) USE OF AN ALLOCATION BASE REPRESENTATIVE OF THE ACTIVITY BEING MANAGED OR SUPERVISED

A number of commentators questioned when the fourth step of the hierarchy in the proposed CAS 418, a base representative of the activity being managed or supervised, was to be used. The Standard has been revised to provide more clearly that this type of base is to be used only to allo-

cate indirect cost pools containing significant amounts of the costs of management or supervision of activities involving direct labor or direct material cost, which are direct costs as defined by the Board. Therefore these cost pools are those which include the costs of managing and supervising final cost objectives or other cost objectives which are accounted for in a similar manner (those listed in § 418.50(d)(3)). A base representative of the activity being managed or supervised is not suitable for the allocation of the costs of management or supervision of activities involving only indirect costs.

For emphasis, the fourth step of the hierarchy has been set forth in a paragraph, § 418.50(d), separate and apart from the first three steps of the hierarchy (§ 418.50(e)) which should be used for allocating other indirect cost pools such as service centers.

(11) CROSS-ALLOCATION AMONG INDIRECT COST POOLS

The March 16, 1978 publication provided that only a cross-allocation or a sequential method could be used. In response to that proposal, commentators suggested that any method that would give the appropriate result be permitted.

The proposed CAS 418 in the July 23, 1979 publication provided for the use of any allocation method which would not result in significantly different allocation from that which would be obtained through using cross-allocation. A number of commentators stated that this provision was too complicated and costly. The Board continues to believe that the Standard should require the use of methods which would provide a reasonable representation of the beneficial or causal relationship existing among indirect cost pools. The Board was persuaded to broaden the test so that this relationship can be achieved by the use of any method that would approximate either the cross-allocation or the sequential method. Accordingly, revisions were made to § 418.50(e)(4) to permit such alternative methods.

(12) CASUAL SALES

A number of commentators suggested that the proposed CAS 418 should specifically allow casual sales of services to be costed at other than full cost. Contractor definition and classification of sales as casual sales varies considerably among contractors. The Board has found no clear and consistent criteria for distinguishing these sales activities other than on the basis of materiality. The Board is of the opinion that for sales to be characterized as casual, they must be an immaterial part of the total activities of a cost pool. The Board expresses again its position that it will not deal with insignificant items of cost. Under the

circumstances, the contracting parties can determine the acceptability of the costing methods to be used. Where sales represent a material part of the total activities of a cost pool, they cannot be deemed to be casual.

(13) DEFINITION OF PRODUCTIVE ACTIVITY

In the proposed CAS 419, the term "productive activity" was important to the determination of the number of pools which would be required for the allocation of overhead costs. Commentators expressed concern that the proposal would result in unnecessary proliferation of overhead pools because of the definition which was provided. The Standard has been revised to provide for the determination of the number of pools based on the concept of homogeneity.

(14) ACCOUNTING FOR THE COSTS OF SPECIAL FACILITIES

The Standard being promulgated today does not provide guidance for accounting for the costs of special facilities (e.g., space chambers, wind tunnels, reactors) accumulated in separate indirect cost pools. These assets usually do not have application to all of the work of a business unit, and this circumstance creates difficult questions concerning the appropriate cost allocation techniques to be applied. The Board recognizes a need for particular attention to the accounting for the limited number of special facilities involved and has established a project in this area to review the cost allocation issues.

(15) DEGREE OF SPECIFICITY IN PROPOSED CAS 419

As discussed previously, a large number of commentators expressed concern that the definition of "productive activity" and the 5 percent materiality test which were included in the proposed CAS 419 could result in unnecessary proliferation of overhead pools. A large number of commentators were also critical of the proposed CAS 419 because in their opinion it provided too great a degree of specificity. The requirements relative to separate overhead pools, the specific reference to the treatment of costs of special facilities, and the treatment of purchased labor and overtime premiums and shift differentials in allocation bases were considered by many commentators to be too procedural and detailed.

The Board was of the opinion that some degree of specificity would be desirable and necessary in this area to minimize differing interpretations by the contracting parties. In light of the number of criticisms on the specificity of the proposed CAS 419, however, the Board decided to remove the references to those terms and provisions. The elimination of these terms and provisions does not reflect a change in position concerning the appropriate

accounting for the costs involved. Rather, in consolidating the proposed 417, 418 and 419 into a single CAS 418 being promulgated today, the Board is providing a more general Standard incorporating the basic concepts of cost allocation previously established in the Board's *Restatement of Objectives, Policies and Concepts*.

(16) EVALUATION OF BENEFITS AND COSTS

Many commentators asserted that the costs of implementing the proposed Standards would outweigh the benefits that would be derived from them. They were concerned that the Standards would require significant accounting changes because of the perceived detailed prescriptions in the Standard and for the potential implementation of changes in cost accounting practices where no material cost impact would result. The Board believes the Standard being promulgated today will significantly reduce the anticipated costs of implementation as compared with the prior proposals. This has been accomplished by reducing the degree of specificity and by emphasizing the importance of materiality in determining when changes in cost accounting practices are required. These revisions should minimize the potential for excessive proliferation of cost pools. The Board notes that this Standard is applicable to a significant percentage of the total costs of negotiated defense contracts. The provisions of this Standard will provide greater assurance of uniformity and consistency in accounting for these costs than was previously available. The Board believes that the benefits of the increased uniformity and consistency in cost allocation which will result from the Standard outweigh the costs of implementation.

Title 4 CFR Chapter III is amended by adding a new Part 418 to read as follows:

PREAMBLES TO COST ACCOUNTING STANDARD 420, ACCOUNTING FOR INDEPENDENT RESEARCH AND DEVELOPMENT COSTS AND BID AND PROPOSAL COSTS

PREAMBLE A

Preamble to Original Publication, 9-25-79

The following is the preamble to the original publication of Part 420, 44 FR 55127, Sept. 25, 1979.

(1) BACKGROUND

Work on the development of this Standard was initiated based on the General Accounting Office Report on the *Feasibility of Applying Uniform Cost Accounting Standards to Negotiated Defense Contracts*. The report referenced problem areas concerned with (1) the allocation of incurred costs to IR&D and B&P projects, (2) the allocation of such costs to cost objectives, and (3) the definition of

IR&D and B&P work tasks. Over the years, Congress has continued to express its concern about the large amount of money reimbursed to defense contractors in the area of IR&D and BP. In 1978, the last reported year, the 90 companies large enough to have advance IR&D and B&P agreements with the Government, were reimbursed by the Government about \$1.2 billion for this effort.

Early research conducted by the Board was directed towards obtaining information on the views, policies, definitions, accounting practices and administrative procedures followed in the management of IR&D and B&P activities by the defense industry, commercial companies, and Government agencies. This research was accomplished by means of questionnaires sent to 65 defense contractors and 10 commercial companies; reviews of General Accounting Office reports, congressional hearings, Armed Services Board of Contract Appeals cases, various technical papers; and discussion with several Government agencies. Also included in the research were evaluations of recommendations made by a study group of the Commission on Government Procurement covering IR&D costs and a Statement concerning the *Accounting for Research and Development Costs* (FAS No. 2) issued by the Financial Accounting Standards Board.

A research draft was distributed on April 29, 1977, to obtain comments. Comments were received from 73 respondents. The Board after considering the comments published a proposed Standard for comment in the *FEDERAL REGISTER* on July 28, 1978. Sixty-three commentators responded to this publication. Because significant revisions appeared appropriate after evaluation of the comments, the Board decided to publish the proposed Standard for comments a second time in the *FEDERAL REGISTER* on May 25, 1979. 46 responses were received from individual companies, Government agencies, professional associations, public accounting firms, industry associations and others. The Board takes this opportunity to express its appreciation for the helpful suggestions and criticisms which have been furnished. The comments furnished by organizations and individuals have resulted in a number of changes in the Standard. The comments below summarize the issues discussed in connection with both proposed Standards and explains major changes which have been made to the earlier proposals. This Standard was previously published as CAS 422. It has been renumbered to CAS 420 to accommodate changes in the work plans of the Board.

(2) NEED FOR A STANDARD

Many commentators questioned the

need for a separate Standard for IR&D and B&P. Almost all of those who raised this issue cited the other allocation Standards, 403 and 410 and proposed indirect cost Standards 417, 418 and 419 and stated that the allocation practices set forth in those Standards adequately cover the allocation of IR&D and B&P costs.

Appendix III of the General Accounting Office Cost Accounting Standards feasibility study is entitled "Problem Areas in the Assignment of Government Contract Costs." It contained a tabulation of problem areas. The subject of "IR&D/B&P/Economic Planning" represented the highest number of reported problems of the 23 subjects on the list. On that list also were the subjects of "allocation", "direct vs. indirect", depreciation, etc. An analysis of disclosure statements in the Cost Accounting Standards Board's data bank showed a considerable divergence in accounting practices followed by Government contractors. For example, the disclosure statements revealed that contractors allocated IR&D and B&P cost pools to final cost objectives by means of such allocation bases as sales, cost of sales, cost input, modified cost input, modified cost of sales, direct labor dollars, manhours, and headcount. Staff research which involved visits with over 50 defense contractors and several Government agencies confirmed this divergence of practice. DOD and NASA have similar procurement regulations covering the accounting for these costs, but other agency regulations vary substantially and, as a result, a variety of accounting practices are in use for IR&D and B&P costs.

This Standard will provide for increased uniformity and consistency of allocation among segments based on the beneficial or casual relationship between the IR&D and B&P costs and segments of a company. The Standard will also provide for increased uniformity in the composition of these costs within contractor's segments, especially in the segments identified as central research laboratories.

The Board recognizes that the already promulgated allocation Standards 403 and 410, and the proposed indirect cost Standards 417, 418 and 419 have general requirements which will be consistent with the requirements of this Standard. Standards 403 and 410, however, would each have to be amended to include the specific accounting provisions of this Standard. IR&D and B&P costs are an important element of the contractor's total costs allocated to its final cost objectives. The Board believes that the accounting practices for these costs should be centralized in a single Standard in order to clearly provide the proper guidance for their alloca-

tion to cost objectives. Neither the contractor nor the Government should have to search out the accounting requirements in various Standards in order to obtain this guidance. By providing this guidance in a single source the Board believes that the administrative and accounting complexities for these costs will be reduced for both the contractor and the Government.

(3) DEFINITIONS

Several commentators continue to raise questions regarding the definitions. The comments generally requested definitions to clarify the accounting for "B&P administrative costs" and "technical" effort associated with IR&D costs. The words requested to be included in the Definition of Bid and Proposal Costs are: "B&P administrative costs, when not separately identified and classified as B&P costs in accordance with the contractor's normal accounting practice, are not considered B&P costs for the purpose of this Standard." Commentators also suggested that the word "technical" be included in the definition of IR&D effort so as to determine the nature of the costs allocable to IR&D effort. The commentators wanted these changes as an aid in determining what costs should be charged directly to these projects.

The definitions of IR&D costs and B&P costs are not intended to include allocation requirements. Guidance on allocation is included in other sections of the Standard. Section 420.50(a)(1) of the Standard provides guidance on what costs are to be charged directly to IR&D and B&P projects. Therefore, the requested additions are not necessary.

(4) ACCUMULATION OF IR&D COSTS AND B&P COSTS BY PROJECT

A few respondents commented on the requirement in the Standard to account for IR&D and B&P costs by project. One commentator stated that he believed that most contractors who will be required to comply with this requirement have the capability to accumulate IR&D and B&P costs by individual projects. The commentator noted that the Board has properly considered the concept of materiality by permitting the combining of the costs of IR&D or B&P efforts of small dollar value in a single project for inclusion in the appropriate pool without the necessity of separate cost identification.

One commentator stated that even though it accounted for IR&D and B&P costs by project, it was certain that there were small contractors who did not have systems which would be sophisticated enough to keep costs in such a way. The staff of the Board visited in excess of 50 contractors in con-

ducting research on this project. In every instance contractors accumulated the costs of IR&D and B&P by project. The Board believes that, with the materiality consideration provided in § 420.50(c), the requirement to accumulate IR&D and B&P costs by project should be retained. In further consideration of the materiality concept, overhead costs and other indirect costs allocable to individual IR&D and B&P projects need not be recorded by individual project if subsequent pool allocations of these costs yield the same results as if they had been so recorded.

It was noted that the reference to "clearly and exclusively" as the criteria for allocating costs directly to IR&D and B&P projects makes a more limited requirement for this allocation than is provided for in proposed Standard 417, Distinguishing Between Direct and Indirect Costs. The Board's intent is to be consistent in the accounting specified for costs incurred in like circumstances, and the use of the terms "clearly and exclusively" in the fundamental requirement was intended to provide this consistent treatment. It was pointed out that the same test which is included in proposed Standard 417 is only one of three tests for making the determination of what cost shall be accounted for as a direct cost.

The Board agrees that the use of "clearly and exclusively" in this Standard without the use of the complete set of criteria would have placed a limitation on what costs should be allocated directly to IR&D and B&P projects, and this would be more restrictive than the requirement contained in proposed Standard 417. The Board believes that it would be inappropriate to restate in CAS 420 the entire fundamental requirement for the proposed Standard on Distinguishing Between Direct and Indirect Costs. It believes further that the techniques for application, § 420.50(a)(1) adequately establish the allocation requirement sought for these costs. For all of these reasons, the fundamental requirement paragraph has been revised accordingly.

(5) ALLOCATION OF BUSINESS UNIT G&A EXPENSES TO IR&D AND B&P COSTS

One commentator raised the question of allocating business unit general and administrative expenses to IR&D and B&P costs. This commentator made the point that accounting for this effort by project is tantamount to treating it as a final cost objective and therefore it should have allocated to it a business unit's general and administrative expenses. Both proposals published in the FEDERAL REGISTER, July 28, 1978 and May 25, 1979, contained the provision that business unit G&A expenses should not be allocated to

IR&D and B&P costs. A majority of respondents to the July 28, 1978 proposal commented favorably on that section of the proposal.

Many of these commentators in replying to an earlier draft of the Standard, which had provided for allocating G&A expenses to IR&D and B&P costs, had expressed the view that IR&D and B&P costs were of general benefit to a segment or a company and therefore similar in nature to G&A expenses. They believed that since such costs were similar in nature to G&A expenses they should not receive an allocation of G&A expenses. The Board was persuaded by this view and for that reason the Standard retains the provisions for not allocating business unit general and administrative expenses to IR&D and B&P costs.

Several commentators directed remarks to accounting for IR&D and B&P costs at organizations of a company that perform as research laboratories. Some stated the belief that G&A expenses of such segments should be allocated to its IR&D costs if the segment is a "central research laboratory." Others, including an industry association, were of the opinion that a research laboratory should be treated as any other segment and its IR&D costs should not receive an allocation of G&A expenses.

The Board for some time has been persuaded that the nature of IR&D and B&P effort is such that it should not receive an allocation of business unit G&A expenses. Nothing in the comments received from the three commentators seeking to have special IR&D or B&P costs accounted for differently than all other IR&D or B&P costs provided the Board with criteria for setting up different accounting treatment. The Board believes that such costs should not receive an allocation of business unit G&A expenses and the Standard so provides.

(6) ALLOCATION OF G&A EXPENSES TO WORK PERFORMED BY ONE SEGMENT FOR ANOTHER SEGMENT OR HOME OFFICE

Many contractors in responding to the proposed Standard objected to the provisions in the proposed Standard which required that G&A expenses be allocated to work performed by one segment for another segment or home office. Some stated the belief that § 420.50(c) was inconsistent with § 420.40(c) in the proposed Standard, which provided that business unit G&A expenses shall not be allocated to IR&D and B&P projects. The Board sees no inconsistency. If the work performed is an IR&D or B&P project of the performing segment and also benefits the receiving segment, it must be transferred to the home office without an allocation of business unit G&A expenses in accordance with

§ 420.50(f)(1). It will then be allocated to benefiting segments pursuant to § 420.50(e). If the work is not IR&D or B&P effort of the performing segment the allocation of general and administrative expenses will be governed by CAS 410.

Commentators also expressed concern that including G&A expenses in the costs of IR&D or B&P work performed by one segment for another might push total IR&D and B&P costs above the negotiated ceilings. They contended that this would make the excess cost unrecoverable from any source. Furthermore, by increasing the allocated cost of a given research effort, less research would be financed by a given research allowance.

The Board recognizes these objections, but believes that the question of whether and how G&A expenses should be allocated must be decided on other grounds. The Board believes that if work is performed at a segment and sold to or transferred to another segment directly, it should be considered a final cost objective of the performing segment. Allocating G&A expenses to such work would be consistent with CAS 410 which provides for allocating general and administrative expenses to stock or product inventory as well as to final cost objectives of the segment. This accounting treatment is consistent with previous Standards and proposals which have dealt with segments as separate units, each with their own final cost objectives. It is also consistent with proposed Standard 419.

Some commentators agreed with the concept of allocating G&A expenses to work which is part of a segment's normal product or service and therefore a final cost objective of the segment, but disagreed with the use of the phrase "project in which the performing segment has an interest." The commentators believed that the phrase was not sufficiently objective to be properly administered.

The Board recognizes that there are valid objections to the use of the descriptive phrase "has an interest (in)." This paragraph (now numbered § 420.50(d)) has been revised to provide that work performed by one segment for another shall not be treated as IR&D or B&P effort of the performing segment unless the work is also part of an IR&D or B&P project of the performing segment.

(7) ALLOCATION OF HOME OFFICE IR&D AND B&P COST POOLS

In being responsive to comments on earlier proposals, the May 1979 proposal provided for allocation of IR&D or B&P costs to a limited group of segments or to specific segments where such identification could be established between specific work and bene-

fitting or causing segments. At the urging of most commentators, the identification requirements and the base for allocation were stated as general requirements in the proposal. Two commentators suggested language to provide that a clear and exclusive identification of work to a specific segment(s) should be required to permit this type of allocation. The Board believes that such a change would be unduly restrictive.

The Board is aware that usually not all IR&D or B&P costs could be identified to specific segments. The Board believes that such residual home office IR&D and B&P costs should be allocated on a base which is representative of the total activity of segments being managed. Cost input therefore was selected in the May 1979 proposal as a good representation of total activity.

Several commentators objected to the use of only one base. As stated previously, the Board is seeking a base that will represent the total activity of the segments reporting to the home office. It does not with the Standard to be needlessly restrictive. The base used to allocate the home office residual expense under CAS 403 is a base representing total activity. A majority of commentators to the proposed Standard suggested that, in lieu of cost input as the base, the company be allowed to allocate residual home office IR&D and B&P costs on the same base it now uses to allocate home office residual expense under CAS 403. The Standard has been revised to provide for that method of allocation, but the amount of IR&D and B&P costs so allocated is not to be added to the residual pool to determine whether use of the 3 factor formula in CAS 403 is required.

One commentator recommended that " * * all IR&D costs be pooled at the home office level and then allocated in a consistent and uniform manner over the entire business. This policy would serve as a deterrent to contractors undertaking frivolous IR&D projects or projects of questionable military relevance in divisions where costs would otherwise be borne primarily by the Government."

Early in its research the Staff considered this approach to determine if it best represented the beneficial or causal relationship between the IR&D and B&P costs and final cost objectives. The staff found that it was not unusual to find IR&D or B&P efforts which were clearly of benefit to or caused by a single segment or a group of segments within a company. For that reason the Board believes that the beneficial or causal relationship between IR&D and B&P costs and final cost objectives can be more effectively identified at organization levels below the one encompassing the entire company.

There may be situations where the

beneficial or causal relationship can best be reflected by pooling and allocating on a general basis over the entire company. In such cases, the method suggested by this commentator would be called for under the Standard.

(8) ALLOCATION OF SEGMENT IR&D AND B&P COST POOLS

Several commentators suggested that where IR&D or B&P effort is determined to be of benefit to or caused by more than one segment, direct transfer of that IR&D or B&P costs between segments should be permitted. The Standard being promulgated today continues to provide that any IR&D and B&P project which benefits more than one segment of the organization shall have its costs transferred to the home office for allocation among benefiting segments. To avoid unnecessary recordkeeping, however, the Board has provided that the transfer can be recorded directly in the accounts of the other segments if the resulting allocation is substantially the same as it would be if passed through the home office.

One commentator was concerned that there would be confusion as to the home office to which such costs would be transferred. The suggestion was made that the Standard provide that such costs be transferred to an intermediate home office. The Board believes that such an addition is not needed. The definitions of both home office and segment in 4 CFR Part 400 make clear that the transfer of costs under this provision of the Standard could be only to the home office most immediate to the segment.

(9) ALLOCATION OF IR&D AND B&P COSTS TO PRODUCT LINES

Many commentators to the proposed Standard felt strongly in their responses that the allocation of IR&D or B&P costs to product lines would be impractical. Most commentators believed that the arguments and disagreements between the parties as to what constitutes a Product Line would outweigh any possible benefits that could be received from the direct identification of cost objectives that would be achieved by such provision.

In visits made by the Staff with several commentators subsequent to the publication of the proposed Standard, the question of using the same definition of Product Line used by the Federal Trade Commission (FTC) in its Line of Business Reporting was discussed. All the commentators were of the opinion that this definition would not be suitable in determining guidance for the allocation of segment IR&D and B&P costs to product lines. The primary concern of the commentators was that the FTC definition establishes product lines within a com-

pany that cross over several segments of the company. Consequently, contractors would face considerable difficulties in attempting to allocate IR&D and B&P costs in accordance with the FTC definition.

In further considering the question of defining Product Line, the comments on the proposal by the Department of Defense were particularly pertinent. Those comments stated that "In the case of product lines, our experience with the cost principle that was in the ASPR prior to 1970 convinced us that it is not practicable to define a product line. In our attempt to designate product lines, and relate development costs to them, we found ourselves in endless arguments with contractors. . . . In our experience we found that contractors and contracting officers could seldom agree on product lines and usually resolved the matter by describing a product line that included all work in the plant. If the product line allocation provision remains in the proposed Standard, we expect these experiences will again be repeated."

The Board has considered the problems connected with the lack of definition and the administrative effort that would accompany any attempt to allocate the costs of individual IR&D or B&P projects to product lines. These provisions are not included in the Standard being promulgated today.

(10) SELECTION OF ALLOCATION BASE FOR SEGMENT IR&D AND B&P COSTS

The majority of commentators objected to the use of only the total cost input base for the allocation of a segment's IR&D and B&P costs to final cost objectives. Most of these commentators suggested the Standard be revised to provide that IR&D and B&P costs be allocated to final cost objectives of the business units using the same base that is used to allocate the business unit G&A expense to final cost objectives.

The Board agrees that the beneficial or causal relationship between IR&D and B&P costs and final cost objectives is similar to the relationship between G&A expenses and final cost objectives. After considering the many comments regarding this part of the Standard, it has been revised and the allocation requirement now states that the IR&D and B&P cost pools shall be allocated to final cost objectives of the business unit using the same base that the business unit uses to allocate its G&A expenses.

(11) DEFERRAL OF DEVELOPMENT COSTS

The proposed Standard provided for the deferral of the cost of IR&D effort which met specific criteria, and established criteria for the identification of such costs. It also noted that

the composition of the costs and the allocation procedure for such costs would require further research before establishing an accounting Standard. Reaction to this provision in the proposal has been extensive and varied.

Several respondents to the May 25, 1979, proposed Standard noted that the Board should not allow the allocation of deferred development costs as this would be in conflict with the Financial Accounting Standards Board's (FASB) Statement No. 2, *Accounting for Research and Development Costs*. One of these pointed out that the FASB in its statement set forth the position that for financial reporting purposes research and development costs should be charged as a current period cost. Another stated that his company did not and would not defer such expenses, even if the Standard permitted such action.

Although the Board has always considered the FASB to be an authoritative body and considers its statements when promulgating its own, the FASB's concern is with external financial reporting, not with contract costing. FAS Statement No. 2 therefore is not determinative for contract costing and pricing purposes.

A few commentators agreed with the provision as stated in the proposal and urged its adoption without modification. One industry commentator said, "We agree with the language as stated and believe the criteria is conceptually sound so as to permit implementation by the acquisition agencies. We do not feel that further research on behalf of the CAS Staff is necessary, and (we) encourage this language be contained in the promulgated standard as written."

The majority of commentators expressed approval of the concept provided that the act of deferral should be at the sole option and discretion of the contractor. The Board has concluded that this would be inappropriate, however, because it would not be consonant with the uniformity and consistency objectives of Pub. L. 91-379.

A broad spectrum of commentators suggested that the Board not change the status quo of this category of costs of deferred development in this Standard. They suggested that the entire subject, including requirements for allocating deferred costs, should be treated in one Standard. The commentators who made this suggestion represented industry, a professional accounting association, and a Government agency.

The Board continues to believe that there are different types of development costs and that objective criteria can probably be found to identify such costs. It believes, also that an important aspect of this question is the accounting treatment, including the amortization and allocation of these

costs. The existence and the allocability of deferred IR&D and deferred development costs are recognized to some degree today in various procurement regulations. Current proposals in the Federal Acquisition Regulations (FAR) increase the recognition and allocability of such costs.

Many commentators criticized the criteria listed in the May 1979 proposed Standard, but were unable to suggest other criteria that would provide the objective tests the Board believes necessary for a Standard on this subject. The Board will undertake research on a project to determine the feasibility of a Standard which will identify and provide for the accounting treatment of deferred development costs. In the interim, the agencies may continue to exercise their authority to identify and allocate such costs. To that end the Standard covers these costs in § 420.40(f)(2) which provides: "IR&D costs incurred in a cost accounting period shall not be assigned to any other cost accounting period, except as may be permitted pursuant to provisions of existing laws, regulations, and other controlling factors."

(12) TRANSITION FROM THE USE OF A COST OF SALES BASE TO A COST INPUT BASE

One commentator noted that the Standard was silent in regard to its application when a contractor was required to convert his accounting system from the use of a cost of sales base to the use of a cost input base for the allocation of a segment's IR&D and B&P costs. This commentator suggested that the Standard include a provision such as was incorporated in the appendix of CAS 410 which provided the accounting to be followed during the transition period. The Board does not believe that this Standard warrants the additional complexity of a transition method. The Board notes that the contractor and the Government may negotiate an equitable adjustment for this change as provided in § 331.50(a)(4)(A) of the Board's regulations.

(13) EFFECTIVE DATE OF STANDARD

One commentator stated that the promulgation of this Standard would require reorientation of both contractor and Government personnel who are charged with the accounting and administration of contracts. The commentator noted that the Standard should provide for an extended implementation period. The primary concern of the commentator was directed towards the negotiation of advance agreements for these costs, and the impact of this Standard on such advance agreements. The Board expects that this Standard will become effective

on March 15, 1980. However, to provide adequate lead time for its applicability the Standard provides that it shall be followed by contractors as of the start of the second fiscal year beginning after the receipt of a contract to which this Cost Accounting Standard is applicable.

(14) COST AND BENEFIT

The Board in taking into account the cost and benefits of the Standard being promulgated today was especially mindful of the significance, both in nature and amount, of the category of costs being considered here. In comments received regarding the proposed Standard published in the FEDERAL REGISTER, some commentators offered opinions as to the cost of implementing the Standard. One commentator stated the proposed Standard will have minimal impact on administrative costs. Some commentators stated that they had not estimated the amount of increased administrative costs which would result from implementation of this Standard. Based on their experience with previously promulgated Standards, these costs depend on the interpretation and implementation requirements used by the auditors and procurement officials responsible for the administration of Cost Accounting Standards. Two commentators provided large cost estimates for implementing this Standard. One commentator based its estimate on the requirement to identify IR&D or B&P projects to product lines. This requirement has been eliminated from the Standard being promulgated.

As mentioned earlier, Congress continues to express its concern regarding the large reimbursements defense contractors receive in order to carry out their IR&D and B&P efforts. (About \$1.2 billion in 1978). As many commentators pointed out, this area of costs (especially IR & D) receives much attention through the medium of advance agreements. These advance agreements contain some accounting ground rules to be followed by the contractor in determining what constitutes IR&D and B&P costs. The current acquisition regulations, however, allow significant flexibility in determining costs for these projects. One of the benefits of the Standard is that it provides increased uniformity and consistency in determining how IR&D and B&P costs are constituted, and how these incurred costs should be allocated to cost objectives.

(15) AMENDMENTS

In addition to the promulgation of 4 CFR Part 420, related amendments to 4 CFR Part 400 and to Standards 4 CFR Part 403 and 4 CFR Part 410 are being promulgated.

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**Part II—Preambles to the Related Rules and
Regulations Published by the Cost
Accounting Standards Board**

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**PART II—PREAMBLES TO THE RELATED
RULES AND REGULATIONS PUBLISHED BY
THE COST ACCOUNTING STANDARDS
BOARD**

**PREAMBLES TO PART 331,
CONTRACT COVERAGE**

PREAMBLE A

Preamble to Original Publication, 2-29-72

The material set forth below is the preamble to the original publication of Part 331, February 29, 1972, at 37 FR 4139. For the preamble to the republication of Part 331 (November 7, 1973, 38 FR 37025), see preamble D of this Supplement. Portions of this preamble relating to Parts 351, 400, and 401 have been omitted; they can be found in the supplements to their respective parts. This preamble to the publication of February 29, 1972, is included as part of the administrative history of Part 331.

General comments. The purpose of the regulations promulgated today by the Cost Accounting Standards Board is to implement section 719 of the Defense Production Act of 1950, as amended, 50 U.S.C. app. 2168, which provides for development of Cost Accounting Standards to be used in connection with negotiated national defense contracts and for disclosure of cost accounting practices to be used in such contracts. The Board believes the materials being promulgated today constitute a significant initial step toward accomplishing one of its major objectives—improved cost accounting and the proper determination of the cost of negotiated defense contracts. The regulations spell out contract coverage (Part 331), disclosure requirements (Part 351), a compilation of Definitions (Part 400), and two Cost Accounting Standards, one calling for consistency in estimating, accumulating, and reporting costs (Part 401), and the other calling for consistency in allocating costs incurred for the same purpose (Part 402).

Development of the material being promulgated today began many months ago with extensive research. It included examining publications on the subject, conferring with knowledgeable, representatives of various Government agencies, Government contractors, industry associations, and professional accounting associations, and identifying and considering all available viewpoints. From this research, the initial versions of the material now being published were developed. As a part of the continuing research effort, these initial drafts were sent to 81 agencies, associations, and Government contractors which had expressed interest in assisting the Board in its work, and their comments were solicited. Some national defense contractors field-tested the material to see how it would apply to and affect their operations and advised the Board of their findings. In each step of the research process, the Board and its staff have urged and received active

participation and assistance by Government, industry, and accounting organizations. Their cooperative efforts contributed in large measure to the exposure draft published in the December 30, 1971, FEDERAL REGISTER for comment.

To better assure that all who might want to comment had an opportunity to do so, the Board supplemented the FEDERAL REGISTER notice by sending copies of the FEDERAL REGISTER materials directly to about 175 organizations and individuals who had expressed interest or had provided assistance in the development of the published material. Also, a press release was distributed announcing the publication, which resulted in numerous articles in journals. The Board availed itself of all opportunities to publicize the proposals and solicit comments on them.

Written comments in response to the published material were requested by February 4, 1972. Comments were received from 105 sources, including Government agencies, professional associations, industry associations, public accounting firms, individual companies, and others. The Board appreciates the obvious care and attention devoted by commentators, and as will be seen below, the Board has greatly benefited from the comments received.

Many of the comments received were addressed to all parts of the proposed Board rules as well as to the question of public availability of the Disclosure Statements. All of the comments received have been carefully considered by the Board taking into account the requirements of section 719. Understandably, many of the comments were addressed to issues which recur in two or more of the proposed parts while others dealt only with specific sections. Comments which dealt with 11 general issues are discussed separately below followed by a section-by-section analysis of other comments. Appropriate changes have been made in the material promulgated based on the Board's disposition of the comments received.

Those comments and suggestions received which are of particular significance are discussed below.

1. *Public availability of disclosure statement.* In a special notice in the notice of proposed rule making, the Board sought comments to assist it in its determination of whether Disclosure Statements submitted by defense contractors and subcontractors should be available to the general public, pursuant to the Public Information Section of the Administrative Procedure Act (5 U.S.C. 552) or whether such information was properly within one of the statutory exceptions to the legal requirement for public availability.

With few exceptions, both Government and industry commentators urged that the Disclosure Statements

not be made available to the general public. Numerous arguments were presented. Among them were that public disclosure by a Government official would violate 18 U.S.C. 1905 (a provision in the Criminal Code making it a crime for a Government official to make certain matters public in certain circumstances), thus making disclosure improper under an exception to the requirement for public availability set out in 5 U.S.C. 552(b)(3); that the cost accounting practices were trade secrets or property of considerable value and that disclosure would deprive the company of their value without compensation; that disclosure would reduce competition; and that the public might be misled in that it might construe disclosures respecting the defense segment of a contractor's business as representative of his entire business organization.

An argument in favor of making the Disclosure Statements available to the public was made by a public interest group. It argued that 5 U.S.C. 552 clearly applies to Disclosure Statements, which do not fall within any exception to public availability; that the public requires access to Disclosure Statements in order to consider adequately and comment intelligently on any Cost Accounting Standards proposed by the Board; that public availability would enhance competition; that Disclosure Statements which are ultimately approved will form a body of precedents to guide others in complying with future Board Standards and that public availability will enable citizens and the Congress to hold both the Board and contracting officials accountable for implementation of section 719. A few commentators stated that they favored, or could see no harm to companies from, public availability of contractors' disclosed practices.

The Board is especially impressed with arguments that cost accounting practices have never been made public, that companies have regarded and treated them as confidential, and that a company's competitive position would be damaged by public disclosure of its cost accounting practices. Since disclosure will be required of many companies or divisions of companies whose principal competitors are not subject to Board regulations, the Board recognizes there might arise competitive disadvantage to the disclosing company or division if its competitors may see its disclosure but need make none themselves. The Board has, in light of these latter arguments, concluded that information received in response to Disclosure Statements is within the exception set forth at 5 U.S.C. 552(b)(4) and that the Board will not make Disclosure Statements public in any case when the company or segment files its statement specifically conditioned on the Government's agreement to treat the

Disclosure Statement as confidential information.

A provision to this effect has been added at § 351.4(d) of Part 351. Additionally, paragraph (a)(1) of the contract clause set forth at § 331.5 has been modified to this effect, and a provision added to it so that subcontractors may submit Disclosure Statements directly to the contracting officer.

While the Board has concluded that public availability of the Disclosure Statements of identified contractors is not required, it will, nevertheless, implement its announced intention of compiling statistical summaries of disclosure data and making those studies available to the public. The Board believes that the creation of a data bank of cost accounting practices will greatly benefit the Board's own research efforts and the formulation of Cost Accounting Standards; summaries of these data or studies of them should also prove to be of great value to the public. Aggregated information not identified to particular contractors will, therefore, be made available to the public.

2. Contractor-subcontractor relationships. Several commentators, stating that contractors cannot dictate the cost accounting practices of their subcontractors at any tier, urged that the Board not hold contractors responsible for increased costs to the United States arising from the failure of subcontractors to follow Cost Accounting Standards or disclosed cost accounting practices. Several commentators also urged that the contractor not be subject to the possibility of a default termination by reason of the actions or inactions of any of its subcontractors at any tier. Finally, some commentators urged that the Board establish a novel concept of privity between the contracting agency and subcontractors with respect to any concerns stemming from Board rules, regulations, and Cost Accounting Standards.

The Board has dealt with many of the issues touched on by these commentators in its conclusions, discussed below, respecting the phasing of applicability and the proposed termination-for-default language in the Contract Clause. The Board is also mindful of the desirability of its maintaining neutrality with respect to contracting policies outside its jurisdiction; thus it should avoid establishing a standard or policy which would influence decisions of whether work should be performed in-house or subcontracted. A Board policy permitting contractors to avoid responsibility for the actions of their subcontractors could surely have such an impact.

The Board reaffirms the established principle that prime contractors are responsible to the Government for performance of their contracts in all required respects and urges that contractors who are fearful of deficiencies

in their subcontractors' performances protect themselves by use of whatever means they currently employ under other flow-down contractual requirements.

3. Exemptions. Many commentators urged the Board to provide exemptions either to the requirement to file a Disclosure Statement or to both that requirement and the requirement to follow Cost Accounting Standards. Exemptions were urged for subcontractors below the first tier, subcontractors with small amounts of defense contracting business, producers of basic or raw materials, colleges and universities, construction contractors, firms which would qualify as small businesses, and others.

The Board has long been concerned with the question of appropriate exemptions. It has specifically requested interested groups to offer suggestions for criteria for use by the Board in considering exemptions. It also requested its staff to study exemptions and has discussed the staff investigations at Board meetings. In light of these studies and the comments received, the Board has found no persuasive reasons for issuing blanket or class exemptions at this time.

The Board recognizes, however, that individual Cost Accounting Standards may by their nature be inapplicable or inappropriate to certain classes or categories of defense contractors or contracts. The Board will continue to consider exemptions from individual proposed Cost Accounting Standards as appropriate.

With respect to the requirement to submit a Disclosure Statement, the Board's proposed regulation provides a phasing of that requirement. The Board remains convinced that a company which together with its subsidiaries received prime contract awards of negotiated national defense contracts including supplemental awards during Federal fiscal year 1971 totaling more than \$30 million should be required to submit a Disclosure Statement as soon as Part 351 of the Board's regulations becomes effective. In order to provide both to other contractors and to Government agencies adequate time within which to study the use of Disclosure Statements, however, the Board will defer determination of the date after which other affected contractors and subcontractors may be required to file Disclosure Statements. From time to time, the Board will announce the dates of applicability to other contractors and subcontractors.

4. Applicability date of standards, rules, and regulations. A related issue raised by many commentators is a request that Cost Accounting Standards be made applicable 90 days after issuance or at the beginning of the contractor's next fiscal year, whichever is later. In order to provide the maximum benefits from use of Cost Ac-

counting Standards, the Board has decided not to adopt any rule which would automatically delay the effective date of Cost Accounting Standards beyond the dates contemplated in section 719(h). That section provides a minimum of 4 months' notice from the date of promulgation, to contractors of the likely applicability of a Cost Accounting Standard. The Board regards this as an adequate time for companies to prepare for use of the standard. The Board nevertheless recognizes that certain standards by their nature may require deferring applicability to the beginning of a contractor's fiscal year next following the effective date, and in such cases that applicability will be stated in the standards concerned.

5. Agency administrative responsibility. Many commentators, noting the Board's statutory responsibility to promote uniformity and consistency in cost accounting practices used in defense contracting and subcontracting, have suggested that uniformity would be promoted by giving the Board or another single Federal agency the sole implementing responsibility respecting Board regulations. Thus, some commentators recommended that the Board itself issue regulations prescribing the frequency of submission of Disclosure Statements and where they must be submitted. Other commentators urged that the Board issue a single regulation prescribing exact methods by which increased costs to the United States will be determined. Other commentators urged that the Board prescribe methods by which advance agreements affecting more than one contract shall be made, some commentators urging that the Board itself make those agreements. Others urged that the Board rule that the contracting agencies must act to approve or disapprove Disclosure Statements within a stated period of time. And finally, some commentators urged that the Board itself be the sole agency to approve the cost accounting practices disclosed through submission of a Disclosure Statement.

The Board finds these recommendations cogent. It also recognizes that to act pursuant to them would require a Board regulation directed to the administrative and contracting procedures of many Federal agencies and in some cases—such as the recommendation for Board approval of disclosed cost accounting practices—substitute a Board regulation for the exercise of contracting officers discretion.

The Board, therefore, has decided not to implement at this time the suggestions set forth in this connection. The Board nevertheless will watch closely during the early implementation by contracting agencies of Board rules, regulations, and Cost Accounting Standards so that it may become aware of any diversity of regulations or actions by contracting agencies. If

the Board finds that an unacceptable amount of diversity has arisen, it will be prepared to reconsider the recommendations that the Board issue its own regulations in many of the areas left by Board regulations to the discretion of contracting agencies.

Many commentators have expressed concern about the problems which could arise from inconsistent actions by different Federal agencies respecting disclosed practices, changes in practices, and equitable adjustment of contract prices and costs. The Board has directed its staff to work with representatives of relevant Federal agencies with the objective of obtaining designation of a single contracting officer for each contractor or major component thereof in order to achieve consistent practices within the standards issued by the Board.

6. *Contract modifications.* Several commentators have urged that negotiated contract changes and amendments over \$100,000 to contracts which are themselves not subject to Board jurisdiction should not be covered. One commentator pointed out that in a long-term contract, most changes represent "instead of" type changes with cost of price adjustments only for the incremental effect of the change. This commentator stated that there is no practical way separately to identify these incremental costs.

The Board is persuaded that for the time being it should not cover negotiated modifications to contracts exempt at their inception. It has therefore, eliminated coverage for the time being of such contract modifications. In doing so, however, the Board intends that the annual extension of existing negotiated contracts and similar contract modifications would not be exempt from the Board's rules, regulations, and Cost Accounting Standards.

7. *Definitions.* The Board is also persuaded of the value of one commentator's suggestion that the Board provide a compilation of definitions of the words or phrases defined in individual Cost Accounting Standards, making those definitions applicable to all such standards. Consequently, a new Part 400 has been added, and all terms defined in Parts 401 and 402 have been placed in it, although they also remain in the particular standards in which they are defined. As more standards are added, any terms defined in them will also be added to Part 400. However, terms defined in Parts 331 and 351 are not included in the glossary of definitions, nor are terms used in those parts necessarily to bear the meanings ascribed to those terms in Part 400.

8. *Application to individual contracts.* Several commentators urged that the Board adopt the date of final agreement on a negotiated price as a cut-off date for the disclosure of cost accounting practices. The Board has

reviewed the merits of selecting that date rather than the date of award to establish the date as of which the contractor's Disclosure Statement must accurately reflect his cost accounting practices, at least with respect to those contracts where cost or pricing data have been submitted pursuant to Pub. L. 87-653. The Board has decided to use the date of final agreement on price, as shown on the signed certificate of current cost or pricing data, with respect to contractors who have submitted cost or pricing data, and to use the date of award of the contract for all other contractors. In addition, the Board has concluded that it is appropriate to use those dates to establish which Cost Accounting Standards shall be applicable to the proposal and to the contract at its inception. Appropriate changes in Parts 331, 351, and 401 have been made to reflect this decision.

9. *Price adjustments.* Many commentators stated that where a contractor's departure from existing disclosed practices is occasioned by the contractor's wish to adopt a newly issued Cost Accounting Standard for all contracts, the Government should be willing to provide upward price adjustment whenever an existing contract is rendered thereby more expensive to perform. The view was often expressed that contractors could not maintain one accounting practice for contracts subject to a particular Cost Accounting Standard, but a different practice for contracts not so subject; therefore, it was alleged, once a contractor had to adopt a standard for any one contract, he would of necessity adopt it for all contracts and amend his Disclosure Statement accordingly.

The Board notes in this connection that the Cost Accounting Standard at Part 402 requires consistency in the allocation of all direct and indirect costs under all covered contracts. If a Cost Accounting Standard were issued which required a company to modify its disclosed cost accounting practices with respect to its earlier practice of allocating direct and indirect costs, Part 402 would require emendment of existing disclosed practices so as to meet that requirement. In such a case, the Board believes it would be unfair to deny an equitable price adjustment arising from such amendment.

Further, the Board has been persuaded by the strong arguments from industry commentators that companies with more than one contract, subject to different Cost Accounting Standards, cannot maintain multiple records to account for each contract related to its set of standards. Another industry commentator stated that the vast majority of companies must apply any required cost accounting practices across their total business, and that it would be impractical if not impossible for companies to apply different practice to different contracts.

The Board has accommodated this view by enabling contractors to apply uniform practices to all covered contracts. Such application will also serve to improve cost accounting practices for all contracts.

The Board has consequently modified both Part 331 and Part 351 to provide three things: First, that a contractor's practices disclosed for any contract shall be the same as the practices currently disclosed and applied on all other covered contracts and subcontracts being performed by that contractor. Second, that a contractor must amend his disclosure of cost accounting practices as new standards are issued and become applicable to new contracts if a change in practices is necessary, so that, at any given time, the same practices prevail under all of the contractor's existing contracts and subcontracts subject to Board jurisdiction. Similarly, contractors must amend Disclosure Statements to reflect any change in practices disclosed under later contracts. Third, that for those amendments of disclosed practices applicable to a particular contract which are occasioned by the issuance of a new Cost Accounting Standard, the Government will equitably adjust the contract price in accordance with the changes clause in the contract or reimburse any increased costs under that contract.

In view of the phasing of the requirement to file a Disclosure Statement, the Board has adopted a contract provision that will provide equitable adjustments in appropriate cases when a contractor who has not yet filed a Disclosure Statement is required to change his established cost accounting practices to comply with newly issued Cost Accounting Standards. On the other hand, any departure from disclosed cost accounting practices which is not required by a newly issued Cost Accounting Standard will not be subject to equitable price adjustment, but only to price adjustment downward in the event that that departure would otherwise result in increased costs being paid by the United States. The Board wishes to emphasize that if the parties to a contractual negotiation mutually agree to a price based on exclusion of costs which are allocable under the contractor's disclosed cost accounting practices, such agreement shall not affect the requirement for conformity with Board rules, regulations, and Cost Accounting Standards in the contractor's allocation of costs between the contract being negotiated and other work.

10. *Materiality.* The Board notes that many commentators urged that a concept of materiality be incorporated in the Board's regulations, to the end that minimal or insignificant modifications of or failures to use disclosed cost accounting practices would not be subject to price adjustment.

The Board agrees that the adminis-

tration of its rules, regulations, and Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of cost. Since this rule of common sense is already practiced by the Government, the Board does not believe that there is any need to attempt to formulate and state in acceptable concept of materiality applicable to all Board rules, regulations, and standards, although the Board might consider doing so if subsequent events indicate the necessity therefor. The Board does recognize that in particular standards a "materiality" statement may be useful, and in such cases, it will include one. See for example the addition at § 402.50(e).

11. *Additional requirements by agencies.* As a final general point, concern was expressed that Federal agencies might require submission of cost proposals in ways inconsistent with the cost accounting practices of some or all of the potential offerors. The Board recognizes that this has happened in the past, but it notes that Board rules, regulations, and Cost Accounting Standards are to be used by relevant Federal agencies as well as by contractors and subcontractors, and it believes that henceforth requests for proposals must be fully consistent with such rules, regulations, and standards, although of course the Federal agency may ask for supplementary information to accompany proposals if this is needed to meet the agency's requirements.

OTHER COMMENTS

Section 331.2 Definitions. A few commentators recommended modifying the definition of "relevant Federal agency." Their purpose was to assure that agencies such as the General Accounting Office and the Renegotiation Board were excluded from the definition of such agencies. Those recommendations have not been accepted, since the Board believes the General Accounting Office, the Renegotiation Board, and other agencies whose responsibilities include review, approval, or other action affecting national defense procurements are within the meaning of "relevant Federal agencies."

One Federal agency urged that the definition of "national defense" be supplemented at the end by adding the phrase "including R. & D. and services." The Board believes this addition unnecessary, in light of the definition at § 331.2(b) of "defense contractor," and the definition of "material" set out in 50 U.S.C. App. 2152 as including "technical information." The Board, of course, agrees that contractors for research and development as well as other services are national defense contractors in light of these definitions.

Several commentators urged that the definition of "negotiated subcontract" at § 331.2(f) be broadened to re-

flect what the commentators believed was the Board's purpose in this definition, that of precluding jurisdiction over subcontracts made after adequate price competition. That is not the Board's intention; instead, the Board intended to exclude from the term "negotiated subcontract" only a subcontract made under conditions which are as close to the conditions governing Federal advertised contracts as possible. Accordingly, the Board has not accepted these suggestions, but it has added language to clarify its intention.

In connection with this comment, the Board notes that several commentators urged that the Board exempt altogether from its jurisdiction any contract made after adequate price competition. The Board believes that any such exemption would be unwarranted and undesirable in view of the legislative history of section 719.

Section 331.5 Contract clause. The major changes in the contract clause urged by commentators have already been discussed in points 2 and 9 of the discussion of general comments. Commentators raised a number of additional points with respect to this contract clause. A great many commentators objected to the provision in paragraph (e) for termination for default. Many commentators urged that the requirement to repay increased costs to the United States should be deemed the sole remedy for a refusal or failure to comply with the requirements of the contract clause. While that remedy may be adequate for almost all cases involving a failure to follow Cost Accounting Standards or disclosed cost accounting practices, it would not be adequate to meet other possible situations, where, for example, a contractor refused to make a post-award submission of a Disclosure Statement or refused to grant access to records as required by the contract clause. In view of the fact that breach of any of the requirements of this clause would be a breach of a material condition of the contract, the default clause generally applicable to performance of the contract provides adequate coverage. Consequently, the Board has deleted the specific termination language in this contract clause as requested by many commentators.

Some commentators urged deletion or modification of paragraph (c) of the contract clause, which the Board has not done, since that language is prescribed by section 719(j). Other commentators urged that the Board set forth a specific period during which contractor and subcontractor documents, papers, or records relating to compliance with Cost Accounting Standards must be retained. The Board believes that there is no need to do so, since the general records retention requirements of any particular contract will establish that period.

One Federal agency requested that

the disputes language in paragraph (d) be modified to accommodate that agency's practice of permitting subcontractors to bring contract disputes directly to that agency's Board of Contract Appeals. The Board has accepted this recommendation. Two Federal agencies recommended deletion of the definitions in this contract clause as unnecessarily duplicating § 331.2. The Board agrees and has made the deletion, except that the definition of "negotiated subcontractor" has been retained in the contract clause for the convenience of contractors and subcontractors.

Other suggestions were received in which the Board was urged to modify other language in the contract clause which is taken directly from provisions in section 719. Preferring to use the statutory language, the Board has not accepted these suggestions. It has however, modified its proposal in paragraph (b) so as to adopt the statutory language, as urged by one commentator.

Section 331.6 Post award disclosure. Two Federal agencies urged that the contracting agencies be authorized to make awards whenever the head of the agency concluded that it was impractical to secure a Disclosure Statement from a contractor or from a subcontractor. Recognizing that any avoidable delays in making procurements are undesirable, the Board has accepted this recommendation. The Board does not expect that the authority thus provided to agency heads will be abused, and it will be informed of all actions taken pursuant to this authority.

* * * * *

Effective date and application. For the convenience of readers, the following summarizes the effective dates set forth in § 331.8, § 351.4(e), and Parts 400, 401, and 402, which were transmitted to the Congress on February 24, 1972, pursuant to section 719(h)(3) of the Defense Production Act of 1950 as amended. After the expiration of a period of 60 calendar days of continuous session following the date of transmittal to the Congress, the regulations herein promulgated shall take effect as set forth in those regulations, unless there is passed by the two Houses a concurrent resolution stating in substance that the Congress does not favor the proposed standards, rules or regulations.

1. The provisions of § 331.4 are to be included in all solicitations issued on or after July 1, 1972, which are likely to lead to contracts covered by standards, rules, and regulations of the Cost Accounting Standards Board.

2. The provisions of § 331.5 are to be included in all contracts resulting from solicitations covered by 1 above. In addition, these provisions are to be included in any other contract which

is within the jurisdiction of the Cost Accounting Standards Board and which is awarded after October 1, 1972.

3. The provisions of Part 351 will be applicable to any contractor who submits a proposal which results in contracts containing the clause in § 331.5 and whose net awards of negotiated national defense prime contracts during Federal fiscal year 1971 totaled more than \$30 million. Contractors whose net awards were less than that amount may be required to complete or submit a Disclosure Statement as the Board announces extensions of this requirement to such contractors.

4. Any contractor having a contract awarded prior to July 1, 1972, which contains a clause which already incorporates requirements governing submission of Disclosure Statements and application of Cost Accounting Standards will be required to comply with the provisions of that clause. In this connection, such contractor and the respective contracting agencies whose contracts contain such a clause should review those contracts to determine whether negotiations should be instituted to make Parts 400 through 402 applicable to them.

PREAMBLE B

Preamble to Amendment of 6-29-72

This amendment redesignated § 331.3 as § 331.3(a) and added a new § 331.3(b). The preamble and amendment were published on June 29, 1972, at 37 FR 12784. Although Part 331 was subsequently republished and revised on November 7, 1973 (38 FR 30725), the preamble to the amendment of June 29, 1972, is included as part of the administrative history of the regulation.

The purpose of this publication by the Cost Accounting Standards Board is to adopt a modification to § 331.3. *Applicability*, of its rules and regulations. The modification adopted today was initially published in the FEDERAL REGISTER of May 23, 1972 (37 FR 10454). Comments regarding that notice of proposed rulemaking were invited to be submitted to the Board by June 23, 1972.

The prescribed period has passed, and no comment opposing the proposed modification has been received. In view of this and for the reasons set forth on May 23, 1972, FEDERAL REGISTER, modification to § 331.3 of the Board's rules and regulations is adopted and made effective on July 1, 1972.

PREAMBLE C

Preamble to Amendments of 2-13-73

This amendment adds a new paragraph (c) to § 331.3, and deletes § 331.6(c). The preamble and amendments were published on February 12, 1973, at 38 FR 4237. Although Part 331 was subsequently republished and revised on November 7, 1973 (38 FR 30725), the preamble to the amendment of February 12, 1973, is included as part of the administrative history of Part 331.

The purpose of this publication by the Cost Accounting Standards Board is to adopt a modification to Part 331, Contract Coverage, of its rules and regulations. The modification was published initially in the FEDERAL REGISTER of December 8, 1972 (37 FR 26127). Some of the material in the modification was also published in the FEDERAL REGISTER of October 6, 1972 (37 FR 21177). Comments regarding the publication on December 8 were invited to be submitted to the Board by January 15, 1973.

The Board received 14 comments from a wide range of commentators. The Board is grateful for their interest and takes this occasion to thank them for the comments.

One commentator urged the Board to require certain additional information to support waiver applications pursuant to paragraphs (1)(i), (1)(iii), and (2)(i) of § 331.3(c). The Board agrees that such additional information will assist it in deciding whether to grant a waiver and therefore has adopted this proposal.

Two commentators urged that the signed, unequivocal statement by a proposed contractor or subcontractor that it refuses to accept a contract containing the Cost Accounting Standards clause might not be obtainable even when there has been such a refusal. The Board agrees and has consequently modified the requirement at § 331.3(c)(1)(i) so that the agency's statement of the fact of an unequivocal refusal, and of the contractor's or subcontractor's specific reasons therefor, will be sufficient to satisfy this requirement.

A commentator suggested that the Board provide for exemption from particular portions of the Cost Accounting Standards clause, as well as providing for exemption from all of it. The Board agrees that it is helpful to spell out such authority and has modified its proposal accordingly.

The Honorable Wright Patman, Chairman of the Committee on Banking and Currency of the House of Representatives, noting that any extensive use of the Board's proposed authority could seriously weaken the objectives of section 719 of the Defense Production Act of 1950, as amended, requested that within 30 days after acting on any request for an exemption the Board transmit to him a full report of the exemption request and its action thereon. The Board is pleased to comply with this request. A similar report will also be submitted to the Chairman of the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate.

Another commentator urged in the interest of assuring maximum access by the public and the Congress to the Board's actions that requests for waivers be published in the FEDERAL REGISTER and that comments on them be solicited that the Board's action on a re-

quest and an explanation of it be published in the FEDERAL REGISTER, and, finally, that notwithstanding any prior publication, that the Board include in its annual report to Congress a listing of every request for waivers received during the year, together with an explanation of the Board's action granting or denying the request. This commentator, asserting that the Board does not have unlimited discretion to grant waivers or exceptions, urges that the standards the Board will apply in acting on requests for waivers be stated.

The Board adopts the suggestion that it include in its annual reports to Congress a listing of the requests it receives for waivers and its disposition of those requests. The Board, however, does not believe that it should publish a notice of requested waiver and solicit comments. As noted above, the Board will provide full information to the Congress and to the public through its reports on its actions on waivers. With respect to this commentator's suggestion that the Board publish the criteria which it will use in acting on requests for waivers, the Board is satisfied that those criteria clearly are implicit in the information which the Board is requiring to be submitted in support of a request for a waiver.

Several commentators urged that the Board delegate its waiver authority to the procuring agencies, stating essentially that waivers could thus be granted more expeditiously. The Board has not accepted this suggestion, since it believes that it should retain control over a matter as important as a total exemption from the requirements of section 719 of the Defense Production Act of 1950, as amended, and also because the Board is convinced that its retention of its waiver authority will not unduly delay action on waiver requests. In this connection, the Board reemphasizes its comments published in the FEDERAL REGISTER for December 8, 1972 (37 FR 26127) that, "The Board * * * is prepared to act promptly in response to requests for waivers but * * * the Board's ability to respond promptly will depend in very large measure on whether or not the agency's request for a waiver is in full accord with the proposed requirements." If experience shows that delegation of this authority is warranted, the Board will, however, reconsider this suggestion.

Some of these commentators also urged that the level of agency officials authorized to submit requests for waivers to the Board be modified to include persons at levels of responsibility below those indicated in the Board's proposal. The Board believes that the level proposed will not unduly burden the procuring agencies and will assure that any request for a waiver of the Board's regulations will receive consideration at a very high level within the procuring agency

before submission to the Board. It, therefore, does not adopt this suggestion at this time, although it may reconsider this suggestion if experience warrants.

Some commentators urged the Board to expand its proposal to permit exemptions on broader bases, instead of confining the exemption authority to particular cases of demonstrated need. The Board does not accept this suggestion, since it does not anticipate wholesale or, indeed, even very numerous requests for waivers. Nevertheless, should a need for broader exemption action be justified, the Board can deal with that need under its authority in section 719(h)(2) of the Defense Production Act of 1950, as amended.

One commentator urged an outright exemption for both foreign and domestic concerns for work performed outside the United States, and other commentators urged the exemption of all subcontracts performed in Canada. The Board has adopted neither of these proposals, since it believes that the arguments advanced for them are unpersuasive in light of the purposes of section 719. The Board believes, further, that the exemption authority being adopted today provides an adequate basis for waivers where they are appropriate.

A commentator is concerned that the phrase, "on a timely basis," in §§ 331.3(c)(1)(iv) and 331.3(c)(2)(ii), if given a narrow interpretation, might suggest that timeliness of delivery is the only condition for granting a waiver. That commentator points out that other conditions also may warrant consideration. The Board agrees with the commentator, but it does not believe that a modification of its proposal is necessary to avoid the narrow interpretation feared.

In the interest of clarity, the waiver provision in § 331.6(c) is deleted from that section and transferred to § 331.3(c).

The Board has revised its proposal as discussed above and has made minor technical improvements. The revised proposal is adopted today.

PREAMBLE D

Preamble to Republication, 11-7-73

This publication (38 FR 30725, Nov. 7, 1973) revised and republished Part 331.

The purpose of this publication by the Cost Accounting Standards Board is to amend Parts 331, 351, 400, 401, 402, 403, and 404 of its rules and regulations. The amendments, which are minor clarifications to the regulations, were published in the FEDERAL REGISTER of September 5, 1973 (38 FR 23971). The amendments:

(a) Renumber Parts 331 and 351 to facilitate insertion of future modifications to those parts; (b) clarify one section of the contract clause at § 331.5; and (c) modify certain definitions in

Parts 400, 401, 402, 403, and 404 for the purposes of uniformity among the various Parts. Only one comment in response to the September publication has been received by the Board. This expressed agreement with the proposed changes.

In view of the foregoing, the following amendments to the Board's regulations are being made effective November 7, 1973:

PREAMBLE E

Preamble to Amendment of 9-19-74

This amendment revised paragraph (c)(4) of § 331.30, and was published on September 19, 1974, at 39 FR 33681.

The purpose of this publication by the Cost Accounting Standards Board is to adopt a modification to Part 331, Contract Coverage, of its rules and regulations. The modification adopted today was initially published in the FEDERAL REGISTER of August 9, 1974 (39 FR 28645). Comments regarding that notice of proposed rulemaking were invited to be submitted to the Board by September 9, 1974.

The August 9, 1974, publication proposed an amendment to § 331.30(c)(4) to permit, under certain circumstances, submission of waiver requests from a level below that of the agency head. No objection to the Board's proposal has been made. Therefore, the proposal has been adopted for the reasons expressed in the August 9, 1974, publication.

PREAMBLE F

Preamble to Amendments of 12-24-74

This document amended § 331.30(a), added § 331.30(b)(8), and amended §§ 331.40 and 331.50. It was published Dec. 24, 1974, at 39 FR 44389.

The purpose of this publication by the Cost Accounting Standards Board is to adopt modifications to Part 331, Contract Coverage, and Part 351, Basic Requirements, of its rules and regulations. These modifications will provide an exemption from Cost Accounting Standards Board requirements for certain national defense contracts and subcontracts of \$500,000 or less.

Public Law 91-379 requires that Cost Accounting Standards must be used in all negotiated prime contract and subcontract national defense procurements with the United States in excess of \$100,000, with certain stated exceptions. From time to time the Board refers to contracts subject to its rules and regulations as "covered contracts". Section 719(h)(2) of Pub. L. 91-379 authorizes the Cost Accounting Standard Board to prescribe rules exempting from its requirements such classes or categories of national defense contractors and subcontractors as it determines, on the basis of the

size of the contracts involved or otherwise, are appropriate and consistent with the purposes sought to be achieved by Pub. L. 91-379. The Board has granted several exemptions to classes or categories of contractors and subcontractors and also has established a procedure under which waiver of the Board's requirements may be granted for individual contracts.

A proposed exemption increasing the minimum contract amount requiring compliance with Cost Accounting Standards Board rules, regulations and Standards from \$100,000 to \$500,000 was published by the Board on September 27, 1974 (39 FR 34669). The Board received 82 responses to the September 27 proposal. Comments were received from individual companies, government agencies, professional associations, industry associations, public accounting firms, and individuals. All of these comments have been carefully considered by the Board, and the Board takes this opportunity to express its appreciation for the helpful suggestions which have been furnished.

The comments below summarize the major issues discussed by respondents in connection with the initial publication and explain the Board's disposition of these issues.

Issuance of the exemption. Practically all the commentators expressed concurrence in the proposed exemption, giving either unqualified support or support with added comments that additional exemptions should also be considered. However, three commentators—a consulting firm, a major aerospace company and a Government agency—disagreed with the proposed exemption, stating that an increase in the threshold for compliance with CAS requirements was inconsistent with the Board's objective of establishing uniformity and consistency among contractors doing business with the Government.

The Board agrees that the adoption of the proposed regulation will exempt a substantial number of contractors and subcontractors who otherwise would be covered, and consequently will permit such companies to follow accounting practices other than those set out in Cost Accounting Standards. However, the Board is aware that compliance with its rules, regulations and standards may involve additional administrative effort, particularly on the part of small companies, which may not be commensurate with the benefit to the Government or the contractor resulting from such compliance. The Board, after considering the efforts required by both the Government and its contractors to assure compliance on all covered contracts in excess of \$100,000, is persuaded that maximum benefit to the Government with minimum cost can be achieved by limiting the mandatory application of its

standards to contractors who receive awards which constitute a substantial majority of the national defense procurement dollars. As was stated at the time the proposed exemption was issued for comment, some 70 percent of the prime contractors of the Department of Defense did not receive one or more negotiated awards in excess of \$500,000 in Fiscal Year 1973. Thus, only 30 percent, or approximately 750 prime contractors, who received contract awards totaling \$20 billion, would continue to be covered. The exemption would remove coverage from only about 10 percent of the dollar value of annual DOD awards.

In view of the foregoing, the Board considers the proposed exemption increasing the minimum contract amount requiring compliance with the Cost Accounting Standards Board rules, regulations, and standards to be in keeping with the purposes sought to be achieved by Pub. L. 91-379 and to be an appropriate exercise of the authority granted to the Board by section 719(h)(2) of that law.

Increase exemption on all contracts to \$500,000. A number of commentators suggested that the \$500,000 single contract threshold for compliance with Board rules, regulations, and standards be changed to exempt all contracts of \$500,000 or less. Those giving reasons in support of this suggestion generally based their comments on simplification of administration. These commentators felt that it would be difficult for the Government or prime contractors, when awarding a prime contract or subcontract in excess of \$100,000 to determine whether the contractor or subcontractor had in existence a prior \$500,000 covered contract.

The Board, in proposing the \$500,000 threshold, did so with the intent of exempting those companies which do not receive contracts in excess of \$500,000 from the Government. However, it was decided in the interest of consistency in cost accounting practices that once a contractor had received a covered contract of that size, compliance with CASB rules, regulations and standards on contracts at the level established in Pub. L. 91-379 was appropriate. This is also consistent with the desire expressed by contractors to follow a single set of accounting practices. Further, the requirement for coverage of contracts in excess of \$100,000 where the contractor already has received a covered contract in excess of \$500,000 will permit the small contracts to be available for equitable adjustment if subsequently issued standards should become applicable. Moreover, once the administrative effort has been expended to comply with standards for contracts in excess of \$500,000, compliance with standards on contracts above the statutory threshold of \$100,000 requires little added effort.

With respect to the commentators' statements concerning the difficulties, when making an award exceeding \$100,000, of determining whether a contractor or subcontractor had in existence a prior award exceeding \$500,000, the Board feels that an administrative requirement can be established for obtaining this information. A similar requirement now exists concerning the disclosure statement, whereby contractors are required to submit a disclosure statement, state that they have previously filed a disclosure statement, or submit a certificate of monetary exemption. The Board feels that a similar requirement can be set concerning the \$500,000 level. The Board is not persuaded that this matter would create problems of sufficient significance to eliminate coverage down to the \$100,000 level.

In considering the advantages of the exemption as proposed compared to its assessment of the administrative difficulties foreseen by commentators, the Board is persuaded that its proposal relative to coverage of awards in excess of \$100,000 should not be changed.

Exemption based on sales. A number of commentators urged that the Board establish an exemption based on sales, using either minimum annual dollar amount of sales to the Government, or Government sales as a percentage of total annual sales, or a combination of these two factors. The most frequently suggested amount was \$10 million of sales to the Government or Government sales amounting to 10 percent of total annual sales. The objective sought by these commentators was an exemption of those companies or business units whose sales to the Government constituted a reasonably small portion of their total annual sales and whose business was essentially commercially oriented.

The Board has given lengthy consideration to the use of a sales basis for the establishment of a minimum threshold for compliance with its rules, regulations and standards. It did not use that basis at this time due to the nature of the problems involved in administering an exemption based on sales. In either of the situations suggested by commentators, the representation concerning the amount of sales must be made by the contractor and subsequently verified by the Government. This verification would impose very substantial and time-consuming efforts on both the Government and the contractor. Particularly in the case of Government sales as a percentage of total sales, Government representatives would be placed in the position of examining a contractor's total sales, including those made in its commercial business. Examination of a company's records concerning its total sales is not presently performed by Government procurement activities and would present new and unique prob-

lems to both parties as well as requiring substantial additional effort on the part of Government representatives.

An exemption based on sales would require a measurement period during which a contractor's status with respect to compliance with standards would be determined. Contracts under which sales were recorded during this period would not be subject to standards. If the volume of sales during the measurement period exceeded a stated threshold, a contractor would then be required to comply with standards under contracts received in subsequent periods. Thus, the contracts that brought the contractor under the Board's rules would not be subject to standards, while those received at a later time would be.

The Board has decided that the administrative problems involved with an exemption based on sales should be considered before establishing such a threshold. The Board will continue to study these problems and investigate whether exemptions based on criteria other than a minimum contract amount would be appropriate and consistent with the purposes of Pub. L. 91-379.

Retroactivity. Several commentators requested that the Board modify its proposal so as to provide retroactive exemption to existing contracts where the circumstances are such that these existing contracts would have been exempt if awarded after the effective date of the proposed regulation.

The Board has no authority to modify existing contractual agreements between the government procurement agencies and their contractors. However, the Board sees nothing inconsistent with its regulations or with Pub. L. 91-379 in modification by the procurement agencies of contracts in this category, assuming of course that the Government receives adequate consideration for deletion of the CAS requirements.

Increase minimum amount. A number of commentators recommended that the exemption proposed be increased to an amount greater than \$500,000, the figure of \$1,000,000 being frequently mentioned. The Board is not now prepared to raise further the minimum contract amount requiring compliance with its promulgations. The Board, in studying an exemption based on minimum contract amount, concluded that the \$500,000 threshold was the most appropriate one for achieving its objectives, all factors considered. The Board will continue to examine various limitations but considers that the threshold established in the proposed exemption best meets its requirements and obligations at this time.

Effect of final payment under contracts subject to CAS clause. Several commentators urged that the exemption of contracts of \$500,000 or less

should not be dependent on the final payment on contracts which are subject to Board requirements, on the grounds that final payment can occur a substantial period of time after completion of work on a contract and that there are many technicalities in closing out a contract which do not involve cost accounting applications.

The Board considers this point to be well taken and has changed the requirement in § 331.30(b)(8) where it first appears to "notification of final acceptance of all items or work to be delivered." At that time it is considered that all direct costs will have been charged to the contract since all work will have been completed, and any further accounting transactions would be the result of adjustments not directly related to contract performance.

Reduction of contract price by exclusion of commercial items. Some commentators, in reading the introductory comments to the Board's initial publication of this exemption, interpreted the phrase "minimum contract amount requiring compliance" in a manner not at all intended by the Board. These commentators interpreted this phrase to permit the price of a contract subject to standards to be reduced by the value of those individual contract items or subassemblies of final contract items whose prices could be considered to be "catalog" or "market" prices, if sold separately. They requested that the regulation be clarified to reflect their interpretation of the Board's introductory comments.

Those requesting this clarification misunderstood the Board's intentions. The Board does not intend that the price of a contract be adjusted to exclude the price of items or subassemblies which, if purchased separately, might be exempt from the Board's promulgations. Consequently, the change in the regulation requested by commentators on this point would be completely inappropriate.

Definition of contractor. One commentator noted that the prefatory comments to the Board's September 27, 1974, publication specifically mentioned the fact that receipt of a contract in excess of \$500,000 by one business unit of a multi-unit company would not in itself require other units of the same company to follow Board requirements. This commentator requested that the definitions of "defense contractor" and "defense subcontractor" contained in § 331.20 (b) and (c) be modified to reflect this intention by the Board.

As the Board stated in its September 27 publication, its contract requirements have been applied to business units, such as a profit center, division, subsidiary, or similar unit of a company, which perform the contract, even in those cases where the contract was entered into on behalf of the overall company rather than the business

unit. This application of the Board's requirements to a performing business unit is well established and unchallenged, and clarification of the definitions of "contractor" and "subcontractor" does not appear necessary.

Effective date. Several commentators raised questions concerning the effective date of the eligibility for this exemption in relation to awards received prior to January 1, 1975. Contractors who have received a prime contract or subcontract in excess of \$500,000 subject to cost accounting standards prior to January 1, 1975, and on which notification of final acceptance of all items or work to be delivered on that contract or subcontract has not been received, is a contractor who has "already received a contract or subcontract in excess of \$500,000," as that phrase is used in § 331.30(b)(8). Therefore, today's publication requires that a contractor meeting this test will be required to comply with standards on all covered prime contracts or subcontracts in excess of \$100,000 received after January 1, 1975, under the provisions of § 331.30.

PREAMBLE G

Preamble to Amendments of 2-2-76

This amendment added paragraph (b)(9) to § 331.30 and was published on February 2, 1976, at 41 FR 4809.

• *Purpose.* The purpose of this publication by the Cost Accounting Standards Board is to adopt a modification to Part 331, Contract Coverage, of its rules and regulations. This modification will provide a conditional exemption for contracts and subcontracts made with United Kingdom firms for performance substantially in the United Kingdom. •

The Cost Accounting Standards Board is authorized by Pub. L. 91-379 to prescribe rules and regulations exempting from its requirements such classes or categories of defense contractors or subcontractors under contracts negotiated in connection with national defense procurements as it determines, on the basis of the size of the contracts involved or otherwise, are appropriate and consistent with the purposes sought to be achieved by the Act. Pursuant to this authorization the Board has issued a regulation, § 331.30, *Applicability, exemption and waiver*, of Title 4, Code of Federal Regulations, which, among other things, establishes a procedure by which procuring agencies may request a waiver of the Board's requirements for a particular contract or subcontract.

The Board from 1972 to date has granted 45 waivers requested by procuring departments and agencies. Of that number, 23 were for contracts or subcontracts to be performed by United Kingdom firms each of which is a defense supplier to the U.K. Gov-

ernment and also is essentially a sole source supplier for the particular item being purchased by the U.S. Department of Defense. The waivers granted to U.K. firms have been based in general on the urgency and essentiality of the procurements, which were reported to preclude any alternative to making the proposed awards. However, the U.K. firms were reported as having objections to complying with the Board's rules and regulations, on the grounds that their accounting practices have been approved by the U.K. Government, their major customer, and may not thereafter be changed without further approval. They were reported as stating that they cannot assume an obligation to comply with Cost Accounting Standards which could be in conflict with U.K. Government Accounting Conventions and the governmentally approved accounting practices for the individual firms.

In view of the recurrence of this position and the high proportion of waiver requests involving U.K. firms, the Board undertook discussions with the U.K. Ministry of Defence concerning the application of Cost Accounting Standards and the Board's rules and regulations to firms which are U.K. defense contractors. As a result of these discussions it has been determined that U.K. defense contractors do disclose their accounting practices to the Ministry of Defence and that the Ministry of Defence approves companies' practices which then cannot be changed without further approval. It has further been determined that a Review Board for Government Contracts, whose chairman and members are nominated by the Government and industry and appointed by the Treasury, but which is established as an independent organization, among other duties periodically reviews and makes recommendations for changes in U.K. Government Accounting Conventions. The Review Board has also issued or sponsored certain cost accounting standards for use by U.K. firms in contracting with the Ministry of Defence.

On November 17, 1975, the Board published for public comment in the FEDERAL REGISTER (40 FR 53271) a proposal for a conditional exemption for U.K. firms performing substantially in the U.K. Nine responses were received to that publication. Responses were received from government departments, defense contractors, an industry association and two individuals. All of these comments have been considered by the Board, and the Board takes this opportunity to express its appreciation for the helpful suggestions which have been furnished.

The comments below summarize the major issues discussed by respondents to the initial publication and explain the Board's disposition of these issues.

U.K. Government Accounting Conventions. Two United States Govern-

ment departments were concerned that the reference in the proposed conditional exemption to the obligation of U.K. firms to disclose cost accounting practices which would be in accord with U.K. Government Accounting Conventions implied or could be understood to require that when matters mandated by the Conventions were in conflict with certain requirements of the Armed Services Procurement Regulation and Energy Research and Development Administration procurement regulations, the policies of the Conventions would prevail.

One of the departments pointed out that the Conventions permit reimbursement of four kinds of costs which are either by U.S. law or by U.S. procurement policy not allowable costs in U.S. contracts. These are entertainment expenses, product advertising, certain donations and certain non-incurred capital costs. The Board recognizes that the Conventions deal broadly with matters which can be regarded as relating to both allocability and allowability of costs. They do indicate that in certain circumstances, the indicated costs are allowable costs under U.K. contracts. However, cost accounting practices covered by Disclosure Statements do not deal with the allowability of costs, only with their measurement and allocation. Where appropriate, a disclosed practice must result in measurement and allocation of a cost in accord with the Conventions; whether that cost is or is not allowed as a cost under U.S. contracts is a matter for agreement by the parties to the contract and is not affected by the requirement that disclosed cost accounting practices be in accord with the Conventions.

Secondly, the department points out that the profit formula used by the U.K. Government is different from the profit formula used in U.S. negotiated procurements. The U.K. profit formula, however, is not a part of the U.K. Government Accounting Conventions governing cost accounting practices, nor does the Disclosure Statement deal with policy on which profits are determined. Consequently, a requirement that disclosed cost accounting practices be in accord with the Conventions does not impinge on the authority of U.S. officials to prescribe policy for the determination of profits under U.S. prime or subcontracts.

Thirdly, the department notes that there are differences between the U.K. Government Accounting Conventions concerning independent research and development and the provisions in ASPR Section XV which are used for compliance with Pub. L. 91-441. Pub. L. 91-441 makes Department of Defense appropriations unavailable for payment of a contractor's independent research and development or bid and proposal costs, unless the work which is paid for has a potential relationship to a military function or operation and

unless other conditions are met. The most important of the other conditions is that there be an advance agreement with the contractor. What has been said above about the allowability of costs is applicable to this point also. Furthermore, nothing in the Board's conditional exemption in any way controls the terms and conditions upon which the Department of Defense may agree in advance with a U.K. firm for the reimbursement to it of independent research and development and bid and proposal costs.

Additionally, the department notes potential differences in the treatment of depreciation costs under the Conventions and under the applicable ASPR requirements, unmodified by the Board's Cost Accounting Standards. The comment does not specify, nor does the Board find, any significant differences at present. The Board does recognize that both the U.S. and U.K. Governments may modify their tax laws and their procurement regulations with an objective to encourage capital investment, and that differences could some day arise. In such case, the Conventions permit sufficient flexibility in individual cases to allow U.S. agencies to reach agreement with U.K. firms on appropriate annual depreciation costs.

Finally, this department has consistently requested unqualified waivers from the Board for use in its prime and subcontracts with U.K. firms. Such firms have in fact been required to follow U.K. Government Accounting Conventions on their work for the U.K. Government, and the department has been able to negotiate mutually agreeable prices for contracts with them despite this circumstance. Under the Board's conditional waiver, the department will have the advantage of a Disclosure Statement from such firms, which could not have been available when an unconditional waiver was sought and which should be of material assistance in the negotiation and audit of new contracts.

The Board is glad that these questions were raised but does not believe it is necessary to modify its proposed conditional exemption to resolve them.

It is appropriate to note here that the Board has not specifically required access to records of U.K. firms by appropriate U.S. officials, as it might have done. Such a requirement appears unnecessary in view of the standard provisions for access to records contained in U.S. defense contracts and subcontracts for performance in the U.K. Access to records through such standard provisions in those contracts will be adequate to assure contractor compliance with the consistency requirement of the conditional exemption.

Another commentator opposed the proposal largely on the basis of his belief that the proposal would require

adoption by U.S. price negotiators and auditors of the pricing practices followed by the U.K. Ministry of Defence. This belief appears to have been based on the reference in the proposal to U.K. Government Accounting Conventions. The Board sees nothing in the conditional exemption which would require U.S. negotiators to accept pricing practices contrary to U.S. procurement regulations and the agreements which U.S. negotiators reach with U.K. firms in the pricing of prime or subcontracts.

This commentator also indicated that not all U.K. firms which are U.S. prime or subcontractors are also suppliers to the U.K. Government. The Board agrees that this could be the case and believes that if so, it is not appropriate for the Board to require that all U.K. firms necessarily adopt the U.K. Government Accounting Conventions. It has consequently modified its proposal to provide that disclosed practices must be in accord with the Conventions only when the disclosing contractor is already required to follow the Conventions. Thus, certain U.K. firms may be subject to neither Cost Accounting Standards nor U.K. Government Accounting Conventions. In such cases, U.S. negotiators must use that firm's Disclosure Statement in arriving at agreement on the cost accounting practices to be followed in contracts subject to the conditional exemption.

Retention of disclosure statements. A commentator pointed out that while the Board had proposed that Disclosure Statements submitted by U.K. firms be filed with the U.K. Ministry of Defence, the Board had not specified that the Statements would be retained in the Ministry. Since that was in fact the Board's intention, the Board has adopted a modification to its proposal in order to make that intention clear.

Prime contractor-subcontractor relationships. Two matters relating to prime contractor-subcontractor relationships were raised. A commentator pointed out that a U.K. subcontract might be subject to price adjustment if the subcontractor changed its disclosed cost accounting practices during contract performance. In such a case, the Government's action would presumably be to require a corresponding change in the cost or price of the prime contract. The Board agrees that this is so, and prime contractors may wish in the future, as some have done in the past, to obtain agreement with U.K. subcontractors for appropriate indemnification in the event the subcontractor's change in practices causes a modification in the cost or price of the prime contract. The Board previously discussed this situation in its original publication of 4 CFR 331.50 and does not consider that specific language addressed to this matter is required to be included in the condition-

al exemption.

Another commentator stated that it was confident that the Board did not intend that the conditional exemption apply to U.S. subcontractors under prime contracts with U.K. firms and urged the Board to address this matter specifically. The Board's proposal does not require any flow-down of the clause, "Consistency in Cost Accounting Practices", from U.K. prime contractors to first tier or lower tier subcontractors. The Board may, after experience in use of that clause is gained, reconsider this matter. In that case, the Board would then have to consider whether it would be appropriate for the Board to require that a U.K. prime contractor be required to pass down to any subcontractor, whether or not a U.S. subcontractor, a more extensive contractual obligation than is imposed on the prime contractor. For the time being, the Board notes the likelihood that U.S. subcontractors under U.K. prime contracts will already be subject to Cost Accounting Standards by reason of other covered prime or subcontracts which that firm has entered into. If this prior coverage has not taken place, the Board believes that the value of achieving coverage through a flow-down provision in a U.K. prime contract is too insignificant to justify the administrative complexities of such a provision.

Further exemptions for foreign suppliers. A commentator, not wishing to comment on the present proposal, nevertheless recommended that the Board exempt all foreign suppliers, on the ground that problems in the administration of the CAS clause are matters of contention and, in the opinion of the commentator, pose relatively greater difficulties in the administration of foreign contracts.

The Board has announced the establishment of projects to investigate the administrative concerns of this commentator and others, and if those concerns prove to be substantial, the Board will take appropriate action. In the more than four years during which the CAS clause has been required to be included in all appropriate foreign contracts and subcontracts, absent a waiver, the Board has heard of no problem in the administration of the clause which has posed any problem in foreign contracts.

Whenever the Board believes a waiver of the CAS clause for foreign firms has been persuasively proposed by a contracting agency, it will grant such a waiver, but the Board's experience to date does not indicate to it any reason to consider a blanket waiver for all foreign prime contracts and subcontracts.

Miscellaneous comments. One commentator, from a major defense contractor, deserves note by the Board because of what the Board perceives to

be major misconceptions and erroneous assumptions underlying the comment.

The comment opposed the proposal for a conditional exemption and favors an unqualified exemption. One reason given, to quote from this comment, is:

By requiring a contract clause which will provide for a penalty to be paid by the U.S. prime contractor in the event that a U.K. subcontractor fails to consistently follow disclosed cost accounting practices where such failure results in increased costs paid by the U.S. Government, is to impose on the U.S. primes an obligation so vague and impracticable as literally to be unique in the history of bilateral contracting.

The Board believes this comment is wholly inaccurate. First, the obligation to consistently follow disclosed or established cost accounting practices is not imposed by the Board's current proposal—it has been present in every U.K. prime contract or subcontract subject to the CAS clause. Secondly, exactly the same obligation of a prime contractor has existed for years with respect to every subcontract it makes which includes the CAS clause. The Board does not believe that the obligation arising under the conditional exemption is either vague or impracticable, and it knows it is not unique.

Additionally, this commentator with respect to the same obligation stated:

For the U.S. Government to impose such alien rules on the defense contracting community in the United Kingdom * * * where neither the Government of the United Kingdom nor the contractors have determined for themselves that there are benefits to the imposition of such punitive rules regarding accounting practices seems patently absurd. Further, to impose on the procurement process such a nebulous and one-sided contractual requirement by the use of the regulatory procedures which will render the clause "mandatory and non-negotiable" is to express an unwarranted contempt by the United States for the standards and practices of business accounting and contracting procedures of the United Kingdom.

Apart from the commentator's several adverse characterizations of the Board's requirements, which are discussed generally below, this portion of its comment does not appear to recognize that the Board's proposal was discussed with the U.K. Government and with representatives of the British defense industries. Through meetings in both Washington and London and through continuing, close consultations, the Board has confidence that its proposal has been carefully reviewed and discussed within the United Kingdom and that its adoption will be welcomed by the firms and governmental agencies affected by it. This careful consultation, and the Board's subsequent proposal for a conditional exemption, arose out of the Board's respect for, not its contempt of, the standards and practices of cost accounting in the United Kingdom.

Finally, this commentator expressed its view that there have been no discernible benefits whatever from the Board's regulations and its further view that the Board has abundant evidence that its regulations requiring consistency in following disclosed cost accounting practices have resulted in "substantial impairment of the economy, efficiency, and effectiveness of procurement * * *". The commentator concluded this point by stating that since it regards the Board's consistency requirement to be "unfair, unworkable and doubtfully enforceable", it would use the proposed conditional exemption for U.K. firms only "with shame and reluctance."

The Board has received reports from procurement agencies of major benefits stemming from use of its consistency requirements, and the Board believes that they have unquestionably improved the economy, efficiency and effectiveness of procurement. The Board believes that those requirements are fair, workable and enforceable.

As noted above, the Board is currently investigating suggestions made by some U.S. defense contractors, including this commentator, to determine whether there are substantial problems in the administration of its requirements to follow disclosed accounting practices consistently. The commentator offers no information concerning any such problem, only its conclusion that the Board has acted wholly improperly in proposing the U.K. conditional exemption. The Board does not agree.

Costs and benefits. The Board discerns no significant cost or inflationary impact of the conditional exemption.

The benefits include a substantial reduction in the number of waiver requests for United Kingdom firms, while establishing a consistency requirement for all U.K. contractors which is necessarily lost when all Board requirements are waived.

A United Kingdom firm could find that its obligations to follow U.K. Government Accounting Conventions might require the firm to change a disclosed cost accounting practice. In such an event, the Board hopes that the cost impact on U.S. contracts or subcontracts of any such change would be negotiated in advance of the effective date of a change to the Convention, so as to avoid the imposition of any interest charges on increased cost paid by the United States. The negotiation relating to a change in disclosed practices would be patterned on the similar negotiation required under Section (a)(4)(B) of the Cost Accounting Standards Clause.

In view of the foregoing, the following change to Part 331 of the Board's regulations is being made effective February 2, 1976.

PREAMBLE H

Preamble to Amendments of 9-12-77

The amendments to 4 CFR Part 331, 42 FR 45625, Sept. 12, 1977 were published as a part of the document which set forth the original 4 CFR Part 332 and amendments to Parts 351 and 403. The complete Preamble appears in the supplement to Part 332.

SMALL BUSINESS

Several commentators urged that all businesses which qualify as small business concerns under the rules and regulations of the Small Business Administration be exempted. The February 16, 1977 proposal would have provided such an exemption only for a small business which received less than \$10 million in awards during its preceding fiscal year. Modified coverage would have been provided for other small businesses. Research indicates that there are very few companies which would fall into the category of small businesses receiving awards of \$10 million or more. In the interest of using a single test, i.e., whether the contractor qualifies as a small business concern, rather than a dual test which would result only in a few small businesses being subject to modified coverage, the Board has adopted the recommendation to exempt all small business concerns. Research indicates that if this action had been applied to Federal Fiscal Year 1976 it would have resulted in exemption of 196 small business concerns which were doing business with the Department of Defense and which had \$460 million of contracts of the type subject to Cost Accounting Standards. Consequently, on average, each small business concern would have a relatively small amount of covered contracts.

OTHER CATEGORIES

Various commentators renewed previous recommendations that the Board exempt other categories of contracts and contractors. The categories included colleges, universities, non-profit organizations, hospitals, and government-owned contractor-operated facilities. The Board has considered these recommendations and concluded that none of these categories should be exempted.

EFFECTIVE DATE

The effective date of the regulations being published today is March 10, 1978. Pub. L. 92-379 provides that regulations shall take effect not earlier than the expiration of the first period of sixty calendar days of continuous session of the Congress following the date on which a copy of the regulations is transmitted to the Congress. The calendars of the Congress indicate that the required sixty days will not pass until some time in February 1978.

Accordingly, March 10, 1978, has been selected to assure sufficient time for the regulation to lie before the Congress.

PREAMBLE I

Preamble to Amendments of 10-5-77

This document added §331.71 and was published Oct. 5, 1977, at 42 FR 54254.

Summary. This modification of the Cost Accounting Standards Board's rules and regulations provides criteria for determining the materiality of costs in given circumstances, in applying words or phrases of materiality used in Cost Accounting Standards, and to limit price adjustments to material amounts of cost.

Supplementary information. A discussion of the background and public comments received in response to the initial publication of these regulations and of the principal issues considered in preparing the final promulgation precedes the regulations.

The purpose of this publication by the Cost Accounting Standards Board is to adopt a modification to Part 331, Contract Coverage, of its rules and regulations. The modification will provide criteria for determining the materiality of amounts of cost in given circumstances. The Board initially considered publishing a definition of the terms "cost accounting practice" and "change to either a disclosed cost accounting practice or an established cost accounting practice" along with the modification dealing with materiality. That definition is being handled separately by the Board, however, and will be considered at a later date.

The Board is authorized by Pub. L. 91-379 to prescribe rules and regulations for implementing Cost Accounting Standards. Pursuant to this authority, the Board is today issuing a modification to its regulations. Contractors and procurement agencies engaged in the implementation and administration of CASB rules, regulations, and Standards have recommended that the Board provide guidance concerning materiality in the administration of the Board's rules, regulations, and Standards.

Representatives from various organizations affected by Standards have pointed out that guidance in this area will facilitate the implementation and administration of CASB pronouncements. A similar recommendation was also received by the Board at an Evaluation Conference in June 1975. The General Accounting Office's Status Report on the Cost Accounting Standards Program—Accomplishments and Problems (PSAD-76-154, Aug. 20, 1976), also referred to the need for guidance on this subject.

Research in this area included a review of data submitted by participants in the Evaluation Conference,

an analysis of papers submitted by various contractors, professional groups, trade associations, and Government agencies, as well as a review of existing procurement regulations, and existing CASB promulgations. A Staff draft of an amendment dealing with materiality criteria and price adjustments was distributed on August 13, 1976. Responses from 53 sources contributed to the Board's further consideration of the issues involved in this proposed amendment.

A proposed amendment to the Board's regulations was published in the FEDERAL REGISTER on February 3, 1977 (42 FR 6591). A total of 45 responses were received from individual companies, Government agencies, professional associations, industry associations, universities, and others. The Board takes this opportunity to express its appreciation for the helpful suggestions and criticisms which have been furnished. The comments furnished by the organizations and individuals have resulted in a number of changes in the amendment being promulgated today. The following material summarizes the issues regarding materiality that were discussed by respondents in connection with the proposed modification and explains the changes made to the proposal published February 3, 1977. The still relevant portions of the comments which accompanied the February 3, 1977, publication have been incorporated in this material.

MATERIALITY CRITERIA

Generally, commentators felt the proposed materiality criteria were a necessary, positive and useful step. However, some commentators suggested that the proposed criteria were not sufficiently specific and would not resolve the materiality questions that currently exist. Some commentators suggested that quantitative criteria be added to the proposed regulation; others suggested that the criteria proposed were suitable.

At the present time, the Board is of the opinion that quantitative limits should not be established for materiality determinations. The essence of materiality criteria is to allow for the exercise of judgment; and absolute dollar amount in one case may be material while in another case the same amount may be immaterial. Accordingly, quantitative limits have not been added to the proposed amendment.

The materiality criteria being promulgated are designed for use in a variety of situations and to resolve issues which have been raised by various sources, Cost Accounting Standards establish the cost accounting appropriate for the determination of contract costs. Departure from the requirements of these Standards may occur and the cost effects of such departure

may be immaterial. The criteria serve to limit price adjustments to material amounts of cost. The regulation also describes the actions to be taken when immaterial amounts of cost are involved in noncompliance with Standards. The criteria for materiality are also to be used in applying words or phrases of materiality used in Cost Accounting Standards. In particular Standards, the Board will continue to give consideration to defining materiality in a specific manner as to either the entire Standard or any provision thereof, whenever it appears feasible and desirable to do so.

ADMINISTRATIVE COSTS

Commentators proposed that the administrative cost of processing a change in cost accounting practice to both the Government and the contractor should be one of the criteria used in determining materiality. The Board's initial publication did not provide for consideration of these costs in determining materiality. Generally, such costs on the part of both the Government and the contractor are absorbed as part of their routine operations. On a conceptual basis, the determination of materiality should be made considering only the amount of costs affected by the proposed changes. As a practical matter, however, the administrative cost to process a contract price adjustment is a factor in a materiality decision.

The Board is persuaded that the administrative cost of processing a change in cost accounting practice should influence a decision as to materiality. For example, if it is estimated that costs would be changed by \$10,000 through processing a change at a Government-contractor administrative cost of \$10,000, then processing the change would be nonproductive whether or not, considering all materiality factors, the estimated change in costs of \$10,000 would be judged material. Accordingly, the Board has added a provision to this modification dealing with such costs.

MEASUREMENT OF COST IMPACT

Commentators suggested that the Board's regulations provide that initially the determination of materiality should be done on a gross, overall, basis rather than on an in-depth cost impact study. These commentators asserted that a provision of this type would help to reduce the time and cost of evaluating and processing proposed changes which are judged to have an immaterial impact. Procedures for measuring and processing cost impact due to both changes in cost accounting practice and noncompliances with Cost Accounting Standards have been developed by the procurement agencies, and they now require an estimate of the general dollar magnitude of the

change as a first step in the process. The Board encourages the use of the materiality criteria promulgated today in conjunction with the existing two-stage cost impact evaluation procedure provided in procurement agency regulations. The Board believes that the effective use of procedures established in agency regulations will accomplish the saving in time and cost desired.

Some Government commentators proposed that § 331.71(b)(2) be deleted. They expressed the view that it dealt with administrative matters and not criteria for the determination of materiality. The question of both the contractor's and the Government's responsibility in situations where non-compliance with Cost Accounting Standards resulted in a cost impact which is immaterial has frequently arisen. The Board believes that the implementation and administration of cost accounting rules, regulations, and Standards will be facilitated by a statement of the Board's position on this matter. Accordingly, the Board believes that the section in question should be retained in its regulations.

RETROACTIVE APPLICATION

Commentators expressed concern that § 331.71(b)(2) would be applied retroactively to immaterial items. The language of this section requires that it be applied to the accounting period for which the cost impact of a non-compliance becomes material and to succeeding cost accounting periods. In any cost accounting period prior to that, by reason of the provisions of this requirement, the cost impact of the noncompliance would have been determined to be immaterial. Thus, no contract modification was or is required.

ILLUSTRATIONS

The February 3, 1977, proposal contained two illustrations of the application of the materiality criteria. A number of commentators stated that the illustrations were too basic to be useful, and that the problems related to the determination of materiality are too numerous and too complex to be adequately illustrated in a regulation of this type. The commentators suggested that the illustrations be eliminated. The Board agrees, and has eliminated the examples in this section.

PREAMBLE J

Preamble to Amendments of 3-10-78

The document published at 43 FR 9775, Mar. 10, 1978, added § 331.20(h), (i), and (j), § 331.50(a)(4)(C), § 331.51, § 332.50(a)(5), and § 332.51, revised § 331.50(a)(4)(B), and (d) introductory text and (d) (1) and (2), and amended Parts 351, 403, 406, and 409.

The purpose of this publication by the Cost Accounting Standards Board is to adopt a modification to part 331,

Contract Coverage, and part 332, Modified Contract Coverage, of its rules and regulations. The Board is also withdrawing a proposal to modify § 331.70. This modification being adopted will (1) provide definitions of the terms "cost accounting practice," and "change to either a disclosed cost accounting practice or an established cost accounting practice," (2) permit the negotiation of equitable adjustments to reflect the cost impact of changes agreed to by both parties to the contract, and (3) establish the effective date for application of standards to subcontracts. The December 1976 proposal to modify the method of determining increased costs is being withdrawn.

The Board is authorized by Pub. L. 91-379 to prescribe rules, regulations, and modifications for implementing cost accounting standards. Pursuant to this authority, the Board is today issuing modifications to its regulations. Contractors and procurement agencies engaged in the implementation and administration of CASB rules, regulations, and standards have recommended that the Board provide guidance concerning the meaning of "cost accounting practice" and "change to either a disclosed cost accounting practice or an established cost accounting practice."

Representatives from various organizations affected by standards have pointed out that guidance in these areas will reduce disagreement and facilitate the implementation and administration of CASB pronouncements. Similar recommendations were also received by the Board at evaluation conferences in June 1975 and October 1977. The General Accounting Office's Status Report on the Cost Accounting Standards Program—Accomplishments and Problems," (PSAD-76-154, August 20, 1976), also referred to the need for guidance on these subjects.

Research in this area included a review of data submitted by participants in the evaluation conferences, an analysis of papers submitted by various contractors, professional groups, trade associations, and Government agencies, as well as a review of existing procurement regulations, the Internal Revenue Code, Accounting Principles Board Opinion No. 20, and existing CASB promulgations. A staff draft of amendments containing definitions of "cost accounting practice" and "change to either a disclosed cost accounting practice or an established cost accounting practice" was distributed on August 13, 1976. Responses from 53 sources contributed to the Board's further consideration of the issues involved in these proposed amendments.

Proposed amendments to the Board's regulations were published in the FEDERAL REGISTER on February 3, 1977 (42 FR 6591). A total of 45 re-

sponses were received from individual companies, Government agencies, professional associations, industry associations, universities and others. The proposed amendments were revised and republished for comment on October 21, 1977 (42 FR 56130) and included a proposed change to the CAS contract clause. A total of 40 responses were received to that publication.

The Board takes this opportunity to express its appreciation for the helpful suggestions and criticisms which have been furnished. These comments have resulted in a number of changes and improvements in the amendments being promulgated today. The following material summarizes the issues discussed by respondents in connection with the proposed modification and explains the changes made to the proposals published February 3 and October 21, 1977. The still relevant portions of the comments which accompanied the earlier publications have been incorporated in this material.

DEFINITION OF COST ACCOUNTING PRACTICE

The need for a definition of "cost accounting practice" has been raised by numerous inquiries from the field and by participants in the evaluation conferences. The Board agrees, and believes that a definition of this term can reduce disputes and contribute to increased uniformity in the administration of the CAS contract clause.

A number of commentators expressed the view that the proposed definition was workable and useful as presented, would serve to reduce disagreements, and would facilitate the administration of cost accounting standards. Some said that the proposal, if adopted, would go a long way towards solving several problems identified in earlier written communications to the Board and oral presentations to the Board and its staff. Some encouraged the Board to promulgate the rule at an early date and commended the Board for taking a very significant step towards solving one of the troublesome and difficult areas of Cost Accounting Standards.

Other commentators suggested that the proposed definition went beyond the authority of the Board in that it included both the measurement of cost and the assignment of cost to cost accounting periods.

They asserted that these are financial accounting topics and are not within the realm of cost accounting. Still other commentators stated that the Board was dealing with detailed practices and procedures rather than Cost Accounting Standards and principles.

As early as March 1973, in the "Statement of Operating Policies, Procedures, and Objectives" and more recently in the May 1977, "Restatement of Objectives, Policies and Concepts,"

the Board stated that Cost Accounting Standards will be established to define and measure cost, determine the cost accounting periods to which costs are assigned, and determine the manner in which costs are allocated to covered contracts. The Board has spoken directly to the measurement of cost in Cost Accounting Standards 404 and 412 and to the assignment of costs to cost accounting periods in Cost Accounting Standards 408, 409 and 412. The definitions being promulgated today are consistent with the Board's authority and previously adopted view that cost accounting practices include measurements of cost, assignment of cost to cost accounting periods and allocation of costs to cost objectives.

Questions have been raised as to whether the measurement of cost includes the determination of the price to be paid by the contractor for goods and services. From the beginning of the project to define a cost accounting practice, the Board has taken the position that the determination of the amount paid or a change in the amount paid for units of goods and services does not constitute a change in cost accounting practices. The definition has been revised to convey this concept more clearly.

With respect to commentators' views on the difference between Cost Accounting Standards, principles, and practices, the Board's 1973 "Statement of Operating Policies, Procedures, and Objectives" and the 1977 "Restatement" describe a Cost Accounting Standard as:

A Cost Accounting Standard is a statement formally issued by the Cost Accounting Standards Board that: (1) Enunciates a principle or principles to be followed, (2) establishes practices to be applied, or (3) specifies criteria to be employed in selecting from alternative principles and practices in estimating, accumulating, and reporting costs of contracts subject to the rules of the Board. A Cost Accounting Standard may be stated in terms as general or specific as the Cost Accounting Standards Boards considers necessary to accomplish its purpose.

This position is similar to the approach the accounting profession takes in dealing with accounting principles for financial reporting. The Accounting Principles Board Opinion No. 20, Accounting Changes, states:

The term accounting principle includes not only accounting principles and practices, but also the method of applying them.

Thus, in line with previous statements, the Cost Accounting Standards Board reiterates its position that the terms "principles and practices" include methods and techniques. The Board's position is consistent with Pub. L. 91-379 and reflects one of the principal purposes of setting Standards, which is to measure the full cost of supplies and services acquired by the Government in a way that is fair to both buyer and seller.

Commentators also raised the question of what should be the required level of detail of a cost accounting practice. The issue is what is the appropriate and necessary level of accounting detail for effective implementation of Pub. L. 91-379. For cost allocation purposes the Board has concluded that the level of detail should include not only the type of base, e.g., direct labor, but also the composition of that base, e.g., the elements of labor costs comprising the base. Similarly, the level of detail should include the types of indirect cost pools as well as the components or items of cost which make up those pools. As to measurement of cost, the level of detail includes identification of components of a particular item of cost and the basis on which cost is measured.

DEFINITION OF CHANGE TO EITHER A DISCLOSED COST ACCOUNTING PRACTICE OR AN ESTABLISHED COST ACCOUNTING PRACTICE

With respect to the February 3, 1977, proposed definition, commentators requested expansion of those changes in cost accounting practices which would not be subject to the provisions of paragraphs (a)(4) and (a)(5) of the Cost Accounting Standards contract clause (4 CFR 331.50). Commentators recommended that changes to improve management controls, accounting changes which the Government and contractors believe would be beneficial in the long run, and changes due to changed business circumstances should be added to § 331.20 as actions which are not considered as a change in cost accounting practice for purposes of paragraphs (a)(4) and (a)(5) of the Cost Accounting Standards Contract Clause (4 CFR 331.50).

The Board notes that in a dynamic business environment it may be desirable to make changes of many types. These changes may include organizational changes, changes in the way work is performed, and changes in the product produced. There may be a variety of reasons for these changes, such as better managerial control, new technology, or changed business conditions.

These business changes by themselves are not changes in cost accounting practices. Such changes may, however, cause a change in a contractor's cost accounting practices. In a circumstance where there is a change in a cost accounting practice, the contractor and Government must take certain action under the provisions of the CAS contract clause. Only when the contracting officer does not make the required determination under the new § 331.50(a)(4)(C) would contracts be amended to insure that the Government does not pay any increased cost as a consequence of the change.

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.

It is to be expected that the accounting system must change—betterments, improvements, modifications or alterations to the system are necessary to accommodate the business changes discussed above. The Board notes that Pub. L. 91-379, in its provisions relative to failure of a contractor to follow consistently his disclosed practices, makes no distinction among the causes of changes in cost accounting practices. Thus, accounting changes of the types described by the commentators, which result in a failure of a contractor to follow consistently his previously disclosed or established practices, remain subject to the CAS contract clause (4 CFR 331.50). While a number of the suggestions made have been adopted and are discussed in the following material, the suggestions that changes in cost accounting practice due to changed circumstances or to improve management control be excluded from adjustment under the CAS contract cause have not been adopted by the Board. These types of changes are subject to review and agreement by the contracting officer and the contracts may be adjusted under new § 331.50(a)(4)(C).

A number of commentators urged that changes resulting from issuances of the Financial Accounting Standards Board should also be excluded from paragraphs (a)(4) and (a)(5) adjustments. The legislative history leading to creation of the Cost Accounting Standards Board shows that standards and principles issued for financial accounting purposes were not deemed suitable for cost accounting for negotiated Government contracts. The Cost Accounting Standards Board views its own work as relating directly to the preparation, use and review of cost accounting data in the negotiation, administration and settlement of negotiated defense contracts. The Board is the only body established by law with the specific responsibility to promulgate Cost Accounting Standards and these Standards have the force and effect of law in the negotiation, administration and settlement of defense contracts.

The Board seeks to avoid conflict and disagreement with similar organizations having other responsibilities in the area of accounting Standards and through continuous liaison makes every reasonable effort to do so. The Board will give careful consideration to the pronouncements affecting financial reporting and in the formulation of Cost Accounting Standards it will take these pronouncements into account to the extent it can do so in accomplishing its objectives. Neverthe-

less, the nature of the Board's statutory authority and its mission to establish Cost Accounting Standards for negotiated defense contracts is such that it must retain and exercise full responsibility for meeting its objectives. Accordingly, the Board has not adopted this suggestion.

ALTERATIONS NOT CONSIDERED CHANGES IN COST ACCOUNTING PRACTICES

The February 1977 proposed definitions specifically provided that certain contractor actions should not be considered as changes in cost accounting practices. These include the initial adoption of a cost accounting practice or the elimination of a cost accounting practice. A number of commentators expressed the opinion that the accounting treatment of a cost which up to a given point in time has been immaterial in amount and now becomes material in amount is a situation very similar to the establishment of a practice for the initial incurrence of a cost. They pointed out that Accounting Principles Board Opinion No. 20, Accounting Changes, treats this situation as a first time incurrence of a cost rather than a change in accounting principle or practice.

The Board has previously expressed the position that administration of Cost Accounting Standards should be reasonable and not seek to deal with immaterial amounts of costs. In concert with this position, the Board in the October 1977 proposal modified § 331.20(i) to provide that a change in accounting for a cost which has previously been immaterial and now becomes material is not a change in cost accounting practice.

The alterations described above are not treated under the CAS contract clause as changes in cost accounting practices. They can, however, result in the establishment of cost accounting practices. Where such is the case, the requirements of the CAS contract clause (4 CFR 331.50) will apply. The new practices must be followed consistently on all CAS contracts, and Disclosure Statements updated where appropriate.

SUBSEQUENT CHANGES UNDER A STANDARD

The Board's October 1977 proposal provided that when a Standard with which the contractor has complied subsequently requires the contractor to alter a cost accounting practice in order to remain in compliance, that alteration shall not be a change in cost accounting practice for purposes of paragraphs (a)(4) and (a)(5) of the CAS clause. Some commentators said that their proposal was inconsistent with the Board's position in 4 CFR Part 403. Others said that unless a contract adjustment can be made under CAS regulations no acceptable

adjustment mechanism was available. Most commentators generally felt that changes of this type should be dealt with under CAS regulations.

The Board believes that this provision is not inconsistent with 4 CFR Part 403. In that Standard, the Board was limiting use of equitable adjustment to the first time that a particular allocation provision of the Standard was applied.

The Board recognizes the points made by the commentators, however, and has concluded that a change in cost accounting practice to remain in compliance with a Standard does not constitute a failure to comply with Cost Accounting Standards or to follow consistently disclosed cost accounting practices. Accordingly, the Board has deleted from the regulations being published today the provision excepting adjustments for subsequent changes under a Standard from being considered under paragraph (a)(4) of the Board's regulations, because changes of this type will be covered by new paragraph (a)(4)(C) of the CAS contract clause which calls for negotiation of an equitable adjustment. The Board also notes that contractors who have filed Disclosure Statements would be required to amend such Statements to describe the practices to be followed.

CHANGE COMPELLED BY LAW OR REGULATION

A number of commentators urged the Board to delete the exception in its October 1977 proposal for price adjustments under cost accounting standards for changes compelled by law or regulation § 331.20(i)(3). Some contended that all changes, regardless of motivation, should be considered for adjustment under the Board's new proposed subparagraph dealing with changes agreed to by the parties. Other commentators urged the Board to remove the exception to preclude a contractor from experiencing a windfall or suffering a loss because of such changes.

The Board agrees with the suggestions made to delete this paragraph, because the Board feels that all contractor proposed changes in cost accounting practice should be considered for contract adjustment. Therefore, a contractor desiring to make a change in cost accounting practice for any reason must negotiate with the contracting officer under the appropriate paragraph of the CAS contract clause.

Should a situation arise where major changes in cost accounting practices would be required by contractors to comply with express provisions of a law or regulation, the Board would seek to accommodate any such requirement by a change in its standards, rules or regulations.

The Board has deleted from these amendments the proposed

§ 331.20(i)(3) which dealt with changes compelled by law or regulation.

ILLUSTRATIONS

Many commentators said that all or some of the illustrations should be deleted, while other commentators said they should be retained. The Board included the illustrations to demonstrate the application of the definitions in situations of the type which have been reported to the Board in the past.

The Board noted that some of the illustrations dealing with changes in organization were being misinterpreted. In effect, the commentators expanded the illustrations to include situations not set forth in the illustrations. The Board concluded that in view of the extent of misinterpretation, it would be questionable value to revise the illustrations to cover all the situations described by commentators. Accordingly, several illustrations dealing with accounting changes related to organizational changes have been deleted.

As the Board stated when the proposed definitions were published in February 1977, the accounting effects of any organizational change must be considered separately and a final decision concerning a change must be based on an evaluation of those effects. Thus, an organizational change per se is not a change in cost accounting practice. One must look at any accounting revision brought about for any reason, including one caused by a change in organization.

By including the illustrations the Board does not intend to imply that all possible situations are covered nor are the illustrations to be used as limitations for accounting changes. The Board believes that the changes made to this section are responsive to the statements made by commentators.

CONTRACT CLAUSE

The Board proposed in October 1977 that where the parties agree to a change in cost accounting practice they should negotiate an equitable adjustment for any cost impact on existing contracts. Most commentators agree with this proposal but some felt that the contracting officer's agreement should not be necessary. Others urged the Board to state that a contracting officer's disagreement with a change is subject to the disputes clause of the contract. Further, a number of commentators suggested that the new contract adjustment paragraph be renumbered (a)(4)(C) to avoid confusion with the pre-existing numbering series. Finally, some commentators asked if the Board planned to make comparable revisions to its Part 332, Modified Contract Coverage.

The October 1977 proposal was in response to urging by both contractor and Government agency representatives to establish an alternative to

paragraph (a)(4)(B) for adjusting contracts where both parties agreed that a change in cost accounting practice was desirable. Under that proposal, a method was established providing for equitable adjustment for these changes. The Board does not agree that contracting officer's agreement is not necessary and remains convinced that Government agreement to the change is essential to protect the Government's interests.

With respect to the treatment of a contracting officer's disagreement with a proposed change in cost accounting practice under the disputes clause of the contract, the Board believes this should be determined under agencies' general rules governing appeals from various types of decisions by contracting officers. Accordingly, the Board has not specifically provided for the application of the disputes clause in this situation.

The Board agrees with the suggestion concerning the renumbering of the paragraph dealing with equitable adjustments for changes in cost accounting practices agreed to by the parties. The amendments being published today have that paragraph numbered (a)(4)(C). Designating the new paragraph as (a)(4)(C) eliminates the need to change citations in other subparagraphs in section 331 from those previously existing in CASB regulations.

With respect to the question concerning comparable revisions to Part 332, the new definitions and illustrations are incorporated in § 332.20 by the existing cross reference to § 331.20. The Board's regulation concerning changes in cost accounting practices agreed to by the contracting officer will be incorporated in §§ 332.50(a) and 332.51 by amendments being published today.

INCREASED COST PAID

Commentators at the 1977 Evaluation Conference and respondents to the February 3 and the October 21, 1977, proposals requested that the Board remove from its regulations the prohibition against increased costs paid because of changes in cost accounting practices (§ 331.50(a)(4)(B)) and/or that the expression "increased costs paid" (4 CFR 331.70) be redefined to exclude fixed price contracts. The Board has established a priority project to perform a comprehensive review of Part 331 of its regulations, including the treatment of increased costs paid.

CONTACTING OFFICER DETERMINATION

Many commentators objected to the Board's including a requirement that a contracting officer make a finding that a change is desirable and is not detrimental to the interest of the Government. Some claimed that such a requirement encroached on manage-

ment's prerogative to design an accounting system to meet its needs; others said the decision concerning changes was an administrative matter, better left to the agencies. Others suggested that different terms be substituted for some of the words. Finally, some commentators said that the Board should require only that agencies prescribe appropriate regulations for the use of the equitable adjustment provision for accounting changes agreed to by the parties.

The Board understands the concerns expressed by the commentators on this matter. It should be recognized, however, that the Board is proposing that equitable adjustments be negotiated for accounting changes not required by Standards. This type of provision was requested by many contractors and Government agencies in the past. These groups insist that agreed-to changes should be allowed and that the contractor should not be required to pay for any increased costs on existing contracts resulting from such desirable changes. The Board is responding to these requests by providing for equitable adjustments for those proposed changes with which the contracting officer agrees if he finds them to be desirable and not detrimental to the interests of the Government.

Management certainly can propose any changes it feels desirable for its own accounting system. If a change is not desirable from the Government's point of view, the Board sees no justification for permitting the contractor to realize economic benefits on existing contracts from the change.

The Board's regulation merely recognizes the contracting officer's position and does not encroach on the administrative responsibilities of the procurement agencies. A contracting officer would routinely make certain that a contractor's proposed change is not detrimental to the Government before agreeing to allow increases in contract prices.

Some suggested alternative words for "desirable" were: "Appropriate, warranted, equitable, fair or reasonable." The Board concludes that all of these tests are encompassed by the Board's language. Accordingly, this statement has not been changed.

The Board expects administrative agencies to publish regulations they feel necessary to define what they conclude is "desirable and is not detrimental to the interest of the Government." Thus, the Board does not agree that it is getting involved in administrative matters.

The Board agrees with the commentators who suggested that the second sentence of § 331.51, which required that the contracting officer document the basis for his finding, be eliminated. The Board believes that the stated documentation requirement is redundant with other language in this sub-

paragraph, and accordingly, that sentence has been eliminated.

WITHDRAWAL OF PROPOSED ALTERNATIVE METHOD OF DETERMINING "INCREASED COSTS"

On December 29, 1976, a proposal was published in the FEDERAL REGISTER to amend § 331.70(b) which, if adopted, would have permitted procurement agencies to use either an estimate-to-complete approach or an original-negotiation-data approach to determine increased costs paid by the United States. As proposed, agencies would have been authorized to use the estimate-to-complete method when negotiations had not been based on cost estimates or such estimates were not readily determinable by the procuring agency.

Most of the comments received expressed opposition to all or part of the proposal. Upon reexamining the subject in light of the comments received, the Board concludes that the proposed alternative method would not provide sufficient improvement in the administration of Standards to warrant its adoption. Additionally, none of the alternatives suggested by the commentators appears likely to benefit the procurement process materially. Accordingly, the proposal to amend § 331.70(b), Contract Coverage, as published in the FEDERAL REGISTER of December 29, 1976, is hereby withdrawn. This subject will be considered in the Board's comprehensive review of Part 331.

COSTS AND BENEFITS

The definitions promulgated today fill a void that had been recognized in numerous comments to the Board and the procurement agencies. The Board believes that the material being promulgated today is in keeping with its responsibility and authority as provided in Pub. L. 91-379. The Board believes further that the appropriate use of the definitions can significantly reduce the time and effort involved in the administration of Cost Accounting Standards. The Board concludes, therefore, that there will be virtually no costs involved in implementing these regulations and that there will be significant benefits with no inflationary effects.

MISCELLANEOUS AMENDMENTS

A number of miscellaneous amendments are being published today to conform language in certain paragraphs of Title 4 CFR Parts 351, 403, 406 and 409. These amendments add references to the new § 331.50(a)(4)(C).

EFFECTIVE DATE

The following changes to the

Board's regulations are being made effective today, March 10, 1978.

PREAMBLE K

Preamble to Amendments of 6-8-78

The document published as 43 FR 24819, June 8, 1978, added § 331.30(b)(3) and revised §§ 403.70(b), 408.70, and 410.70 and 415.80. Portions of this preamble, relating to Parts 401 through 410 and 415 have been omitted; they can be found in the supplements to their respective parts.

The Cost Accounting Standards Board is authorized by Pub. L. 91-379 to prescribe rules and regulations exempting from its requirements such classes or categories of defense contractors or subcontractors under contracts negotiated in connection with national defense procurements as it determines on the basis of the size of the contracts involved or otherwise, are appropriate and consistent with the purposes sought to be achieved by the Act.

The Cost Accounting Standards Board has been requested by several Federal agencies and by representatives of educational institutions to consider the extent to which its standards, rules, and regulations should apply to educational institutions that are subject to Federal Management Circular 73-8 or OMB Circular A-21 and to consider whether an exemption for such institutions from Board promulgations is appropriate. The Board had provided exemptions for them in certain specific standards where the application would not be appropriate.

On March 15, 1978, the Board published for comment in the FEDERAL REGISTER (43 FR 10699) a proposal to exempt most educational institutions. The exemption would not apply to contracts with federally funded research and development centers operated by such educational institutions. Forty-seven comments have been received, all of which favored the proposed action by the Board although some respondents requested minor changes and clarifications.

A few commentators expressed concern that an educational institution receiving a contract from the Government could apportion the contract effort between the university and the FFRDC to take advantage of differences in cost accounting required under CAS and under FMC 73-8. If this becomes a problem, the procuring agencies are able to take the necessary corrective action.

Several commentators noted that there could be some misunderstanding concerning the applicability of CAS 403 to the university which is functioning as a "home office" for an FFRDC. The Board intends that CAS 403 not be applicable to the university in this situation and minor changes have been made to the language to

clarify its intent.

One commentator indicated that the definition of FFRDC is not meaningful and suggested that the Board list the criteria by which NSF designates an FFRDC. Since coverage is intended only for those organizations designated as FFRDC's by the NSF based on whatever criteria they deemed appropriate, inclusion of their current criteria would not be useful. Accordingly, no changes have been made in the definition included in § 331.30(b)(3).

One commentator noted that the removal of current exemptions from CAS 403, 408, and 410 for FFRDC's will require a transitional period. It is considered that the provisions of §§ 403.70(a), 408.80, and 410.80 will furnish sufficient time for compliance by the FFRDC's with those standards. Section 403.70(a) provides that a contractor, if not exempt, shall be required to comply at the start of his first cost accounting period following receipt of the award of a negotiated national defense contract making the standard applicable. A contract awarded after August 1, 1978, will make the standard applicable to a FFRDC. Consequently, a FFRDC must comply with CAS 403 as of the start of its next cost accounting period after receipt of a contract after August 1. Standards 408 and 410 apply in the same way. It is recognized that all FFRDC's do not necessarily receive a new contract each year and that annual funding may be by means of an amendment to an existing contract. Applicability would be at the start of a cost accounting period after receipt of a new contract or after receipt of the annual extension of an existing contract.

The Board having found the exemption appropriate and consistent with purposes sought to be achieved by Pub. L. 91-379, is modifying its regulations as set forth below.

PREAMBLE L

Preamble to Amendments of 11-14-78

The document published on Nov. 14, 1978, at 43 FR 52693 revised § 331.30 (b)(5), (c)(1) and (c)(2).

The Cost Accounting Standards Board is today promulgating amendments to its regulations dealing with exemptions for contracts and subcontracts performed by foreign governments and foreign concerns. On July 31, 1978, the Cost Accounting Standards Board published a proposal under which contracts or subcontracts with foreign concerns could be exempted from certain individual standards if an authorized official of a relevant Federal agency determines that application of the standards to such contracts or subcontracts is inappropriate. The Board received 12 comments on the proposal.

One commentator opposed the proposal as unnecessary because the Board itself has authority to grant exemptions when such action is appropriate and asserted that delegation is undesirable because such decisions are too important to be delegated. The Board agrees that decisions concerning exemptions are important and has carefully considered the proposed action in the light of all comments and other available information. Based on that consideration the Board has concluded that it should grant a specific categoric exemption. Consequently no delegations are needed. Moreover because of the categoric exemption, the need to amend individual standards is obviated.

One government agency to whom delegation of authority was proposed noted that in implementing the delegation, one of the factors it would consider in determining whether the application of an individual standard is appropriate is the matter of sovereignty. Because of the action being taken today, there is no need to comment on the appropriate weight to be assigned to that factor.

Another commentator also discussed sovereignty and suggested that the United States has no legal right to impose the requirements of its laws and regulations on foreign contracts. To support this assertion, the commentator cited an official of the Department of Defense who attributed some of the difficulties in foreign procurements to the insistence upon contracts rather than general agreements. Whether a contract or some other instrument is used is something to be decided by other agencies of the government and not by the CASB. The Board has long recognized that its Standards are not applicable to non-contractual arrangements and agrees with the suggestion that if the procuring agencies used some noncontractual arrangement to transact business with foreign contractors, CAS would be inapplicable to the transaction. However, when the parties agree to use a negotiated national defense contract or subcontract as the vehicle for transacting business, the agreement must include the standards, rules, and regulations of the Board.

One commentator expressed the opinion that no substantial benefit would accrue to the United States under the limited exemption originally proposed but that a complete exemption from all Cost Accounting Standards Board requirements would be beneficial. Instead of the proposed exemption and delegation, that commentator recommended that all contracts and subcontracts with foreign firms and governments be exempt from all CAS requirements. The Board does not agree that a limited exemption would produce no significant benefits but that a complete exemption would.

Significant benefits accrue to the United States Government from all standards, in part because each standard enhances the likelihood of achieving the goal of uniformity and consistency set forth in Pub. L. 91-379. The Board believes that by exempting foreign contracts from some standards there is a detriment rather than a benefit insofar as the public law itself is concerned. Nonetheless the Board has been advised that the requirement to apply some standards has become a significant impediment to efficient, successful contracting with foreign concerns and foreign governments.

The exemption being granted today will remove that impediment while continuing to provide protection through the application of CAS 401 and 402. In addition, foreign concerns will still be required to file Disclosure Statements.

The requirements of CAS 401 and 402 are fundamental to any sound cost accounting program. In the Board's view application of these standards is essential to provide some assurance that a contractor's cost accounting practices are sufficient to provide reliable information on which to base the negotiation, administration, and settlement of contracts. Similarly, the requirement for disclosure which is also being continued unchanged, serves to assure that necessary information about cost accounting practices is available to the Government.

Several commentators recommended that in addition to contracts with foreign contractors, the Board should exempt contracts with foreign governments. The Board has concluded that this recommendation has merit and the exemption being promulgated today has been amended accordingly. Because the exemption established in 1972 for the Canadian Commercial Corp., an agency of the Canadian Government, is included in today's exemption action, the 1972 exemption is being withdrawn.

One commentator suggested a need to define "foreign concerns" and another recommended that "performance" be defined. The term "foreign concern" has already been defined by the Board in § 331.30(c)(2).

As to what constitutes "performance," the Board believes that in general it encompasses the contractor's activity under the contract up to the point of inspection and acceptance of the items called for by the contract. However, because of the complexity and variety of contracts, the Board believes that the contracting agency can best determine whether a specific contract is to be performed outside the United States.

A number of commentators suggested various changes in the delegation procedures proposed by the Board. Since the Board is withdrawing the

delegation, there is no need to consider these suggestions.

One commentator suggested that the reference in § 331.30(c) to the Assistant Secretary of Defense (Installations and Logistics) be changed to reflect organizational changes in the Department of Defense. This revision has been made.

PREAMBLE M

Preamble to Revision, 9-18-80

The material set forth below is the preamble to the revision and republication of Part 331, September 18, 1980, at 45 FR 62011. This preamble to the publication of September 18, 1980, is included as part of the administrative history of Part 331.

SUMMARY

On June 1, 1979, the Board published in the FEDERAL REGISTER proposed revisions to Parts 331, 332 and 351 of its regulations dealing with contract coverage and the filing of Disclosure Statements. Based on comments to its June 1 proposal, the Board made substantial modifications in the proposed revisions and republished the revised Parts again for comment on February 8, 1980. After considering the comments to the second publication and reviewing all suggestions from interested parties, the Board has determined that the revised regulations are ready for promulgation. It believes that the revised regulations will result in improved administration and will be more readily understood by parties subject to the regulations.

EFFECTIVE DATE

April 1, 1981.

SUPPLEMENTARY INFORMATION

In the FEDERAL REGISTER of June 1, 1979, (44 FR 31655) the CASB published for comment proposed revisions to Parts 331, 332 and 351 of its regulations. The revisions were made for the purpose of simplifying these parts of the regulations and to modify them where experience indicated that changes would be desirable. Thirty-six responses were received by the Board to its request for comments.

The Board after consideration of the comments modified its proposed revisions and again published the revised parts for comment in the FEDERAL REGISTER of February 8, 1980 (45 FR 8677). Twenty comments were received to the February publication. The Board wishes to thank all of the respondents for their constructive suggestions which were of substantial assistance to the Board in its review and revision of these parts.

In the February 8 proposal two areas of the regulations drew a substantial number of comments from the respondents, the exemption of firm fixed price contracts (FFPs) awarded

without submission of cost data and the definition of "increased costs paid by the Government" as such may occur under FFPs after award. The Board's views on these two areas and on other comments received are as follows:

1. *Exemption.* Commentators generally endorsed the Board's proposal to exempt FFPs awarded without submission of any cost data. However, most commentators urged the exemption be expanded to require that cost data be certified or that the data have been relied on as the basis of price.

The Board is not persuaded that the suggested modifications should be made in describing those contracts which would be subject to this exemption. Situations occur in which cost data are submitted in support of a price but are not certified because the award is designated as adequate price competition. Whether the data are used in a particular case can be difficult to establish. The Board however is satisfied that such data would not be submitted unless they were to be used. Because of this and because of the administrative simplicity of the test, the Board believes that the circumstances which would support an exemption of certain FFPs being adopted today is appropriate.

One commentator opposed the establishment of this exemption on the grounds it provided a positive incentive for a potential contractor to seek to avoid submission of cost data. Controlling law and regulations establish the circumstances under which a potential contractor may be required to submit cost data to support a price proposal in a national defense procurement. In addition Government representatives have authority to act to assure that the Government's interests are properly protected. Consequently, whether a potential contractor may or may not have an incentive to avoid submitting cost data is not determinative as to whether such data are submitted. The Board believes that Government representatives, in cases where they deem it appropriate, will obtain whatever data they are entitled to. Nonetheless, the Board acknowledges that linking application of Cost Accounting Standards to submission of cost data could result in requests for waivers from the cost data submission requirements that would not be made if cost data alone were involved. In order to preclude this result the Board has revised the exemption so that contracts on which submission of cost data was avoided by obtaining a waiver of cost or pricing data requirements nonetheless remain subject to the Cost Accounting Standards requirements.

2. *"Increased costs paid" under FFPs after contract award.* In its February 8 proposal the Board deleted certain proposed revisions contained in its

June 1, 1979 proposal concerning the adjustment of FFP contracts in view of the objections of most commentators to the proposed changes. The Board in its February proposal limited changes in the regulations affecting FFPs to a clarification in § 331.70(b) concerning the measurement of increased costs paid by the United States under those contracts. The modified § 331.70(b) paragraph was the subject of adverse comment by a majority of industry commentators who maintain that under FFP contracts once price is agreed to, there can be no increased cost paid by the U.S. attributed to any subsequent changes the contractor may make in its cost accounting practices.

The question of adjustment of FFPs has been the subject of extensive discussions since 1972. In its original promulgations the Board recognized that there was increased cost paid by the U.S. under a FFP contract if during the accumulating and reporting process the contractor adopted practices that reduced his cost allocations below the allocation determined during the estimating process. It is noted that in the proposed contract regulations published for comment on December 30, 1971, a provision the same in all essential aspects to the present § 331.70(b) was included. At that time no commentator questioned the applicability of CAS to FFPs.

The second sentence of Section (h)(1) of Pub. L. 91-379 is as follows:

Such regulations shall require * * * a contract price adjustment, with interest, for any increased cost paid because of the defense contractor's failure to comply with * * * standards or to follow consistently his disclosed cost accounting practices * * * in pricing contract proposals and in accumulating and reporting contract performance cost data.

This provision prescribes price adjustments for all contracts where there is a failure to comply in pricing proposals and in accumulating and reporting costs. Since the Congress did not exclude FFP contracts when it provided for recovery of increased cost paid to the contractor because of a failure to comply or failure to follow, it was and still is incumbent on the Board to insure that, in the absence of an exemption, such recovery is accomplished. Pub. L. 87-653, Truth in Negotiations, provides that the price of a contract shall be adjusted to exclude any significant sum by which a firm fixed price was increased because the cost data furnished by the contractor, in essence, was insufficient to enable the Government to judge accurately the contractor's cost estimates used in negotiating. The Board's requirements for adjustments to firm fixed price contracts when there is a failure to follow the cost accounting practices on which price was based embody essentially the same measurement princi-

ple. The Board's requirements concerning fixed price contracts constitute a recognition of the fact that the price agreed to at the outset is higher than the price that would have been agreed to if the Government had known about the accounting change. This constitutes a constructive increase in the costs paid by the United States. In view of the foregoing, the Board's regulations will continue to require recovery of increased costs paid by the United States on FFPs. However, to emphasize that the contracting parties are the ones to determine what the contract price would have been and that there are no precise rules to be used in such determinations, further provision has been added to § 331.70(b).

(3) *Modification of § 331.70(f).* One commentator suggested that § 331.70(f) be modified to delete reference to "all affected contracting officers" and place the authority to effect agreement in the hands of one contracting officer delegated by affected agencies to handle CAS matters. In § 331.70(e) the Board urged that the contracting agencies designate such an individual and generally agencies have done so. However, this is a voluntary action of the agencies and the Board is not in a position to make it mandatory.

Two commentators urged § 331.70(f) be modified to refer to aggregate cost increases and offsets rather than deal with adjustments to individual contracts. In § 331.70 (e) and (f) the CASB has suggested techniques which it considers will permit substantially easier administration in situations in which a number of covered contracts may be involved. However, basic procurement statutes and Pub. L. 91-379 all deal with individual contracts and in the end adjustments must be made on an individual contract basis. Consequently, it is considered that reference to adjustments on an individual contract basis and allowance for offset among contracts where appropriate is the more precise way of discussing contract price adjustments.

(4) *Statement on Fairness.* One commentator requested the Board issue a statement on fairness in the application of its contract clause and related interpretations. The essence of the statement recommended would be that the results in any particular case arising from application of the Board's Standards, rules and regulations must be deemed "fair" in some general undefined sense by the negotiating parties or the Board's issuance may be disregarded. The Board's Restatement of Objectives, Policies and Concepts contains a statement that a Standard is fair when, in the Board's best judgment, it shows neither bias nor prejudice to either party. The Board views its rules and regulations on contracts and price adjustments in the same

light. In any given case, the results of contract pricing may ultimately be regarded as fair or unfair by either or both parties to the contract because, on a case-by-case basis, fairness is viewed from the personal vantage point of the particular party. It is impossible to adopt such a subjective criteria and have meaningful Standards. Consequently any attempt to define "fairness" in the context of individual contract negotiations is inappropriate.

(5) *Miscellaneous.* There were various miscellaneous comments and suggestions on the Board's proposal to which the following comments are addressed:

(a) *Application of revised regulations.* Two commentators requested that the regulations, as revised by this promulgation, be applied to existing contracts. To the extent the Board has restated its interpretations to its regulations, such restatement would apply to existing contracts. However, other modifications will become effective only on the date specified in the revised regulations. This date is established so that sufficient lead time is available to procurement agencies to develop and publish any implementing regulations or instructions. The revised regulations other than restated interpretations will only apply to contracts and events which occur after the effective date of the regulation.

(b) *Section 351.120(a), Disclosure Statement revisions.* This paragraph was modified to provide that a Disclosure Statement must be revised when a change is made by the contractor whether or not the Government has agreed to the change. One commentator objected to this revision on the grounds it would increase the contractor's workload substantially. The change was made merely to clarify an existing requirement. It does not make a substantial change in the requirements set forth in the paragraph.

(c) *Increase the threshold for contract coverage and Disclosure Statement application.* Several contractors requested that the Board increase the threshold for contract coverage so as to make the application of CASB requirements effective only on contracts of \$500,000 or more. Commentators also stated that the threshold for Disclosure Statement application should be increased. The Board has recently given consideration to both of these suggestions and is of the opinion that current thresholds are appropriate and no change in threshold application has been made in the regulations published today.

(d) *Deletion of post award disclosure under § 331.60.* One commentator objected to the deletion under § 331.60 of the provisions for post-award submission of Disclosure Statements. The Board considers the time currently provided under § 351.40 to be more

than adequate for the preparation and submission of Disclosure Statements prior to award. Consequently, it considers that provisions for post-award submission is unnecessary.

(e) *"Cost to Complete" method of § 331.70(b).* One commentator urged that the Board provide under § 331.70(b) for the use of the "Cost of Complete" method of determining contract adjustments. It is considered that this paragraph, as revised, gives the contracting parties sufficient guidance with respect to the measurement of price impact. Consequently, the requested change has not been made.

(f) *Deletion of submission of disclosure statement of CASB.* Since the Board was receiving copies of disclosure statements to assist in its research in developing standards and since that development has been substantially completed, receipt by the Board of disclosure statements is unnecessary. Consequently, this requirement has been deleted.

Title 4 CFR Parts 331 and 332 are revised in their entirety and Part 351 is amended by revising §§ 351.30, 351.40, 351.60, 351.70, 351.80, and 351.120 and by deleting and reserving §§ 351.50 and 351.110 as follows:

PREAMBLES TO PART 332, MODIFIED CONTRACT COVERAGE

PREAMBLE A

Preamble to Original Publication 9-12-77

The material set forth below is the preamble to the original publication of Part 332, 42 FR 45625, Sept. 12, 1977.

CONTRACT COVERAGE, MODIFIED CONTRACT COVERAGE, BASIC REQUIREMENTS AND COST ACCOUNTING STANDARDS

This publication adds a new Part 332 and amends Parts 331, 351 and 403 of the Cost Accounting Standards Board's rules, regulations and Standards. The proposal to add Part 332 and to amend Parts 331 and 351 were published for comment in the February 16, 1977 FEDERAL REGISTER (42 FR 9389). The proposal to amend Part 403 was published for comment in the November 30, 1976 FEDERAL REGISTER (41 FR 52473). Appropriate periods for comment on the proposals were provided. Numerous and extensive comments were received concerning both proposals. The Board appreciates the interest expressed by the commentators and thanks them for their participation.

COMMENTS OF PARTS 332, 331 AND 351

GENERAL

Many commentators expressed general approval of the proposal to

exempt certain businesses and provide modified coverage for others. Information available to the Board does not demonstrate that the benefits to be derived from applying all requirements to all contracts clearly outweigh the cost of requiring such application. Moreover the Board does not believe that many small companies with less sophisticated accounting systems and small accounting staffs can comply with the Board's requirements without experiencing inordinate difficulty and some cost. Under these circumstances, the Board has concluded that it is appropriate to remove completely the obligation of small businesses to comply with Standards, rules, and regulations of the Board. In reaching this conclusion the Board has also given some weight to the belief expressed by a few commentators that the prospect of having to comply with Board requirements has caused some companies to avoid Government contracts.

As noted by some commentators who opposed the Board's proposal, the granting of exemptions tends to reduce rather than increase uniformity of cost accounting practices because of the exemptions. In that sense the action may be viewed as not being in furtherance of that statutory goal which is set forth in Pub. L. 91-379. It has long been recognized that uniformity is an extremely important objective of the Board's actions. It is not, however, the only consideration. If there were any doubt on this point, the fact that the Law authorizes the Board to prescribe rules and regulations exempting contractors from its requirements should dispel that doubt. The Board believes that the action being taken is consistent with its statutory duties viewed as a whole even though uniformity among some business units will be reduced.

THRESHOLD DETERMINATIONS

Several commentators noted that the \$10 million threshold provided in Part 332 would be based on all contracts subject to Cost Accounting Standards rather than being limited to national defense contracts and subcontracts. They noted that Pub. L. 91-379 does not apply to nondefense contracts and that such contracts are subject to Board Standards rules and regulations only to the extent that the Administrator of General Services has extended coverage to it. Because of this they urged that the calculation be made only on the basis of national defense contracts and subcontracts. This recommendation has been adopted by the Board.

The proposal to exempt all contracts under \$500,000 was viewed as generally desirable by many commentators. Some recommended that \$1 million or more be established as the minimum coverage level. However, some commentators opposed exempting small

contracts of a contractor required to follow Standards on large contracts. They contended that once the contractor has to establish practices in compliance with Standards, there is no additional burden involved in applying those practices to its small contracts. In any case it is unlikely that application of those practices could result in burdens that would be equal to those that would result from applying one set of cost accounting practices to large contracts and another set to small contracts. For this reason the Board has not adopted the proposal to exempt all contracts under \$500,000. Instead the existing provisions providing for coverage of smaller contracts awarded to a business unit which has received an award of \$500,000 or more are being retained.

One commentator noted that some contractors receive contract awards of \$10 million or more every other year and few, if any, covered awards in the intervening years. The large contracts would not be subject to disclosure requirements or Standards under the February 16 proposal. The Board has remedied this problem by providing that any single contract award of \$10 million or more is subject to all Standards and must be covered by a Disclosure Statement.

SMALL BUSINESS

Several commentators urged that all businesses which qualify as small business concerns under the rules and regulations of the Small Business Administration be exempted. The February 16, 1977 proposal would have provided such an exemption only for a small business which received less than \$10 million in awards during its preceding fiscal year. Modified coverage would have been provided for other small businesses. Research indicates that there are very few companies which would fall into the category of small businesses receiving awards of \$10 million or more. In the interest of using a single test, i.e., whether the contractor qualifies as a small business concern, rather than a dual test which would result only in a few small businesses being subject to modified coverage, the Board has adopted the recommendation to exempt all small business concerns. Research indicates that if this action had been applied to Federal Fiscal Year 1976 it would have resulted in exemption of 196 small business concerns which were doing business with the Department of Defense and which had \$460 million of contracts of the type subject to Cost Accounting Standards. Consequently, on average, each small business concern would have a relatively small amount of covered contracts.

OTHER CATEGORIES

Various commentators renewed pre-

vious recommendations that the Board exempt other categories of contracts and contractors. The categories included colleges, universities, non-profit organizations, hospitals, and Government-owned contractor-operated facilities. The Board has considered these recommendations and concluded that none of these categories should be exempted.

PART 332 ELIGIBILITY

The February 16 publication would require that a contractor have less than \$10 million in covered contracts and that the covered contracts be less than 10% of total sales to be eligible for Part 332. In discussing this provision some commentators proposed a wide variety of tests in lieu of the tests proposed in that publication. Some suggested using only a dollar test or only a percentage test rather than both. The amounts recommended ranged up to \$100 million and 50 percent of total sales. Some suggested using sliding scales to determine eligibility. None of the suggested tests appear more likely to achieve the purposes of the Board than the test originally proposed. The Board has therefore retained its initial proposal.

SCOPE OF PART 332

A number of commentators recommended that eligibility for Part 332 should result in complete exemption. Others recommended that requirement for compliance with Parts 401 and 402 be the only requirement and that the disclosure obligation be eliminated. The Board believes that substantial benefits may be derived by continuing to require compliance with Parts 401 and 402. There is nothing which suggests that compliance with the two Standards entails any significant cost. Consequently this requirement is being retained. According to information reported to the Board, adoption of Part 332 will relieve 264 segments of 131 contractors of the requirements to comply with all Standards but will remove only \$405 million of contracts from full coverage.

DISCLOSURE STATEMENT REQUIREMENTS

Many commentators suggested that preparation of a Disclosure Statement was burdensome. They also contended that in the situation where a large commercial contractor receives only a few small contracts containing a Cost Accounting Standards clause the need for a Disclosure Statement appears to be minimal. Some asserted that adoption of the proposal to require a Disclosure Statement for all covered contracts would reduce the number of companies that would accept contracts subject to the Board's Standards, rules and regulations. The Board is persuaded that for the time being Disclosure Statements should not be required for

all covered contracts. Accordingly it is not adopting the February 16 proposal. The Board is retaining the existing Disclosure Statement requirement provided in Part 351 except that a business unit will be required to submit a Disclosure Statement if it is a company or a segment of a company which received awards of national defense contracts subject to Cost Accounting Standards in excess of \$10 million during its preceding cost accounting period rather than the preceding Federal fiscal year.

REVISIONS TO PART 351

Part 332 and the amendments to Part 331 generally will result in annual determinations being made of a contractor's obligation to follow Standards and to submit Disclosure Statements. The determination will be made on the basis of sales and awards data from the immediately preceding cost accounting period. The requirement to continue to submit a Disclosure Statement so long as the contractor has a contract subject to Cost Accounting Standards will no longer apply. Disclosure Statements must be maintained for and applied to only those contracts which were awarded during a cost accounting period in which the contractor met the filing requirements of § 351.40. Sections 351.40 and 351.50 have been revised to reflect this change.

SEGMENTS OF LARGE COMPANIES

A number of commentators sought to have small segments of large companies treated in the same way that small businesses are treated. In their view, small segments are competing in the same environment as small business and are operating with essentially similar capacity and resources. Therefore, such segments, they concluded, should be subject to the same rules as small business. The Board does not accept this line of reasoning. Even in those cases where a segment may appear to operate as a small business its status as a segment precludes it from being regarded in the same way. It has available to its capacities and resources of the company of which it is a part. Also the policy considerations of the Small Business Act have no applicability to segments of a larger company. Further, as a practical matter, the rules already exist in the Small Business Administration for identifying small business concerns. There are no comparable rules for identifying small segments.

As indicated by the February 16 proposal the Board nonetheless recognizes that segments which are engaged in primarily noncovered work should be eligible for modified coverage. This coverage is provided by Part 332. It will apply to segments which accord-

ing to information submitted to the Board have average covered sales of approximately \$1.4 million per segment. The relatively small amount of covered contract sales by each of these segments, the limited Government interest in the total business activity of the unit and the fact that the implementation and administration involves some cost lead to the conclusion that modified coverage is appropriate and sufficient to protect the interests of the Government.

SUMMARY

The results of the Board's adoption of Part 332 and amendment of Parts 331 and 351 are:

1. None of the Board's requirements apply to a business unit unless it has received an award of at least one covered contract of more than \$500,000. Thereafter covered contracts of more than \$100,000 are subject to the Board's requirements.

2. A Disclosure Statement must be submitted by any business unit receiving a covered contract if it is either a company which received net awards of negotiated national defense prime contracts and subcontracts subject to Cost Accounting Standards totaling \$10 million or more in its preceding cost accounting period or a segment of such a company.

3. Contracts awarded to any business unit which received less than \$10 million in awards of covered contracts in its preceding cost accounting period are subject to:

(a) Standards 401 and 402, if the dollar amount of such awards is equal to less than 10 percent of the business unit's total sales during that period; or

(b) All Standards, if the dollar amount of such awards is equal to 10 percent or more of the business unit's total sales during that period.

4. Any single award of a covered contract of \$10 million or more is subject to all Standards and requires submission of a Disclosure Statement.

5. Contracts awarded to any business unit which received \$10 million or more in awards of covered contracts during the preceding cost accounting period are subject to all Standards.

6. Notwithstanding the foregoing, all businesses which qualify as small business concerns under the rules and regulations of the Small Business Administration are exempt from all Cost Accounting Standards Board requirements.

COMMENTS ON PART 403

With respect to the amendment of Part 403, the November 30, 1976 proposal was to revise that Standard to make it applicable to any contract which was subject to Cost Accounting Standards generally. The amendment being promulgated today retains this concept. However, as recommended by

a number of commentators, the Board deferred the promulgation of this amendment pending the amendments to Parts 331 and 351 and the addition of Part 332 discussed above.

The decision to extend the application of Part 403 to additional contractors was made on the basis of extensive research. This research included both those contractors who were already required to use Part 403 and those who were expected to use it as a result of this amendment. With respect to the current users, the Board is satisfied that this Standard has resulted in more equitable allocations, with little administrative effort in most cases. With respect to potential additional users, the research indicated that many of these would have to make few, if any, changes to comply with Part 403 and that the remainder could comply with little difficulty. The Board notes in addition, an independent study by the Conference Board which found that defense contractors who are using Part 403 for contract costing purposes are using the same allocation procedures for internal reporting purposes. According to the Conference Board, it was typical of these companies to allocate home office expenses on a blanket basis prior to the promulgation of Part 403. (Information Bulletin No. 17, February 1977.)

A number of commentators suggested various limitations for the application of Part 403. Some of these suggestions were expressed in general terms. Some of the commentators recommended, for example, that the requirement to use Part 403 should not be extended to "small contractors." Alternatively or additionally it was recommended that Part 403 should not be required for a large contractor with little work subject to Cost Accounting Standards. More specifically, recommendations were received to exempt those contractors with less than 10 percent of their revenue from Government work. Others recommended that contractors who have less than \$10 million in contracts subject to Cost Accounting Standards should be exempt. The Board believes that the recommendations of this nature have been accommodated to the extent desirable and practical by the amendments to Parts 331 and 351 and the addition of Part 332 being promulgated today. Accordingly, any further exemption from Part 403, specifically, is considered to be unnecessary.

In publishing the proposed amendment to Part 403 in the FEDERAL REGISTER of November 30, 1976, the Board stated that there is evidence that almost all contractors who were required to make significant changes in their allocation practices as a result of Part 403 did so without undue trouble or expense. Several commentators questioned the Board's conclusion in this regard. The Board's conclusion

was based in part on Staff research involving 147 home offices who now use Part 403 to allocate home office expenses. This research sought to determine, among other things, the administrative problems and expense involved in making allocations pursuant to Part 403. Government auditors reported that of the 147 home offices, only 4 had problems in developing the necessary data and that there was evidence of significant administrative costs at one of these four offices. In addition, evidence of significant administrative costs in making the allocations was found by the Government auditors at four other of the 147 home offices.

Some of the respondents who questioned the Board's conclusions regarding administrative problems and expense referred to an industry report on the economic impact of Cost Accounting Standards as support for this position. These respondents variously referred the Board to those sections of the report which summarized (i) contractor's appraisal of benefits from Part 403; (ii) the number of contractors who were required to make changes as a result of Part 403; (iii) the number of noncompliance notices issued in connection with Part 403; and (iv) the increase and decrease in costs allocated to Government work as a result of CAS 403. Nothing in these sections, however, specifically addresses the question of administrative problems or expense involved in complying with Part 403.

Two associations reported that, contrary to the Board's findings, their member companies had experienced trouble and expense in complying with Part 403. These associations declined to identify the companies involved, the nature of the problems, or the amount of the expenses. Under these circumstances, there is no basis to alter the conclusion that contractors have been able to make changes required as a result of Part 403 without undue trouble or expense.

One commentator stated that it would not be desirable to make more contractors subject to Part 403 because he believes it to be defective, particularly with respect to its application to the allocation of state and local taxes. With respect to the application of the Standard to the allocation of state and local taxes specifically, the Board notes that it reached its conclusion on the basis of considerable research and extensive deliberation. Moreover, it has reexamined its conclusions, even after the promulgation of Part 403. Notwithstanding the views of the commentator, the Board continues of the view that the provision in question is proper. Accordingly, the Board does not agree that this Standard should not be extended to additional contractors because of the tax allocation provision.

EFFECTIVE DATE

The effective date of the regulations being published today is March 10, 1978. Pub. L. 91-379 provides that regulations shall take effect not earlier than the expiration of the first period of sixty calendar days of continuous session of the Congress following the date on which a copy of the regulations is transmitted to the Congress. The calendars of the Congress indicate that the required sixty days will not pass until some time in February 1978. Accordingly, March 10, 1978, has been selected to assure sufficient time for the regulation to lie before the Congress.

PREAMBLE B

NOTE: For text of Preamble B to Part 332, see Preamble M to Part 331, published at 45 FR 62009, Sept. 18, 1980.

PREAMBLES TO PART 351, BASIC REQUIREMENTS

PREAMBLE A

Preamble to Original Publication, 2-29-72

The material set forth below is the preamble to the original publication of Part 351, February 29, 1972, at 37 FR 4139. For the preambles to the revision of Part 351 (October 4, 1973 and November 7, 1973), see preambles B and C. Portions of this preamble, relating to Parts 331, 400, and 401 have been omitted; they can be found in the supplements to their respective parts. This preamble to the publication of Part 351 is included as part of the administrative history of Part 351.

General comments. The purpose of the regulations promulgated today by the Cost Accounting Standards Board is to implement section 719 of the Defense Production Act of 1950, as amended, 50 U.S.C. App. 2168, which provides for development of Cost Accounting Standards to be used in connection with negotiated national defense contracts and for disclosure of cost accounting practices to be used in such contracts. The Board believes the materials being promulgated today constitute a significant initial step toward accomplishing one of its major objectives—improved cost accounting and the proper determination of the cost of negotiated defense contracts. The regulations spell out contract coverage (Part 331), disclosure requirements (Part 351), a compilation of Definitions (Part 400), and two Cost Accounting Standards, one calling for consistency in estimating, accumulating, and reporting costs (Part 401), and the other calling for consistency in allocating costs incurred for the same purpose (Part 402).

Development of the material being promulgated today began many months ago with extensive research. It included examining publications on the subject, conferring with knowledgeable representatives or various

Government agencies. Government contractors, industry associations, and professional accounting associations, and identifying and considering all available viewpoints. From this research, the initial versions of the material now being published were developed. As a part of the continuing research effort, these initial drafts were sent to 81 agencies, associations, and Government contractors which had expressed interest in assisting the Board in its work, and their comments were solicited. Some national defense contractors field-tested the material to see how it would apply to and affect their operations and advised the Board of their findings. In each step of the research process, the Board and its staff have urged and received active participation and assistance by Government, industry, and accounting organizations. Their cooperative efforts contributed in large measure to the exposure draft published in the December 30, 1971, FEDERAL REGISTER for comment.

To better assure that all who might want to comment had an opportunity to do so, the Board supplemented the FEDERAL REGISTER notice by sending copies of the FEDERAL REGISTER materials directly to about 175 organizations and individuals who had expressed interest or had provided assistance in the development of the published material. Also, a press release was distributed announcing the publication, which resulted in numerous articles in journals. The Board availed itself of all opportunities to publicize the proposals and solicit comments on them.

Written comments in response to the published material were requested by February 4, 1972. Comments were received from 105 sources, including Government agencies, professional associations, industry, associations, public accounting firms, individual companies, and others. The Board appreciates the obvious care and attention devoted by commentators, and as will be seen below, the Board has greatly benefited from the comments received.

Many of the comments received were addressed to all parts of the proposed Board rules as well as to the question of public availability of the Disclosure Statements. All of the comments received have been carefully considered by the Board taking into account the requirements of section 719. Understandably, many of the comments were addressed to issues which recur in two or more of the proposed parts while others dealt only with specific sections. Comments which dealt with 11 general issues are discussed separately below followed by a section-by-section analysis of other comments. Appropriate changes have been made in the material promulgated based on the Board's disposition of the comments received.

Those comments and suggestions received which are of particular significance are discussed below.

1. *Public availability of disclosure statement.* In a special notice in the notice of proposed rule making, the Board sought comments to assist it in its determination of whether Disclosure Statements submitted by defense contractors and subcontractors should be available to the general public, pursuant to the Public Information Section of the Administrative Procedure Act (5 U.S.C. 552) or whether such information was properly within one of the statutory exceptions to the legal requirement for public availability.

With few exceptions, both Government and industry commentators urged that the Disclosure Statements not be made available to the general public. Numerous arguments were presented. Among them were that public disclosure by a Government official would violate 18 U.S.C. 1905 (a provision in the Criminal Code making it a crime for a Government official to make certain matters public in certain circumstances), thus making disclosure improper under an exception to the requirement for public availability set out in 5 U.S.C. 552(b)(3); that the cost accounting practices were trade secrets or property of considerable value and that disclosure would deprive the company of their value without compensation; that disclosure would reduce competition; and that the public might be misled in that it might construe disclosures respecting the defense segment of a contractor's business as representative of his entire business organization.

An argument in favor of making the Disclosure Statements available to the public was made by a public interest group. It argued that 5 U.S.C. 552 clearly applies to Disclosure Statements, which do not fall within any exception to public availability; that the public requires access to Disclosure Statements in order to consider adequately and comment intelligently on any Cost Accounting Standards proposed by the Board; that public availability would enhance competition; that Disclosure Statements which are ultimately approved will form a body of precedents to guide others in complying with future Board Standards and that public availability will enable citizens and the Congress to hold both the Board and contracting officials accountable for implementation of section 719. A few commentators stated that they favored, or could see no harm to companies from, public availability of contractors' disclosed practices.

The Board is especially impressed with arguments that cost accounting practices have never been made public, that companies have regarded and treated them as confidential, and that a company's competitive position

would be damaged by public disclosure of its cost accounting practices. Since disclosure will be required of many companies or divisions of companies whose principal competitors are not subject to Board regulations, the Board recognizes there might arise competitive disadvantage to the disclosing company or division if its competitors may see its disclosure but need make none themselves. The Board has, in light of these latter arguments, concluded that information received in response to Disclosure Statements is within the exception set forth at 5 U.S.C. 552(b)(4) and that the Board will not make Disclosure Statements public in any case when the company or segment files its statement specifically conditioned on the Government's agreement to treat the Disclosure Statement as confidential information.

A provision to this effect has been added at § 351.4(d) of Part 351. Additionally, paragraph (a)(1) of the contract clause set forth at § 331.5 has been modified to this effect, and a provision added to it so that subcontractors may submit Disclosure Statements directly to the contracting officer.

While the Board has concluded that public availability of the Disclosure Statements of identified contractors is not required, it will, nevertheless, implement its announced intention of compiling statistical summaries of disclosure data and making those studies available to the public. The Board believes that the creation of a data bank of cost accounting practices will greatly benefit the Board's own research efforts and the formulation of Cost Accounting Standards; summaries of these data or studies of them should also prove to be of great value to the public. Aggregated information not identified to particular contractors will, therefore, be made available to the public.

2. Contractor-subcontractor relationships. Several commentators, stating that contractors cannot dictate the cost accounting practices of their subcontractors at any tier, urged that the Board not hold contractors responsible for increased costs to the United States arising from the failure of subcontractors to follow Cost Accounting Standards or disclosed cost accounting practices. Several commentators also urged that the contractor not be subject to the possibility of a default termination by reason of the actions or inactions of any of its subcontractors at any tier. Finally, some commentators urged that the Board establish a novel concept of privity between the contracting agency and subcontractors with respect to any concerns stemming from Board rules, regulations, and Cost Accounting Standards.

The Board has dealt with many of the issues touched on by these com-

mentators in its conclusions, discussed below, respecting the phasing of applicability and the proposed termination-for-default language in the Contract Clause. The Board is also mindful of the desirability of its maintaining neutrality with respect to contracting policies outside its jurisdiction; thus it should avoid establishing a standard or policy which would influence decisions of whether work should be performed in-house or subcontracted. A Board policy permitting contractors to avoid responsibility for the actions of their subcontractors could surely have such an impact.

The Board reaffirms the established principle that prime contractors are responsible to the Government for performance of their contracts in all required respects and urges that contractors who are fearful of deficiencies in their subcontractors' performances protect themselves by use of whatever means they currently employ under other flow-down contractual requirements.

3. Exemptions. Many commentators urged the Board to provide exemptions either to the requirement to file a Disclosure Statement or to both that requirement and the requirement to follow Cost Accounting Standards. Exemptions were urged for subcontractors below the first tier, subcontractors with small amounts of defense contracting business, producers of basic or raw materials, colleges and universities, construction contractors, firms which would qualify as small businesses, and others.

The Board has long been concerned with the question of appropriate exemptions. It has specifically requested interested groups to offer suggestions for criteria for use by the Board in considering exemptions. It also requested its staff to study exemptions and has discussed the staff investigations at Board meetings. In light of these studies and the comments received, the Board has found no persuasive reasons for issuing blanket or class exemptions at this time.

The Board recognizes, however, that individual Cost Accounting Standards may by their nature be inapplicable or inappropriate to certain classes or categories of defense contractors or contracts. The Board will continue to consider exemptions from individual proposed Cost Accounting Standards as appropriate.

With respect to the requirement to submit a Disclosure Statement, the Board's proposed regulation provides a phasing of that requirement. The Board remains convinced that a company which together with its subsidiaries received prime contract awards of negotiated national defense contracts including supplemental awards during Federal fiscal year 1971 totaling more than \$30 million should be required to submit a Disclosure State-

ment as soon as Part 351 of the Board's regulations becomes effective. In order to provide both to other contractors and to Government agencies adequate time within which to study the use of Disclosure Statements, however, the Board will defer determination of the date after which other affected contractors and subcontractors may be required to file Disclosure Statements. From time to time, the Board will announce the dates of applicability to other contractors and subcontractors.

4. Applicability date of standards, rules, and regulations. A related issue raised by many commentators is a request that Cost Accounting Standards be made applicable 90 days after issuance or at the beginning of the contractor's next fiscal year, whichever is later. In order to provide the maximum benefits from use of Cost Accounting Standards, the Board has decided not to adopt any rule which would automatically delay the effective date of Cost Accounting Standards beyond the dates contemplated in section 719(h). That section provides a minimum of 4 months' notice from the date of promulgation, to contractors of the likely applicability of a Cost Accounting Standard. The Board regards this as an adequate time for companies to prepare for use of the standard. The Board nevertheless recognizes that certain standards by their nature may require deferring applicability to the beginning of a contractor's fiscal year next following the effective date, and in such cases that applicability will be stated in the standards concerned.

5. Agency administrative responsibility. Many commentators, noting the Board's statutory responsibility to promote uniformity and consistency in cost accounting practices used in defense contracting and subcontracting, have suggested that uniformity would be promoted by giving the Board or another single Federal agency the sole implementing responsibility respecting Board regulations. Thus, some commentators recommended that the Board itself issue regulations prescribing the frequency of submission of Disclosure Statements and where they must be submitted. Other commentators urged that the Board issue a single regulation prescribing exact methods by which increased costs to the United States will be determined. Other commentators urged that the Board prescribe methods by which advance agreements affecting more than one contract shall be made, some commentators urging that the Board itself make those agreements. Others urged that the Board rule that the contracting agencies must act to approve or disapprove Disclosure Statements within a stated period of time. And finally, some commentators urged that the Board itself be the sole agency to

approve the cost accounting practices disclosed through submission of a Disclosure Statement.

The Board finds these recommendations cogent. It also recognizes that to act pursuant to them would require a Board regulation directed to the administrative and contracting procedures of many Federal agencies and in some cases—such as the recommendation for Board approval of disclosed cost accounting practices—substitute a Board regulation for the exercise of contracting officers' discretion.

The Board, therefore, has decided not to implement at this time the suggestions set forth in this connection. The Board nevertheless will watch closely during the early implementation by contracting agencies of Board rules, regulations, and Cost Accounting Standards so that it may become aware of any diversity of regulations or actions by contracting agencies. If the Board finds that an unacceptable amount of diversity has arisen, it will be prepared to reconsider the recommendations that the Board issue its own regulations in many of the areas left by Board regulations to the discretion of contracting agencies.

Many commentators have expressed concern about the problems which could arise from inconsistent actions by different Federal agencies respecting disclosed practices, changes in practices, and equitable adjustment of contract prices and costs. The Board has directed its staff to work with representatives of relevant Federal agencies with the objective of obtaining designation of a single contracting officer for each contractor or major component thereof in order to achieve consistent practices within the standards issued by the Board.

6. *Contract modifications.* Several commentators have urged that negotiated contract changes and amendments over \$100,000 to contracts which are themselves not subject to Board jurisdiction should not be covered. One commentator pointed out that in a long-term contract, most changes represent "instead of" type changes with cost of price adjustments only for the incremental effect of the change. This commentator stated that there is no practical way separately to identify these incremental costs.

The Board is persuaded that for the time being it should not cover negotiated modifications to contracts exempt at their inception. It has, therefore, eliminated coverage for the time being of such contract modifications. In doing so, however, the Board intends that the annual extension of existing negotiated contracts and similar contract modifications would not be exempt from the Board's rules, regulations, and Cost Accounting Standards.

7. *Definitions.* The Board is also persuaded of the value of one commenta-

tor's suggestion that the Board provide a compilation of definitions of the words or phrases defined in individual Cost Accounting Standards, making those definitions applicable to all such standards. Consequently, a new Part 400 has been added, and all terms defined in Parts 401 and 402 have been placed in it, although they also remain in the particular standards in which they are defined. As more standards are added, any terms defined in them will also be added to Part 400. However, terms defined in Parts 331 and 351 are not included in the glossary of definitions, nor are terms used in those parts necessarily to bear the meanings ascribed to those terms in Part 400.

8. *Application to individual contracts.* Several commentators urged that the Board adopt the date of final agreement on a negotiated price as a cut-off date for the disclosure of cost accounting practices. The Board has reviewed the merits of selecting that date rather than the date of award to establish the date as of which the contractor's Disclosure Statement must accurately reflect his cost accounting practices, at least with respect to those contracts where cost or pricing data have been submitted pursuant to Pub. L. 87-653. The Board has decided to use the date of final agreement on price, as shown on the signed certificate of current cost or pricing data, with respect to contractors who have submitted cost or pricing data, and to use the date of award of the contract for all other contractors. In addition, the Board has concluded that it is appropriate to use those dates to establish which Cost Accounting Standards shall be applicable to the proposal and to the contract at its inception. Appropriate changes in Parts 331, 351, and 401 have been made to reflect this decision.

9. *Price adjustments.* Many commentators stated that where a contractor's departure from existing disclosed practices is occasioned by the contractor's wish to adopt a newly issued Cost Accounting Standard for all contracts, the Government should be willing to provide upward price adjustment whenever an existing contract is rendered thereby more expensive to perform. The view was often expressed that contractors could not maintain one accounting practice for contracts subject to a particular Cost Accounting Standard, but a different practice for contracts not so subject; therefore, it was alleged, once a contractor had to adopt a standard for any one contract, he would of necessity adopt it for all contracts and amend his Disclosure Statement accordingly.

The Board notes in this connection that the Cost Accounting Standard at Part 402 requires consistency in the allocation of all direct and indirect costs under all covered contracts. If a Cost

Accounting Standard were issued which required a company to modify its disclosed cost accounting practices with respect to its earlier practice of allocating direct and indirect costs, Part 402 would require amendment of existing disclosed practices so as to meet that requirement. In such a case, the Board believes it would be unfair to deny an equitable price adjustment arising from such amendment.

Further, the Board has been persuaded by the strong arguments from industry commentators that companies with more than one contract, subject to different Cost Accounting Standards, cannot maintain multiple records to account for each contract related to its set of standards. Another industry commentator stated that the vast majority of companies must apply any required cost accounting practices across their total business, and that it would be impractical if not impossible for companies to apply different practices to different contracts. The Board has accommodated this view by enabling contractors to apply uniform practices to all covered contracts. Such application will also serve to improve cost accounting practices for all contracts.

The Board has consequently modified both Part 331 and Part 351 to provide three things: First, that a contractor's practices disclosed for any contract shall be the same as the practices currently disclosed and applied on all other covered contracts and subcontracts being performed by that contractor. Second, that a contractor must amend his disclosure of cost accounting practices as new standards are issued and become applicable to new contracts if a change in practices is necessary, so that, at any given time, the same practices prevail under all of the contractor's existing contracts and subcontracts subject to Board jurisdiction. Similarly, contractors must amend Disclosure Statements to reflect any change in practices disclosed under later contracts. Third, that for those amendments of disclosed practices applicable to a particular contract which are occasioned by the issuance of a new Cost Accounting Standard, the Government will equitably adjust the contract price in accordance with the changes clause in the contract or reimburse any increased costs under that contract.

In view of the phasing of the requirement to file a Disclosure Statement, the Board has adopted a contract provision that will provide equitable adjustments in appropriate cases when a contractor who has not yet filed a Disclosure Statement is required to change his established cost accounting practices to comply with newly issued Cost Accounting Standards. On the other hand, any departure from disclosed cost accounting practices which is not required by a

newly issued Cost Accounting Standard will not be subject to equitable price adjustment, but only to price adjustment downward in the event that that departure would otherwise result in increased costs being paid by the United States. The Board wishes to emphasize that if the parties to a contractual negotiation mutually agree to a price based on exclusion of costs which are allocable under the contractor's disclosed cost accounting practices, such agreement shall not affect the requirement for conformity with Board rules, regulations, and Cost Accounting Standards in the contractor's allocation of costs between the contract being negotiated and other work.

10. *Materiality.* The Board notes that many commentators urged that a concept of materiality be incorporated in the Board's regulations, to the end that minimal or insignificant modifications of or failures to use disclosed cost accounting practices would not be subject to price adjustment.

The Board agrees that the administration of its rules, regulations, and Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of cost. Since this rule of common sense is already practiced by the Government, the Board does not believe that there is any need to attempt to formulate and state in acceptable concept of materiality applicable to all Board rules, regulations, and standards, although the Board might consider doing so if subsequent events indicate the necessity therefor. The Board does recognize that in particular standards a "materiality" statement may be useful, and in such cases, it will include one. See for example the addition at § 402.50(e).

11. *Additional requirements by agencies.* As a final general point, concern was expressed that Federal agencies might require submission of cost proposals in ways inconsistent with the cost accounting practices of some or all of the potential offerors. The Board recognizes that this has happened in the past, but it notes that Board rules, regulations, and Cost Accounting Standards are to be used by relevant Federal agencies as well as by contractors and subcontractors, and it believes that henceforth requests for proposals must be fully consistent with such rules, regulations, and standards, although of course the Federal agency may ask for supplementary information to accompany proposals if this is needed to meet the agency's requirements.

Section 351.14 Disclosure Statement. Several commentators pointed out that the statement was too detailed or complex, or urged that the Statement be modified to require only a statement of cost accounting policy and philosophy. The Board believes that such generalized and unspecific statements would not assist it adequately in

performance of its responsibilities. Further, in order to permit the statutory requirements of disclosure of cost accounting practices and consistency to be met, the Board concluded that the extent of detail now called for in the Disclosure Statement is necessary.

Two commentators suggested that references to ASPR, the Internal Revenue Code and financial accounting be deleted from the Disclosure Statement since the contractors stated they are irrelevant to their cost accounting practices. The Board did not agree with these suggestions for the reason that in most cases the regulations have been referred to in the Statement in lieu of redefining certain words, such as "Independent Research and Development Costs." Furthermore, with particular respect to the Internal Revenue Code, the Board cannot ignore that income tax considerations often influence cost accounting practices, such as those for depreciation.

The Board has deleted the item in the Statement calling for an explanation of the difference between commercial and Government cost accounting practices since the Board agrees with several commentators that inclusion of such information in the Disclosure Statement is not needed.

An educational institution and one association pointed out that the terminology in the Disclosure Statement was not responsive to the special circumstances of educational institutions. The Board made appropriate word-changes to a number of items in the Statement to accommodate educational institutions.

By far, the majority of the comments addressed to the Disclosure Statement dealt with suggestions for clarification of terminology and intent of the various items in the statement. The Board considered each comment and made appropriate revisions to the statement. The part most affected by these revisions is Part IV—Indirect Costs. Several items in the part were rearranged in sequence to improve clarity, and instructions covering the items in Part IV were restated.

Effective date and application. For the convenience of readers, the following summarizes the effective dates set forth in § 331.8, § 351.4(e), and Parts 400, 401, and 402, which were transmitted to the Congress on February 24, 1972, pursuant to section 719(h)(3) of the Defense Production Act of 1950 as amended. After the expiration of a period of 60 calendar days of continuous session following the date of transmittal to the Congress, the regulations herein promulgated shall take effect as set forth in those regulations, unless there is passed by the two Houses a concurrent resolution stating

in substance that the Congress does not favor the proposed standards, rules, or regulations.

* * * * *

3. The provisions of Part 351 will be applicable to any contractor who submits a proposal which results in contracts containing the clause in § 331.5 and whose net awards of negotiated national defense prime contracts during Federal fiscal year 1971 totaled more than \$30 million. Contractors whose net awards were less than that amount may be required to complete or submit a Disclosure Statement as the Board announced extensions of this requirement to such contractors.

4. Any contractor having a contract awarded prior to July 1, 1972, which contains a clause which already incorporates requirements governing submission of Disclosure Statements and application of Cost Accounting Standards will be required to comply with the provisions of that clause. In this connection, such contractor and the respective contracting agencies whose contracts contain such a clause should review those contracts to determine whether negotiations should be instituted to make Parts 400 through 402 applicable to them.

PREAMBLE B

Preamble to Amendments of 10-4-73

These amendments (38 FR 27507, Oct. 4, 1973) added §§ 351.41 and 351.50(c), and amended § 351.70.

The purpose of this publication by the Cost Accounting Standards Board is to modify Part 351, Basic Requirements, of its rules and regulations. A proposed modification to Part 351 was published in the FEDERAL REGISTER of July 27, 1973 (38 FR 20101). That proposal was a revision of an earlier proposal published on May 21, 1973. Thirty-three sets of comments were received in response to the July publication and after considering those comments (discussed below), the Board is today publishing an amendment to its rules relative to the requirement for the submission of Disclosure Statements by defense contractors.

The Board's July 27 proposal required that, in determining who must file Disclosure Statements, only negotiated contracts of the type which are subject to Cost Accounting Standards were to be considered. All commentators who dealt with this matter supported the proposal. The Board, therefore, in the amendments being published today, specifically limits the contract awards to be included in the computation of a contractor's volume of defense contracts in determining whether the revised filing requirement has been met, to those of the type sub-

ject to the Board's jurisdiction. The Board recognizes that Standards were not required in contracts in Fiscal Year 1972. In view of this, the amendment refers to "negotiated national defense prime contracts of the type which are subject to Cost Accounting Standards." This filing requirement, therefore, includes all negotiated defense prime contracts in excess of \$100,000 except those where the negotiated price is based on (1) established catalog or market prices of commercial items sold in substantial quantities to the general public or (2) prices set by law or regulation, or contracts which are otherwise exempt.

The amendment being published today by the Board to reduce the dollar level above which filing of a Disclosure Statement will be required excludes from the computation the amounts of all subcontracts and those negotiated defense prime contracts not subject to Cost Accounting Standards. In view of this exclusion, the Board is providing that if the dollar volume of prime contract awards to be considered exceeds \$10 million, the contractor will be required to submit a Disclosure Statement. Also, in computing the amount, the amendments require that contracts awarded in either Federal Fiscal Year 1972 or 1973 should be considered. Contractors who meet the threshold amount in either year would be required to file Disclosure Statements, effective April 1, 1974.

The Board believes that the inclusion of the amount of subcontract awards in the Disclosure Statement filing requirement would be appropriate because subcontracts, unless specifically exempt, are subject to the Board's Standards, rules and regulations. The Board recognizes, however, that there is a lack of records relative to the nature of subcontracts awarded during fiscal years 1972 and 1973. Because of this, the Board concludes that it is inappropriate to include subcontracts in the determination of the threshold amount for filing Disclosure Statements at this time.

The amendments being published today thus limit consideration to the dollar value of prime contracts only. The Board wishes to point out, however, that future levels of the threshold amount may call for inclusion of the dollar value of subcontract awards in the calculation. Contractors are hereby advised that they may be required to determine the dollar value of negotiated defense subcontract awards subject to Cost Accounting Standards beginning with July 1, 1973. Contractors and subcontractors may find it advantageous to begin to identify and accumulate the value of such awards separately.

A major defense agency commented that reduction of the threshold at this time would be premature. It stated

that a large number of Disclosure Statements would now be required from contractors less likely to have sophisticated accounting systems. Consequently, greater agency manpower efforts would be required to review them for adequacy. Also, the agency expressed concern with the upcoming work required for compliance reviews and the possibility of negotiation of price adjustments relative to Standards. Finally, it stated that a number of manpower spaces have already been provided in order to support Board requirements. The agency suggested that a threshold reduction be deferred until after July 1, 1974.

The Board believes that Disclosure Statements from "contractors less likely to have sophisticated accounting systems" would seem to be especially needed by the Government in order to know more precisely how such contractors account for their costs. Additionally, the Government has gained a great deal of experience in reviewing the Disclosure Statements already received, which should aid review of newly submitted statements on an expeditious basis. With respect to the potential workload required in compliance reviews, Government agencies have always had a responsibility for reviewing contractor accounting practices and the use of those practices for Government contract costing. The Disclosure Statement provides a benchmark which should facilitate such reviews in the future. Moreover, the Board is advised that most Disclosure Statements filed under the existing \$30 million threshold have been reviewed for adequacy, and compliance reviews are now being made as a part of other routine audit work.

The need to provide manpower spaces to support Board requirements is to be expected. The advantages of the expanded disclosure requirement, however, are many. For example, another defense agency strongly endorsed the Board's proposal to reduce the threshold because of the useful information provided in Disclosure Statements to contracting officers and auditors. Additionally, one agency previously reported to the Board that the Disclosure Statement has become a valuable tool in giving the negotiator more cost visibility while another referred to the Statement as a significant asset for use in reviewing contract proposals. After considering the agencies' comments referred to above, the Board has concluded that a reduction in the threshold is desirable and within the capabilities of the agencies' staffs to review the additional statements that would be submitted.

The Board's July proposal included an effective date of January 1, 1974. The Board has concluded that additional time between the publication of these amendments and the effective date of the reduced threshold should

be given to allow agencies to prepare fully to handle the additional volume of Disclosure Statements that will be submitted. Also, additional time will further assure that contractors meeting the new threshold requirement can complete the Disclosure Statement without interference with the prospective award of contracts. For these reasons, the amendments being published today require that contractors meeting the threshold must submit a Disclosure Statement in order to receive a covered contract after April 1, 1974.

Nine commentators urged the Board to provide an exemption for profit centers, divisions, etc., which are predominately commercially oriented and which have only a small dollar volume or percentage of covered defense contracts. The Board has announced that it is initiating a study to consider the establishment of a minimum dollar amount or percentage of covered contract effort below which contractors' profit centers and divisions would be exempt from Board Standards, rules and regulations, including the disclosure requirement. In any case, the Board has concluded that \$10 million in covered contracts on a company wide basis is a significant dollar volume and that it warrants establishment of the requirement for submission of a Disclosure Statement.

Two commentators objected to the establishment of an absolute dollar amount of awards as a basis for determining the requirement for filing a Disclosure Statement. They suggested that a percentage of overall business would be more appropriate. This kind of information is not available at the present time. In estimating the number of Disclosure Statements that would be submitted at any threshold amount, and relating that number of statements to the agency's capability to process them, the Board uses statistics on contract awards maintained by defense agencies. Because of this, for the present the Board has retained the requirement to compute the threshold amount for filing a Disclosure Statement in terms of a dollar volume of contract awards. The study discussed above may provide information to allow the Board to consider use of a percentage of covered contracts in relation to total business as a factor in setting future threshold requirements.

While not specifically related to the Board's proposal of July 27, 1973, the Board has received a number of oral inquiries concerning the intent of the second sentence of § 351.120(d) of the Board's regulations, which states:

Revised data for items 1.4.0 through 1.7.0, 8.1.0 and 8.2.0 must be submitted annually at the beginning of the contractor's fiscal year.

The Board did not intend that the changes to these items should be considered in counting the number of

changes which would necessitate the resubmission of an entire Disclosure Statement. This information, which relates to the volume of business, should be sent to the recipients of Disclosure Statements only on an annual basis and only if the responses to the items in the Disclosure Statement on file require a change. If on a year-to-year basis, the sales data remain such that the contractor would check the same box in the Disclosure Statement, the Board's rules and regulations do not require resubmission of data concerning these particular items.

The Board's July 27 proposal included a requirement that contractors were to submit a copy of their Disclosure Statement to the Board only after a determination of adequacy has been made of the Statement. All commentators who dealt with this point supported this proposal, and it is included in the amendment being published today.

Today's publication is numbered in consonance with the new numbering system published on September 5, 1973, as part of the proposal set forth in 38 FEDERAL REGISTER 171 at page 23971 et seq. Pending adoption of the September 5, proposal, references to §§ 331.60, 351.40, 351.50, and 351.70 refer to §§ 331.6, 351.4, 351.5 and 351.7 respectively of the Board's current rules and regulations. The new § 351.41 will be located immediately after § 351.4 which will become § 351.40.

PREAMBLE C

Preamble to Revision of Part 351, 11-7-73

This publication (38 FR 30725, Nov. 7, 1973) revised Part 351 in its entirety, with the exception of §§ 351.41, 351.50(c) and the last sentence of § 351.70.

The purpose of this publication by the Cost Accounting Standards Board is to amend Parts 331, 351, 400, 401, 402, 403, and 404 of its rules and regulations. The amendments, which are minor clarifications to the regulations, were published in the FEDERAL REGISTER of September 5, 1973 (38 FR 23971). The amendments: (a) Re-number Parts 331 and 351 to facilitate insertion of future modifications to those parts; (b) clarify one section of the contract clause at § 331.5; and (c) modify certain definitions in Parts 400, 401, 402, 403, and 404 for the purposes of uniformity among the various parts. Only one comment in response to the September publication has been received by the Board. This expressed agreement with the proposed changes.

In view of the foregoing, the following amendments to the Board's regulations are being made effective November 7, 1973:

PREAMBLE D

Preamble to Amendment of 12-12-73

This publication (38 FR 32460, Dec. 12, 1973) amended § 351.140 and added a new § 351.145.

The purpose of this publication by the Cost Accounting Standards Board is to modify Part 351, Basic Requirements, of its rules and regulations. A proposed modification to Part 351 was published in the FEDERAL REGISTER of September 17, 1973 (38 FR 26072). That proposal dealt with a Disclosure Statement form designed expressly for submission by colleges and universities. Comments were requested on that proposal from the general public.

Public Law 91-379 which applies to most negotiated defense prime contracts and subcontracts in excess of \$100,000 requires that contractors shall disclose in writing their cost accounting practices. The Disclosure Statement form, CASB-DS-1 has been designed to facilitate the meeting of this requirement by contractors. Representatives of colleges and universities had expressed to the Board a desire to have a separate Disclosure Statement to cover their practices. Form CASB-DS-2, being published today, was devised for that purpose and incorporates terminology more commonly used by colleges and universities.

Comments on the September 17 proposal were received from 15 commentators, who offered suggestions for changing the proposed form to explain or further clarify the intent of the questions. Insofar as practicable, the Board has made changes to the college and university Disclosure Statement form to accommodate the suggestions made.

Colleges and universities required to submit Disclosure Statements after April 1, 1974, should use Form CASB-DS-2. Any college or university which has previously submitted a Disclosure Statement should use Form CASB-DS-2 for any amendments which are to be effective after April 1, 1974.

PREAMBLE E

Preamble to Amendments Published 12-24-74

This publication revised §§ 351.40(a) and amended § 351.130, and was published on Dec. 24, 1974, at 39 FR 44389.

The purpose of this publication by the Cost Accounting Standards Board is to adopt modifications to Part 331, Contract Coverage, and Part 351, Basic Requirements, of its rules and regulations. These modifications will provide an exemption from Cost Accounting Standards Board requirements for certain national defense

contracts and subcontracts of \$500,000 or less.

Public Law 91-379 requires that Cost Accounting Standards must be used in all negotiated prime contract and subcontract national defense procurements with the United States in excess of \$100,000, with certain stated exceptions. From time to time the Board refers to contracts subject to its rules and regulations as "covered contracts". Section 719(h)(2) of Pub. L. 91-379 authorizes the Cost Accounting Standard Board to prescribe rules exempting from its requirements such classes or categories of national defense contractors and subcontractors as it determines, on the basis of the size of the contracts involved or otherwise, are appropriate and consistent with the purposes sought to be achieved by Pub. L. 91-379. The Board has granted several exemptions to classes or categories of contractors and subcontractors and also has established a procedure under which waiver of the Board's requirements may be granted for individual contracts.

A proposed exemption increasing the minimum contract amount requiring compliance with Cost Accounting Standards Board rules, regulations and Standards from \$100,000 to \$500,000 was published by the Board on September 27, 1974 (39 FR 34669). The Board received 82 responses to the September 27 proposal. Comments were received from individual companies, government agencies, professional associations, industry associations, public accounting firms, and individuals. All of these comments have been carefully considered by the Board, and the Board takes this opportunity to express its appreciation for the helpful suggestions which have been furnished.

The comments below summarize the major issues discussed by respondents in connection with the initial publication and explain the Board's disposition of these issues.

Issuance of the exemption. Practically all the commentators expressed concurrence in the proposed exemption, giving either unqualified support or support with added comments that additional exemptions should also be considered. However, three commentators—a constituting firm, a major aerospace company and a Government agency—disagreed with the proposed exemption, stating that an increase in the threshold for compliance with CAS requirements was inconsistent with the Board's objective of establishing uniformity and consistency among contractors doing business with the Government.

The Board agrees that the adoption of the proposed regulation will exempt a substantial number of contractors and subcontractors who otherwise would be covered, and consequently

will permit such companies to follow accounting practices other than those set out in Cost Accounting Standards. However, the Board is aware that compliance with its rules, regulations and standards may involve additional administrative effort, particularly on the part of small companies, which may not be commensurate with the benefit to the Government or the contractor resulting from such compliance. The Board, after considering the efforts required by both the Government and its contractors to assure compliance on all covered contracts in excess of \$100,000, is persuaded that maximum benefit to the Government with minimum cost can be achieved by limiting the mandatory application of its standards to contractors who receive awards which constitute a substantial majority of the national defense procurement dollars. As was stated at the time the proposed exemption was issued for comment, some 70 percent of the prime contractors of the Department of Defense did not receive one or more negotiated awards in excess of \$500,000 in Fiscal Year 1973. Thus, only 30 percent, or approximately 750 prime contractors, who received contract awards totaling \$20 billion, would continue to be covered. The exemption would remove coverage from only about 10 percent of the dollar value of annual DOD awards.

In view of the foregoing, the Board considers the proposed exemption increasing the minimum contract amount requiring compliance with the Cost Accounting Standards Board rules, regulations, and standards to be in keeping with the purposes sought to be achieved by Pub. L. 91-379 and to be an appropriate exercise of the authority granted to the Board by section 719(h)(2) of that law.

Increase exemption on all contracts to \$500,000. A number of commentators suggested that the \$500,000 single contract threshold for compliance with Board rules, regulations, and standards be changed to exempt all contracts of \$500,000 or less. Those giving reasons in support of this suggestion generally based their comments on simplification of administration. These commentators felt that it would be difficult for the Government or prime contractors, when awarding a prime contract or subcontract in excess of \$100,000 to determine whether the contractor or subcontractor had in existence a prior \$500,000 covered contract.

The Board, in proposing the \$500,000 threshold, did so with the intent of exempting those companies which do not receive contracts in excess of \$500,000 from the Government. However, it was decided in the interest of consistency in cost accounting practices that once a contractor had received a covered contract of that size, compliance with CASB rules,

regulations and standards on contracts at the level established in Pub. L. 91-379 was appropriate. This is also consistent with the desire expressed by contractors to follow a single set of accounting practices. Further, the requirement for coverage of contracts in excess of \$100,000 where the contractor already has received a covered contract in excess of \$500,000 will permit the small contracts to be available for equitable adjustment if subsequently issued standards should become applicable. Moreover, once the administrative effort has been expended to comply with standards for contracts in excess of \$500,000, compliance with standards on contracts above the statutory threshold of \$100,000 requires little added effort.

With respect to the commentators' statements concerning the difficulties, when making an award exceeding \$100,000, of determining whether a contractor or subcontractor had in existence a prior award exceeding \$500,000, the Board feels that an administrative requirement can be established for obtaining this information. A similar requirement now exists concerning the disclosure statement, whereby contractors are required to submit a disclosure statement, state that they have previously filed a disclosure statement, or submit a certificate of monetary exemption. The Board feels that a similar requirement can be set concerning the \$500,000 level. The Board is not persuaded that this matter would create problems of sufficient significance to eliminate coverage down to the \$100,000 level.

In considering the advantages of the exemption as proposed compared to its assessment of the administrative difficulties foreseen by commentators, the Board is persuaded that its proposal relative to coverage of awards in excess of \$100,000 should not be changed.

Exemption based on sales. A number of commentators urged that the Board establish an exemption based on sales, using either minimum annual dollar amount of sales to the Government, or Government sales as a percentage of total annual sales, or a combination of these two factors. The most frequently suggested amount was \$10 million of sales to the Government or Government sales amounting to 10 percent of total annual sales. The objective sought by these commentators was an exemption of those companies or business units whose sales to the Government constituted a reasonably small portion of their total annual sales and whose business was essentially commercially oriented.

The Board has given lengthy consideration to the use of a sales basis for the establishment of a minimum threshold for compliance with its rules, regulations and standards. It did not use that basis at this time due to

the nature of the problems involved in administering an exemption based on sales. In either of the situations suggested by commentators, the representation concerning the amount of sales must be made by the contractor and subsequently verified by the Government. This verification would impose very substantial and time-consuming efforts on both the Government and the contractor. Particularly in the case of Government sales as a percentage of total sales, Government representatives would be placed in the position of examining a contractor's total sales, including those made in its commercial business. Examination of a company's records concerning its total sales is not presently performed by Government procurement activities and would present new and unique problems to both parties as well as requiring substantial additional effort on the part of Government representatives.

An exemption based on sales would require a measurement period during which a contractor's status with respect to compliance with standards would be determined. Contracts under which sales were recorded during this period would not be subject to standards. If the volume of sales during the measurement period exceeded a stated threshold, a contractor would then be required to comply with standards under contracts received in subsequent periods. Thus, the contracts that brought the contractor under the Board's rules would not be subject to standards, while those received at a later time would be.

The Board has decided that the administrative problems involved with an exemption based on sales should be considered before establishing such a threshold. The Board will continue to study these problems and investigate whether exemptions based on criteria other than a minimum contract amount would be appropriate and consistent with the purposes of Pub. L. 91-379.

Retroactivity. Several commentators requested that the Board modify its proposal so as to provide retroactive exemption to existing contracts where the circumstances are such that these existing contracts would have been exempt if awarded after the effective date of the proposed regulation.

The Board has no authority to modify existing contractual agreements between the government procurement agencies and their contractors. However, the Board sees nothing inconsistent with its regulations or with Pub. L. 91-379 in modification by the procurement agencies of contracts in this category, assuming of course that the Government receives adequate consideration for deletion of the CAS requirement.

Increase minimum amount. A number of commentators recommend-

ed that the exemption proposed be increased to an amount greater than \$500,000, the figure of \$1,000,000 being frequently mentioned. The Board is not now prepared to raise further the minimum contract amount requiring compliance with its promulgations. The Board, in studying an exemption based on minimum contract amount, concluded that the \$500,000 threshold was the most appropriate one for achieving its objectives, all factors considered. The Board will continue to examine various limitations but considers that the threshold established in the proposed exemption best meets its requirements and obligations at this time.

Effect of final payment under contracts subject to CAS clause. Several commentators urged that the exemption of contracts of \$500,000 or less should not be dependent on the final payment on contracts which are subject to Board requirements, on the grounds that final payment can occur a substantial period of time after completion of work on a contract and that there are many technicalities in closing out a contract which do not involve cost accounting applications.

The Board considers this point to be well taken and has changed the requirement in § 331.30(b)(8) where it first appears to "notification of final acceptance of all items or work to be delivered." At that time it is considered that all direct costs will have been charged to the contract since all work will have been completed, and any further accounting transactions would be the result of adjustments not directly related to contract performance.

Reduction of contract price by exclusion of commercial items. Some commentators, in reading the introductory comments to the Board's initial publication of this exemption, interpreted the phrase "minimum contract amount requiring compliance" in a manner not at all intended by the Board. These commentators interpreted this phrase to permit the price of a contract subject to standards to be reduced by the value of those individual contract items or subassemblies of final contract items whose prices could be considered to be "catalog" or "market" prices, if sold separately. They requested that the regulation be clarified to reflect their interpretation of the Board's introductory comments.

Those requesting this clarification misunderstood the Board's intentions. The Board does not intend that the price of a contract be adjusted to exclude the price of items or subassemblies which, if purchased separately, might be exempt from the Board's promulgations. Consequently, the change in the regulation requested by commentators on this point would be completely inappropriate.

Definition of contractor. One com-

mentator noted that the prefatory comments to the Board's September 27, 1974, publication specifically mentioned the fact that receipt of a contract in excess of \$500,000 by one business unit of a multi-unit company would not in itself require other units of the same company to follow Board requirements. This commentator requested that the definitions of "defense contractor" and "defense subcontractor" contained in § 331.20 (b) and (c) be modified to reflect this intention by the Board.

As the Board stated in its September 27 publication, its contract requirements have been applied to business units, such as a profit center, division, subsidiary, or similar unit of a company, which perform the contract, even in those cases where the contract was entered into on behalf of the overall company rather than the business unit. This application of the Board's requirements to a performing business unit is well established and unchallenged, and clarification of the definitions of "contractor" and "subcontractor" does not appear necessary.

Effective date. Several commentators raised questions concerning the effective date of the eligibility for this exemption in relation to awards received prior to January 1, 1975. Contractors who have received a prime contract or subcontract in excess of \$500,000 subject to cost accounting standards prior to January 1, 1975, and on which notification of final acceptance of all items or work to be delivered on that contract or subcontract has not been received, is a contractor who has "already received a contract or subcontract in excess of \$500,000," as that phrase is used in § 331.30(b)(8). Therefore, today's publication requires that a contractor meeting this test will be required to comply with standards on all covered prime contracts or subcontracts in excess of \$100,000 received after January 1, 1975, under the provisions of § 331.30.

PREAMBLE F

Preamble to Amendments of 8-4-75

This publication (40 FR 32747, Aug. 4, 1975) amended § 351.40 by revising (c) and adding (f); deleted § 351.41; amended § 351.50 by revising (a) and (c) and adding (d); and amended § 351.120 by revising (d) and adding (e). A correction to the language which amended § 351.40 appeared at 40 FR 33819, Aug. 12, 1975.

The purpose of this publication by the Cost Accounting Standards Board is to modify Part 351, Basic Requirements, of its rules and regulations and Part 403, Allocation of Home Office Expenses to Segments. A proposed modification to Part 351 was published in the FEDERAL REGISTER of April 3, 1975 (40 FR 14942). Twenty-seven sets of comments were received in response

to that publication. After considering those comments, the most significant of which are discussed below, the Board is today publishing an amendment to its rules relative to the requirement for the submission of Disclosure Statements by defense contractors and subcontractors.

1. *Fiscal Year Coverage.* The Board's April 3 proposal provided that any company which, together with its subsidiaries, received more than \$10 million in prime contracts subject to Cost Accounting Standards in Government fiscal years 1974 or 1975 would be required to file Disclosure Statements. Board regulations now require the filing of Disclosure Statements on the basis of prime contracts awarded in fiscal years 1971, 1972 or 1973. There were no objections voiced by commentators to the inclusion of fiscal years 1974 and 1975 in the filing requirement. Accordingly, the amendments being published today require that companies who exceeded the threshold amounts in either of those fiscal years will be required to file Disclosure Statements.

2. *Effective Date.* The Board's proposal established July 1, 1975, as the effective date for the requirement to include awards made in fiscal years 1974 and 1975. Most commentators pointed out that in view of the short time permitted between submission of comments on the proposal and the July 1 date, any company which met the new requirement would not have sufficient time to file a satisfactory Disclosure Statement to permit receipt of a covered contract. The Board agrees, and accordingly, the amendments being published today establish an effective date of January 1, 1976, for the new requirement. Thus, any company which, together with its subsidiaries, received more than \$10 million in prime contract awards subject to Cost Accounting Standards in Government fiscal years 1974 or 1975 must submit a Disclosure Statement in order to receive a covered national defense contract after January 1, 1976.

The April 3 proposal also provided for including subcontract awards in the computation to determine if a company meets the requirement for the filing of Disclosure Statements, beginning with Federal fiscal year 1976. The proposal stated that companies which met the threshold in fiscal year 1976 would be required to file Disclosure Statements as of July 1, 1976. In view of the need for a company to determine whether or not it met the filing requirement and then have sufficient time in which to prepare a satisfactory Disclosure Statement, the effective date for filing a Disclosure Statement on the basis of fiscal year 1976 data has been changed to March 31, 1977. For fiscal years subsequent to 1976, companies will be required to file

Disclosure Statements as a condition of receiving a contract by March 31 following the end of the fiscal year in which the threshold is met. This should permit contractors to make their eligibility determination in sufficient time to allow preparation of acceptable Disclosure Statements.

3. *Inclusion of Subcontracts.* The Board's proposal required that beginning with Federal fiscal year 1976 (July 1, 1975-June 30, 1976) companies would be required to include, in addition to prime contract awards, the value of subcontract awards received subject to Cost Accounting Standards in their computation to determine if they must file Disclosure Statements. Beginning with that fiscal year and for all subsequent fiscal years, the Board's proposal stated that any company which, together with its subsidiaries, received more than \$10 million in prime contract awards and subcontract awards subject to Cost Accounting Standards would be required to file Disclosure Statements.

Some commentators questioned how the value of awards was to be considered in determining if a company met the threshold. The \$10 million figure is to include both prime contract awards and subcontract awards and may, in fact, be met by companies receiving only subcontracts subject to Standards. There was no intention that companies must have received one or more prime contracts in order to be required to file a Disclosure Statement. The determination of whether or not a company has \$10 million in awards subject to Cost Accounting Standards must include both prime contracts and subcontracts.

A number of commentators objected to the inclusion of subcontract awards in a requirement for filing Disclosure Statements. They argued that in many cases they do not have sufficient information to determine whether a subcontract is subject to Standards. Some commentators stated that in many cases prime contractors pass through to subcontractors all Standard Government contract clauses whether or not they are required to be included in the subcontract. They allege that, in some cases, when the prime contractors are contacted to determine specifically whether or not a subcontract which contains the Cost Accounting Standards Clause is, in fact, subject to Standards, the prime contractor states that it is not. Because of this, the commentators claim they would be required to establish an elaborate information-gathering system to assure that they properly identify every subcontract subject to Standards.

The argument about the adequacy of information concerning coverage of subcontracts has been made to the Board on a number of occasions. In October 1973, when the Board pub-

lished an earlier revision to the Disclosure Statement filing requirement it advised contractors that they may be required to determine the dollar value of defense subcontract awards subject to CAS, and encouraged them to begin to identify and accumulate the value of subcontract awards separately. Many contractors are in fact effectively identifying subcontracts subject to Standards. These facts persuade the Board that identification of covered subcontracts is feasible, although the Board recognizes that some firms may have to clarify their information exchange procedures with the prime contractors with whom they do business.

The Board believes that the inclusion of the amount of subcontract awards in the Disclosure Statement filing requirement is appropriate because subcontracts, unless specifically exempt, are legally subject to the Board's Standards, rules and regulations. Accordingly, the amendments being published today provide for the inclusion of subcontract awards subject to Standards in the determination made by a company as to whether or not it must file a Disclosure Statement. This requirement is effective with Government fiscal year 1976 and applies to all subsequent fiscal years.

4. *Change in Fiscal Year Period.* Several commentators noted that the Federal Government is changing the dates of its fiscal year following Federal fiscal year 1976. The new fiscal year period will be from October 1 through the following September 30. The period July 1, 1976, thru September 30, 1976, will be known as Federal fiscal period 197T. These commentators asked whether or not contracts awarded in that period should be included in some way with a normal fiscal year's contract awards. The Board feels that it is not desirable to upset the regular twelve-month fiscal year computation period and accordingly has concluded that contracts awarded in that three-month period need not be included by companies in determining the value of contract awards received in fiscal year 1976 or any subsequent fiscal year.

5. *Previously Announced Filing Requirements.* The Board's proposal included a requirement that any company which has submitted or was required to submit a Disclosure Statement to the Government under the previously announced filing requirements by virtue of having received a covered contract shall remain subject to those requirements so long as it has any contract subject to Cost Accounting Standards. The proposal also required that Disclosure Statements from those companies on file with the Government must be maintained in current form by those companies. There were virtually no comments received on this requirement. The amendments being published today

contain that requirement as set out in the April 3 proposal.

6. *Applicability of CAS 403.* A number of commentators noted that the April 3 proposal deleted § 351.41 of the Board's regulations. This paragraph restated the requirement that only companies that met the Disclosure Statement filing requirement for Federal fiscal year 1971 were required to comply with CAS 403. *Allocation of Home Office Expenses to Segments.* These commentators asked that the Board's position be clarified as to whether or not any current revision to the Disclosure Statement requirement also changed the coverage of CAS 403. It was not the Board's intention to broaden the coverage of CAS 403 at this time. The possibility of extending the coverage of that Standard is the subject of a separate study currently underway. To make the Board's intention wholly clear, § 403.70 of CAS 403 is being revised to state explicitly rather than by cross reference the continuing coverage of that Standard. This revision has no substantive significance whatever, but instead merely sets out specifically what was and continues to be the exemption from that Standard, which was before today accomplished by reference to § 351.40 of the Board's Basic Requirements. Contractors and subcontractors which together with their subsidiaries did not receive net awards of negotiated national defense prime contracts during Federal fiscal year 1971 totaling more than \$30 million continue to be exempt from Standard 403.

7. *Amendments to Disclosure Statements.* The Board's April 3 proposal also included revised procedures for handling changes to the Disclosure Statement. Contractors would be required to submit only the Disclosure Statement pages on which changes have been made. All commentators supported these revised procedures, and they are being published today as part of the Board's regulations.

The Board's April 3 proposal also included a provision enabling procurement agencies to issue regulations prescribing criteria under which a contractor may be required to submit a complete, updated Disclosure Statement. A number of commentators expressed concern over this provision. They felt that procuring agencies perhaps would issue regulations that were not consistent with the Board's intention and for this reason they urged that the Board prescribe criteria under which procurement agencies could make such a request.

The Board appreciates the concern expressed by the commentators. It would appear, however, that agencies would have a need for a complete, updated Disclosure Statement only where the number of amended pages submitted is so great that review of a Disclosure Statement would obviously

be an excessively cumbersome process. The Board urges agencies to consider these views when adopting their criteria for submittal of a complete, updated Disclosure Statement. The Board has concluded that it should not itself set criteria for this particular requirement.

8. *Computation of Dollar Amount of Contract Awards.* A number of commentators asked that the Board clarify its intent as to which contracts should be included in the computation of the dollar amounts. The Board feels that covered contracts awarded in any fiscal year in which the computation is being made should be included. This would mean that for all of fiscal year 1974, negotiated defense prime contracts in excess of \$100,000 would be included by a company in determining if it met the requirement to file a Disclosure Statement.

For the first six months of fiscal year 1975 all covered contracts in excess of \$100,000 would be included in the figure for that fiscal year. For the balance of fiscal year 1975 only those awards which are subject to Standards would be included. This means that if a company was not performing under a covered contract exceeding \$500,000 at January 1, 1975, and did not receive an award exceeding that amount in the last six months of the fiscal year, then only the covered contracts received in the first six months would be included. Only those companies which received an award of \$500,000 or more in the last six months of the year would add up their covered contracts, including those subsequently awarded in amounts of \$100,000 or more, to arrive at the total amount awarded in that period, to be added to the total for the first six months.

Beginning with Federal fiscal year 1976 only companies which receive at least one award exceeding \$500,000 either as a prime contract or subcontract subject to Standards will be required to include the value of awards received to determine if they must file a Disclosure Statement. In essence, it is the Board's intention that contracts subject to Cost Accounting Standards shall be included in the computation to determine if the filing requirement has been met by a company for fiscal year 1974 and all subsequent fiscal years.

9. *Summary of Disclosure Statement Filing Requirements.* The Board has amended the requirement for filing Disclosure Statements a number of

Fiscal period	Government contracts to be included in computation	Amount (million)	Effective date
Fiscal year 1971.....	Net negotiated prime defense contracts.....	\$30	Oct. 1, 1972.
Fiscal years 1972, 1973.....	Defense prime contracts of the type subject to CAS.....	10	Jan. 1, 1974.
Fiscal years 1974, 1975.....	Defense prime contracts subject to CAS.....	10	Jan. 1, 1976.
Fiscal year 1976.....	Defense prime contracts and subcontracts subject to CAS..	10	Mar. 31, 1977.
Following years.....	Defense prime contracts and subcontracts subject to CAS..	10	Mar. 31 following fiscal year.

10. *Modification.* The modifications being adopted today are limited to those areas in which the Board considers clarification or changes warranted at the present time. From time to time the Board may announce further changes in the criteria for applicability of the disclosure requirement.

The following modifications to Part 351 of the Board's regulations are being made, effective August 1, 1975, in view of the foregoing.

PREAMBLE G

Amendment published 9-12-77

The material set forth below is the preamble to the revision of § 351.40(e) and (f). This preamble was part of a document which also set forth amendments to Parts 331, 332 and 403. The complete preamble appears in the supplement to Part 332.

DISCLOSURE STATEMENT REQUIREMENTS

Many commentators suggested that preparation of a Disclosure Statement was burdensome. They also contended that in the situation where a large commercial contractor receives only a few small contracts containing a Cost Accounting Standards clause the need for a Disclosure Statement appears to be minimal. Some asserted that adoption of the proposal to require a Disclosure Statement for all covered contracts would reduce the number of companies that would accept contracts subject to the Board's Standards, rules and regulations. The Board is persuaded that for the time being Disclosure Statements should not be required for all covered contracts. Accordingly it is not adopting the February 16 proposal. The Board is retaining the existing Disclosure Statement requirement provided in Part 351 except that a business unit will be required to submit a Disclosure Statement if it is a company or a segment of a company

times. As a convenience to those affected by CAS, there follows a tabulation showing these requirements.

which received awards of national defense contracts subject to Cost Accounting Standards in excess of \$10 million during its preceding cost accounting period rather than the preceding Federal fiscal year.

REVISIONS TO PART 351

Part 332 and the amendments to Part 331 generally will result in annual determinations being made of a contractor's obligation to follow Standards and to submit Disclosure Statements. The determination will be made on the basis of sales and awards data from the immediately preceding cost accounting period. The requirement to continue to submit a disclosure Statement so long as the contractor has a contract subject to Cost Accounting Standards will no longer apply. Disclosure Statements must be maintained for and applied to only those contracts which were awarded during a cost accounting period in which the contractor met the filing requirements of § 351.40. Sections 351.40 and 351.50 have been revised to reflect this change.

EFFECTIVE DATE

The effective date of the regulations being published today is March 10, 1978. Pub. L. 91-379 provides that regulations shall take effect not earlier than the expiration of the first period of sixty calendar days of continuous session of the Congress following the date on which a copy of the regulations is transmitted to the Congress. The calendars of the Congress indicate that the required sixty days will not pass until some time in February 1978. Accordingly, March 10, 1978, has been selected to assure sufficient time for the regulation to lie before the Congress.

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Part III—Preambles Published Under the FAR System

PART III—PREAMBLES PUBLISHED UNDER THE FAR SYSTEM

PREAMBLE A TO 30.404, CAPITALIZATION OF TANGIBLE ASSETS

This final rule, in Federal Acquisition Circular (FAC) 84-38, revises 30.404-40(b)(1), 30.404-60(a)(1), and 30.404-60(a)(1)(i).

SUMMARY

Section 30.404 requires that contractors have written policies for capitalization which must include a minimum acquisition cost criterion of \$1000. The standard is being amended to raise the threshold to \$1500. The purpose of the change is to permit contractors to adopt practices appropriate in today's economy.

Effective Date: The effective date of this modification is September 19, 1988.

BACKGROUND

Supplementary Information. The CAS Board established the minimum acquisition cost criterion for capitalization at \$500 when it originally promulgated CAS 404 in 1973. The Board's initial \$500 limitation encompassed the practices of 97 percent of the companies whose Disclosure Statements were filed with the Board. In the promulgation comments to the Standard, the Board recommended that the special limits in the standard “. . . may need to be reviewed in the future . . . (and will be revised) promptly if developments warrant a change.”

On March 3, 1980, the Board did revise the limitation upward to \$1000 as it recognized that circumstances had changed significantly since the promulgation of Standard 404. The Board found that the performance of several official indices showed increases from 60 to 80 percent, and a survey of companies not influenced by the limitation of Standard 404 showed a significant number using \$1000 as the minimum criterion for capitalization.

The impact of inflation has continued over the 7 years since 1980, although at a lower level. Indices from the Commerce Department for the implicit price deflators on nonresidential structures and machinery and equipment showed increases from 30 to 35 percent over the period 1979 through 1985. When applied to the current \$1000 criterion, this yields values from \$1300 to \$1350. In addition, economic projections showed inflation levels rising slightly from 1986 through 1989. Consequently, this change increases the minimum acquisition cost criterion for capitalization of tangible capital assets to \$1500 to cover both actual and projected price increases.

The amendment which is now being promulgated is derived directly from the proposed rule which was published in the *Federal Register* on July 9, 1986 (51 FR 24971), with an invitation for interested parties to submit comments.

Four letters of comment were received on the July 9, 1986, proposal. Only one letter directly addressed the appropriateness of the proposed revisions to 30.404. That comment stated that inflation should not be the motivating factor in determining significant costs for capitalization, but rather materiality of the cost should be the factor in determining significance.

The CAS Board's comments in the CAS 404 preamble and its action to increase the capitalization threshold based upon inflation, discussed above, indicate that the Board considered the materiality and significance of asset acquisition cost to be directly related to the

level of prices in the economy. The Defense Acquisition Regulations Council and the Civilian Agency Acquisition Council agree with the CAS Board's outlook on this matter and expect the increase in capitalization threshold provided in this modification to 30.404 will be beneficial to Government contract costing by not requiring capitalization of assets that are of insignificant value.

PREAMBLE A TO 30.416, ACCOUNTING FOR INSURANCE COSTS

This final rule, in Federal Acquisition Circular (FAC) 84-38, revises 30.416-50(a)(3)(ii).

SUMMARY

FAR 30.416-50(a)(3)(ii) revisions delete the requirement to use state rates in discounting certain self-insured losses to present value.

Effective Date: The effective date of this modification is September 19, 1988.

This modification shall be followed by each contractor on or after the start of its next cost accounting period, beginning after receipt of a contract to which this modification is applicable.

BACKGROUND

Supplementary Information. Section 30.416 provides that the amount of insurance cost to be assigned to a cost accounting period is the projected average loss (PAL) for that period plus insurance administration expense in that period. The PAL is either the insurance premium, where the risk of loss is covered by the purchase of insurance, or a self-insurance charge, where the exposure to risk is not covered by the purchase of insurance. Where it is probable that the actual amount of losses will not differ significantly from the PAL, the actual amount of losses may be considered to represent the PAL for the period as the self-insurance charge.

In self-insurance, when the actual amount of losses is being used to represent the PAL, contractors are to discount those losses to present value, where payments to the claimant will not take place for over a year after the loss occurs. If a state provides a discount rate for computing lump-sum settlements, 30.416 requires that the state rate be used for computing present value. Otherwise, the Pub. L. 92-41 Treasury rate is to be used. The differing rates specified by the states, and the lack of specified rates in some states, result in inconsistent treatment of self-insurance charges on defense contracts.

The purpose of requiring a present value computation for contract cost accounting purposes is to recognize the time value of money for funds advanced to and used by the contractor for extended periods before being disbursed. The Pub. L. 92-41 Treasury rate is generally specified for this purpose. The majority of state laws covering worker's compensation insurance specify a rate in the range of 3-6 percent. The use of a low rate results in a larger settlement than would use of a current money market rate. The purpose of low state rates is to discourage lump-sum settlements. This purpose is unrelated to that of fair valuation for contract cost accounting purposes. The use of state rates may produce inaccurate measures of present values and will most certainly create inconsistencies in the pricing of contracts due to the lack of consistent deter-

minations of present values. Consequently, the proposed rule, published in the *Federal Register* on July 8, 1986 (51 FR 24788), deleted the reference to state discount rates at 30.416-50(a)(3)(ii) and required use of the Pub. L. 92-41 Treasury rate in all cases.

Four comments were received in response to the proposed rule. None of the comments directly challenged the appropriateness of the proposed revision. Therefore, no changes were made to the proposed rule as a result of the public comments.