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PROGRESS REPORT TO THE CONGRESS

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**COST
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COST ACCOUNTING STANDARDS BOARD

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WASHINGTON, D. C. 20548
Telephone: (202) 386-6213

ELMER B. STAATS
Chairman

HERMAN W. BEVIS
CHARLES A. DANA
ROBERT K. MAUTZ
ROBERT C. MOOT



ARTHUR SCHOENHAUT
Executive Secretary

August 15, 1973

Dear Sirs:

In accordance with Section 719(k) of the Defense Production Act of 1950, as amended, I respectfully submit the second progress report of the Cost Accounting Standards Board for the year ending June 30, 1973. Subsequent reports of Board progress, activities, and operations will be made annually.

Sincerely yours,

A handwritten signature in cursive script, which reads "Elmer B. Staats".

Chairman

The President of the Senate

The Speaker of the House of Representatives

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HIGHLIGHTS OF ACTIVITIES

The Cost Accounting Standards Board was created as an agent of the Congress in August 1970 by an amendment (Public Law 91-379) to the Defense Production Act of 1950. The Board was formally organized in January 1971 following the initial appropriation of funds for its operations. The Board's first progress report covering activities from its inception through June 30, 1972, was submitted to the Congress on August 15, 1972.

The individuals originally appointed as members of the Board by the Chairman, who is Comptroller General of the United States, continued to serve with the Board through June 30, 1973. This report describes the progress made by the Board during the fiscal year then ended. Summarized below are the highlights of the activities of the Board during the year.

1. Relationships with Other Organizations--The Board's second full year of operation has seen the realization of the Board's expressed desire for a marked increase in the level and extent of participation, cooperation, and communication with other Federal agencies, industry, the accounting profession, the academic community, and other interested individuals. There are now approximately 500 organizations and individuals to whom Board proposals and promulgations are regularly mailed. The Board is gratified that these organizations and individuals generally have provided constructive reviews and comments of Board materials. (See page 6.)

2. Research and Development of Standards--The Board has developed an extensive program for the research of potential Cost Accounting Standards. The research procedure requires an in-depth study of each subject area and continuous dialogue with Government agencies, contractors and representatives of the accounting profession. Actual practices of

contractors and the underlying accounting concepts are considered by the Board in developing alternative proposals which are then carefully explored with specific contractors. Before promulgation of any Standard, the Board obtains extensive comments. After considering these comments, the Board makes appropriate revisions to proposed Cost Accounting Standards and final publication is made in the Federal Register accompanied by a detailed analysis of the Board's reasons for revising or not revising various sections of proposed Standards in accordance with comments received. The Board's research procedure is described at page 9.

3. Statement of Operating Policies, Procedures and Objectives--The Board issued in March 1973 a Statement of Operating Policies, Procedures and Objectives which it distributed widely. The Board intends that this document improve general understanding of its fundamental objectives and concepts and thus provide a basis for continuing productive dialogue with those concerned with the Board's work. The Statement describes the framework within which the Board is formulating Cost Accounting Standards and related rules and regulations in carrying out its legislative mandate under Public Law 91-379. The principal matters contained in the Statement are summarized at page 13 of this report, and the Statement is included in its entirety as Appendix B.

4. Disclosure of Cost Accounting Practices--Effective July 1, 1972, major contractors were required to submit Disclosure Statements to procuring agencies as a condition of obtaining a negotiated defense contract subject to Public Law 91-379. The cost accounting practices disclosed are required to be followed consistently for all covered contracts. This disclosure requirement was initially applied only to those companies which received prime contract awards of negotiated defense contracts during fiscal year 1971 totaling more than \$30 million. More than 900 Disclosure Statements have been submitted to Government agencies by 92 of the largest contractors

who received about \$20 billion of negotiated prime contracts during fiscal year 1971.

The Board published in the Federal Register for July 27, 1973, a proposal to reduce the filing requirement, on which comments from the public are invited. The revised proposal would reduce the filing requirement, effective January 1, 1974, to \$10 million of negotiated prime defense contract awards in the Government's fiscal years 1972 or 1973. This reduced threshold would be determined by excluding any negotiated awards which were \$100,000 or less or which were for contracts where the price negotiated was 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. (See page 16.)

5. Cost Accounting Standards--The first two Cost Accounting Standards to be used in connection with negotiated contracts became effective July 1, 1972. These Standards require (a) consistency in estimating, accumulating and reporting costs and (b) consistency in allocating costs incurred for the same purpose and in like circumstances. During fiscal year 1973 the Board promulgated two additional Standards which became effective July 1, 1973: a Standard on Allocation of Home Office Expenses to Segments, which is applicable initially to those contractors who were awarded negotiated defense prime contracts during fiscal year 1971 totaling more than \$30 million, and a Standard on Capitalization of Tangible Assets, which is applicable to all prime contractors and subcontractors who receive negotiated defense contracts in excess of \$100,000. In addition, the Board has in various stages of research and development potential Standards dealing with 19 subjects. The Standards promulgated by the Board during the year and the nature and status of current research studies are summarized starting at page 19 of this report.

6. Effectiveness of Board Promulgations--The Board has a continuing responsibility to evaluate the effectiveness of materials which it promulgates and believes that its evaluation process can be aided best by obtaining reports from Federal agencies. Reports received from defense agencies indicate that despite their limited experience the agencies have noted that contractors are exercising greater care in contract proposal preparation. Also, the agencies reported that submission and review of Disclosure Statements has provided contracting officials with adequate descriptions of practices followed by contractors. The Board believes that future reports will provide it with much needed information concerning the effectiveness of its promulgations. (See page 28.)

7. Exemptions and Waivers--The Board has continued to consider the granting of exemptions to classes or categories of contractors or contracts. Also, the Board has established a procedure whereby waiver of Board requirements may be granted under certain circumstances for particular contracts or subcontracts. During fiscal year 1973, the Board, at the request of the Department of Defense, granted three class exemptions. Also during the past year the Board received and granted five requests for waiver of all or a portion of the requirements of the Cost Accounting Standards Contract Clause. In addition, the Board has been notified that the requirement for submission of a Disclosure Statement has been waived by agencies of the Department of Defense for two contract actions under the provisions of a Board regulation authorizing waiver in certain circumstances. (See page 30.)

BOARD ORGANIZATION AND OPERATIONS

The Comptroller General of the United States, Elmer B. Staats, is designated by Public Law 91-379 as Chairman of the Cost Accounting Standards Board. Pursuant to that law, he appointed four members to serve with him on the Board for a term of 4 years each. The Board Members appointed in January 1971 are:

Herman W. Bevis who was Senior Partner of Price Waterhouse & Co. Mr. Bevis is currently a member of the Banking and Securities Industry Committee and until recently was its Executive Director.

Robert K. Mautz who was Weldon Powell Memorial Professor of Accountancy at the University of Illinois and is a Partner in the firm of Ernst & Ernst, Certified Public Accountants.

Charles A. Dana who is Director of Government Accounting Controls of Raytheon Company.

Robert C. Moot who was Assistant Secretary (Comptroller) of the Department of Defense. Mr. Moot is currently Vice President-Finance of AMTRAK.

On March 5, 1971, the Board selected Arthur Schoenhaut, then Deputy Controller of the Atomic Energy Commission as Executive Secretary; and on April 25, 1971, Harry R. Van Cleve, who had served as General Counsel of the General Services Administration, became the Board's General Counsel. As of June 30, 1973, the Board had a full-time staff of 34 employees--22 professional and 12 administrative and clerical. In staff selection, the Board has been successful in recruiting and maintaining the same balance of representation evidenced by the backgrounds of Board Members, i.e., people from Government, industry, the accounting profession, and the academic community.

Appendix A to this report provides a brief background description of each Board Member and each professional staff member.

RELATIONSHIPS WITH OTHER ORGANIZATIONS

Since its inception, the Board has vigorously encouraged the cooperation of all those who might be interested in Cost Accounting Standards. The Board's second full year of operation has been characterized by a marked increase in the level and extent of participation, cooperation and communication with other Federal agencies, industry (both associations and individual companies), the accounting profession, the academic community and other interested groups and individuals. The Board continues to find these relationships to be of considerable benefit.

Recognizing that cooperation by departments and agencies of the Executive Branch would be very important in achieving the full benefit of its regulations and Standards, the Board established an Interagency Advisory Committee in 1972. The Committee was initially composed of controller and procurement representatives of the Atomic Energy Commission, the Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration, and was chaired by a representative of the Office of Management and Budget. During fiscal year 1973, in recognition of the administrative extension by the General Services Administration of the Board's Standards, rules, and regulations to nondefense contracts, this Committee was expanded to include representation from the Department of Health, Education and Welfare and the Department of Transportation.

The Standards, rules and regulations which were developed and promulgated during fiscal year 1972 became effective and were implemented during fiscal year 1973. The cooperative spirit of the Interagency Advisory Committee and of the individual Federal agencies involved has materially assisted in the

implementation of these promulgated Standards, rules and regulations. For example, the Atomic Energy Commission, the Department of Defense and the National Aeronautics and Space Administration, the three principal relevant Federal agencies under Public Law 91-379, issued uniform implementing regulations.

The General Services Administration, in its publication of the Federal Procurement Regulations (FPR) provided that, with certain exceptions, the Board's Standards, rules, and regulations, as a matter of policy, are to be extended to nondefense contracts, thus better assuring consistent application of Board issuances to contractors having both defense and nondefense contracts. However, the FPR exempts certain negotiated contracts that are similar to defense contracts covered by Public Law 91-379.* The Board is optimistic that continued cooperation with

*As set forth in FPR Temporary Regulation No. 27, Supplement No. 4, the negotiated nondefense contracts which are exempted are firm fixed price contracts awarded after the procuring agency receives offers from at least two firms not associated with each other, "Providing, That (1) the solicitation to all competing firms is identical; (2) price is the only consideration in selecting the contractor from among the competing firms solicited; and (3) the lowest offer received in compliance with the solicitation from among those solicited is accepted; and Providing further, That the profit center, division, or similar organizational unit of a company to which the contract is to be awarded is not on the date of such award performing a contract or subcontract subject to the Cost Accounting Standards Clause (for the purpose of the second proviso, performance of a contract or subcontract extends from the date of award of the contract to the date when the work required by the contract is completed)."

the Interagency Advisory Committee and the General Services Administration ultimately will result in the application of Board promulgations to all Government negotiated contracts of the types covered by Public Law 91-379.

The Defense Contract Audit Agency and the Defense Contract Administration Services, the two agencies having principal responsibility for the implementation of Board promulgations within the Department of Defense, have established Cost Accounting Standards monitors or specialists at their headquarters and field locations throughout the United States. The primary function served by these individuals is to assure uniform implementation of Board promulgations through advice and assistance to auditors and administrative contracting officers in the field. A number of contractors have stated that this assistance has proved to be beneficial to contractors as well. These actions manifest the high degree of interest shown by the agencies in Board promulgations and should contribute materially to effective implementation of the CASB promulgations both by the agencies and by the contractors involved.

Contract costing often deals with the same expenditures and the same problems of allocation to time periods as are of interest in financial and income tax accounting. The Board, therefore, believes that cooperation and coordination with other authoritative bodies will be of considerable benefit to all organizations having similar responsibilities for issuing pronouncements involving accounting matters. Since early 1973, when the newly created Financial Accounting Standards Board (FASB) was being organized, the Board has had several meetings with representatives of the FASB to exchange ideas in areas of mutual interest. The Board also has met with officials of the Securities and Exchange Commission and the Internal Revenue Service to explore areas of common interest.

As discussed elsewhere in this report, additional Cost Accounting Standards were promulgated

during fiscal year 1973, and a number of subjects are in various stages of research and development as potential Standards. The Board continues to be impressed by, and has benefited significantly from, the responses and cooperation it is receiving from professional accounting organizations, contractors, industry associations, the academic community and interested individuals. Professional organizations such as the American Institute of Certified Public Accountants and the Financial Executives Institute (FEI), which have established special committees to deal extensively with the Board, have devoted substantial effort to the Board's research activities. The FEI, for example, has formed a 22-member committee to deal with the Board on individual projects that are under study by the Board. Frequent informal discussions are held with committee members on research plans and procedures and on draft Standards. Continuing dialogue throughout the Board's extensive research procedure is maintained with committees of this type.

There are now approximately 500 organizations and individuals to which Board proposals and promulgations are regularly mailed for comment, testing, and evaluation. Most of these organizations and individuals have provided constructive reviews and comments.

RESEARCH AND DEVELOPMENT OF STANDARDS

Before the promulgation of any Standard, the Board makes an in-depth study of the subject area. It includes extensive research and careful testing of alternative proposals. Although the precise nature of the research varies somewhat, depending upon the subject under consideration, certain basic elements of the research procedure are followed each time.

After a topic has been authorized by the Board for research, authoritative materials on the subject are reviewed, including sources such as books and theses, Government procurement regulations, pronouncements of accounting and regulatory groups, Court and Board of

Contract Appeals decisions, Government agency reports of problems, and Disclosure Statements filed by contractors with the Board. At the time of reviewing these materials, issues and sources of problems related to the topic under research are identified, e.g., lack of recognition of underlying cost concepts, inadequacy of guidelines, misunderstanding in interpreting existing regulations.

Concurrently, the initial phase of liaison with various contractors and governmental agencies is begun through correspondence, telephone conversations, personal interviews, or plant visits to obtain empirical data and to discuss actual practices and the underlying accounting concepts.

With information gained from both library research and field visits, there is usually prepared an issues paper and a list of questions to be answered concerning those issues. At this stage, views of appropriate committees of various professional associations are sought.

Based on this research, a preliminary draft of a proposed Cost Accounting Standard is developed which is discussed with appropriate groups such as professional accounting associations, contractors, and Government agencies. After considering suggestions made, a draft is mailed to many of the organizations and individuals who have volunteered to participate in the Board's research process. The draft Standard is usually accompanied by questions designed to elicit information concerning potential administrative problems and estimated costs of implementation. Also, certain statistical data may be obtained directly from contractors or may be obtained for the Board by the Defense Contract Audit Agency.

After comments on this preliminary draft are analyzed, the Board publishes a proposed Cost Accounting Standard in the Federal Register. This initial publication, which is viewed by the Board as an integral part of its research process, serves as a public solicitation by the Board for comments on the proposed

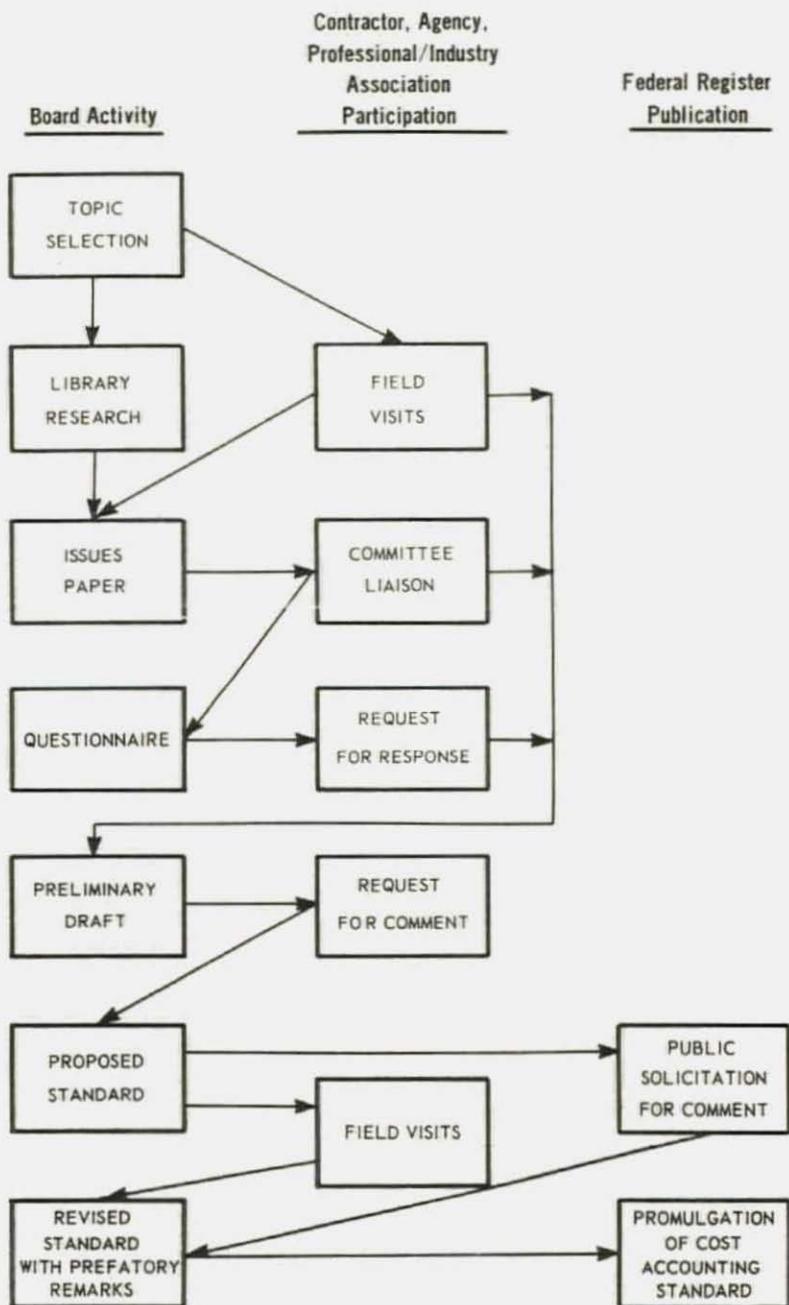
Standard. After this initial publication, a number of contractors and Government agencies are visited to discuss further all aspects of the proposed Standard, with additional special emphasis on the anticipated administrative costs of implementation and the probable benefits to be achieved through adoption of the Standard.

On the basis of careful consideration of all comments submitted by the public and the further discussions with outside organizations, the Board makes appropriate revision of the proposed Cost Accounting Standard and publishes it for the second time in the Federal Register. The Board's reasons for revising or not revising various sections of the proposed Standard in accordance with the comments received are also included in the second publication in the form of extensive prefatory remarks.

Standards promulgated by the Board are sent to the Congress at the time of the second publication in the Federal Register. The Standards become effective unless the Congress, within 60 days of continuous session, passes a concurrent resolution stating in substance that it does not favor the proposed Standard. The Board's promulgations have the full force and effect of law.

The Board's research process leading to the promulgation of a Standard is shown graphically on page 12. In an effort to facilitate its research process, the Board is exploring the practicality of developing one or more computerized cost models for purposes of simulation and testing of preliminary draft Standards. Because of the need for close staff coordination in developing cost models, the work is being performed by in-house staff. A preliminary version of a computerized cost model, currently operational, is capable of reclassification of costs between direct and indirect, creation of new cost pools, introduction of new allocation bases, and inclusion or exclusion of cost pools in allocation bases. Further development of simulation techniques should facilitate evaluation of changes in Government contract costs caused by changes in cost accounting practices and consideration

THE BOARD'S RESEARCH PROCESS



of estimated costs of implementation of changes in cost accounting practices required by proposed Standards.

STATEMENT OF OPERATING POLICIES, PROCEDURES
AND OBJECTIVES

In March 1973, the Board issued a Statement of Operating Policies, Procedures and Objectives which it distributed widely. This Statement describes the framework within which the Board is formulating Cost Accounting Standards and related rules and regulations in carrying out its legislative mandate under Public Law 91-379.

The Board intends that this document improve general understanding of its fundamental objectives and concepts and thus provide a basis for productive dialogue with those concerned with the Board's work. Interested members of the public should, on the basis of this Statement, be better able to focus on the complex and difficult issues which the Board faces in promulgating Cost Accounting Standards. The Statement is not intended to be final or all-encompassing; the Board may from time to time amplify, supplement, or modify its views as it proceeds with consideration of individual Standards.*

The principal matters contained in the Statement are summarized below, and the Statement is included in its entirety as Appendix B.

*Although not every Board member is in full agreement with every policy, procedure and objective set out in the Statement, the Board is in agreement that the document provides a useful, overall framework within which it can develop specific Cost Accounting Standards. In the few cases where individual members may have differing views, they may set forth those views and the reasons for them if it becomes appropriate to do so in the context of the Board's consideration of a particular Cost Accounting Standard, rule or regulation.

Objectives--The Board defines a Cost Accounting Standard as a statement 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. It may be stated in terms as general or as specific as the Board considers necessary to accomplish its purpose. Also discussed is the applicability of the terms "uniformity" and "consistency" in relation to the Board's statutory goals and the Board's views on significant concepts such as fairness and materiality.

Relationship to Other Authoritative Bodies--A number of authoritative bodies have been established to issue pronouncements affecting accounting and financial reporting. The Board seeks to avoid conflicts or disagreements with such other bodies and, through continuous liaison and review of pronouncements affecting financial and tax reporting, will make any reasonable effort to do so. The nature of the Board's authority and its mission, however, is such that it must retain and exercise full responsibility for meeting its objectives.

Nondefense Applications--The Board is of the opinion that uniformity among all Government agencies in contract Cost Accounting Standards is a highly desirable objective. The Board is gratified, therefore, that the Federal Procurement Regulations have, through administrative decision, extended Cost Accounting Standards to contracts of nondefense agencies.

Single Government Representative--As a result of the Board's recommendation, Federal agencies have established a procedure to provide that only one contracting officer will deal with a given contractor regarding application of the requirements of the Board. The Board is optimistic about the benefits to be derived by both the Government and contractors from this single-representative system and the Board will continue to encourage and assist Government agencies in assuring that the system matures and functions effectively.

Responsibilities for Compliance--The Board notes that the basic responsibility for securing compliance by contractors with Board promulgations rests with the relevant Federal contracting agencies. The Board nevertheless must retain responsibility for evaluating the effectiveness of the Standards, rules, and regulations that it promulgates.

Interpretations--When there are widespread and serious questions of the Board's intention or meaning in its promulgations, the Board may at its discretion respond to requests for authoritative interpretations of its rules, regulations and Standards. Such interpretations will be published in the Federal Register and will be considered by the Board as an integral part of the rules, regulations, and Standards to which the interpretations relate.

Exemptions--In accordance with its legislative authority, the Board has exempted certain classes of contracts. In addition, the Board has established a mechanism by which exemptions, where justified, can be granted for particular contracts and subcontracts. The Board anticipates that it will grant exemptions only in rare and unusual cases, in recognition of the fact that exemptions reduce the extent to which the primary goals of increased uniformity and consistency are achieved.

Cost Allocation Concepts--The Board will adhere to the concept of full costing wherever appropriate and notes that, as an ideal concept, costs should be assigned to cost objectives based on a beneficial or causal relationship. To approach this latter goal, the Board believes in the desirability of direct identification of costs with final cost objectives to the extent practical. Where costs are not directly identified with final cost objectives, they should be allocated in accordance with preferable techniques described in the Statement.

DISCLOSURE OF COST ACCOUNTING PRACTICES

Effective July 1, 1972, major contractors were required to submit Disclosure Statements to procuring agencies as a condition of obtaining negotiated contracts subject to P.L 91-379. A Disclosure Statement is required to cover the practices of each of the contractor's profit centers, divisions or similar organizational units whose costs included in the total price of any covered contract exceeded \$100,000. Under certain conditions, corporate or group offices are required to complete a specific portion of the Statement. The cost accounting practices disclosed are required to be followed consistently for all covered contracts. This disclosure requirement was initially applied only to those companies which together with their subsidiaries and affiliated companies under common control, received prime contract awards of negotiated national defense contracts during Federal fiscal year 1971 totaling more than \$30 million.

In completing the Disclosure Statement, a contractor must define what it considers as direct costs of contracts and disclose its method of charging such costs to contracts. The contractor must also disclose its method of distinguishing direct from indirect costs and its method of allocating indirect costs to contracts.

The initial filing requirement affected 92 of the largest contractors who received about \$20 billion of negotiated prime contracts over \$100,000 during fiscal year 1971. More than 900 Disclosure Statements have been submitted to Government agencies by reporting units of these companies since July 1, 1972.

In 1972, the Board had announced that there would be a phased requirement for the submission of Disclosure Statements. In this connection, the Board published in May 1973 a proposal to reduce the filing requirement to be effective January 1, 1974. After

consideration of the comments received in response to that proposal, the Board published in the Federal Register for July 27, 1973, a revised proposal, on which comments from the public are invited. The revised proposal would reduce the filing requirement to \$10 million of negotiated prime defense contract awards in the Government's fiscal years 1972 or 1973. This reduced threshold would be determined by excluding any negotiated awards which were \$100,000 or less or which were for contracts where the price negotiated was 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. The proposed reduced filing requirement would be effective January 1, 1974.

Representatives of colleges and universities have expressed to the Board a strong desire to have a separate form of Disclosure Statement to cover their practices. Colleges and universities are now subject to Board Standards, rules and regulations only in contracts awarded by defense agencies. Colleges and universities have unique accounting systems that differ markedly from those of other Government contractors subject to Disclosure Statement requirements. Accordingly, the Board is working with officials of universities and related organizations to design a Disclosure Statement that accommodates their unique characteristics.

The Board has provided that contractors when submitting Disclosure Statements may request that such statements be treated by the Government as containing confidential information. Copies of Statements identified by the contractor as confidential are not made available to any organization or individual outside of the Government under existing rules and regulations of the Board. At the present time, an action is pending in the Federal District Court for the District of Columbia challenging the validity of these rules and regulations. The action was brought under 5 U.S.C. 552, The Freedom of Information Act, by Peter J. Petkas of the Corporate

Research Accountability Group (Petkas v. Staats,
Civil Action No. 2238-72).

A copy of each completed Disclosure Statement is sent to the Board for its use in developing future Cost Accounting Standards. Responses to the Statements are maintained in a computerized data bank which permits various analyses and correlations of the data. Information in aggregate statistical form will be made available to interested outside organizations and individuals. The Board is considering publication of a statistical summary of the responses to all the Disclosure Statements which have been received.

COST ACCOUNTING STANDARDS

In its previous Progress Report to the Congress, covering the period from the Board's inception through June 30, 1972, the Board reported that the first two Cost Accounting Standards to be used in connection with negotiated contracts were promulgated in the Federal Register in February 1972 and became effective July 1, 1972. These Standards require (1) consistency in estimating, accumulating, and reporting costs and (2) consistency in allocating costs incurred for the same purpose and in like circumstances. The two Standards, together with the Disclosure Statement which was also promulgated in the initial year of the Board's operation, provide that individual contractors must follow cost accounting practices uniformly for all covered contracts at any given point in time.

The Board has promulgated two additional Cost Accounting Standards which became effective July 1, 1973, and has in various stages of research and development potential Standards dealing with 19 subjects. The Standards promulgated by the Board during the past year and the nature of current research studies are summarized below.

ALLOCATION OF HOME OFFICE EXPENSES TO SEGMENTS

This Standard was published in its final form in the Federal Register of December 14, 1972. The Standard is applicable initially to those contractors (about 100) who received net awards of negotiated national defense prime contracts during Federal fiscal year 1971 totaling more than \$30 million. Educational institutions are temporarily exempt from the requirements of the Standard. After further study, the Board will consider the desirability of lowering the \$30 million threshold to make the Standard applicable to additional contractors.

Home office expenses which are allocated to the various segments of a contractor, and in turn to contracts, can constitute an important element of total

contract cost. Prior to the promulgation of this Standard, there were no procurement regulations or authoritative accounting statements dealing with many of the complex issues and problems involved in the allocation of home office expenses. Therefore, the allocation of those expenses varied among contractors and was often a source of controversy and intensive dispute. A number of problems regarding the allocation of general and administrative expenses were reported in the Comptroller General's Report on the "Feasibility of Applying Uniform Cost Accounting Standards to Negotiated Defense Contracts" (January 1970). Additional problems in this area were later reported to the Cost Accounting Standards Board. Such problems included disagreements on (1) the propriety in certain circumstances of using a particular base for allocating home office expenses to segments; (2) whether and to what extent certain kinds of segments, such as foreign subsidiaries, should be included in the allocation base; and (3) the required degree of homogeneity of expense pools.

This Standard requires that home office expenses shall be allocated on the basis of beneficial or causal relationships between the supporting and receiving activities. For this purpose, home office expenses are to be allocated directly to segments to the maximum extent practical. Significant expenses not directly allocated are to be grouped in logical and homogeneous expense pools to facilitate allocation on the basis of beneficial or causal relationships; for certain service functions, a hierarchy of allocation methods has been provided to facilitate selection of an appropriate allocation base.

The remaining, or residual, home office expenses (generally those of managing the company as a whole) are to be allocated to segments by means of a base representative of the total activity of such segments. A three-factor formula must be used for those expenses when they exceed certain specified percentages of an organization's operating revenue. The three-factor formula takes into account the major

subjects of management concern, i.e., volume or activity, employees, and invested capital.

As part of the extensive research preceding the promulgation of this Standard, field studies were made of the management philosophy and operations of the home offices of 40 companies representing a wide variety of industries. Following this and other research, a proposed Standard was published for the first time in the Federal Register of June 30, 1972, with an invitation for interested parties to submit written data, views, and comments to the Board. Responses were received from 130 sources, including individual companies, Government agencies, professional associations, industry associations, public accounting firms, and others. All of these comments were carefully reviewed and analyzed before promulgation of the Standard.

The Board also obtained information 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. The Board concluded that the probable benefits of this Standard outweigh the probable cost of implementation.

CAPITALIZATION OF TANGIBLE ASSETS

This Cost Accounting Standard requires that, for purposes of cost measurement, contractors establish and adhere to reasonable policies with respect to capitalization of tangible assets in accordance with certain criteria set forth in the Standard. Cost measurements generally are based on the concept of enterprise continuity; this concept implies that major asset acquisitions will be capitalized, so that the costs 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.

Research on this subject by the Board indicated the need for more definitive capitalization criteria for defense contract costing. The Armed Services Procurement Regulation relies primarily on the Internal Revenue Code and Internal Revenue Service regulations and generally accepted accounting principles for capitalization criteria. The provisions of the Code and regulations have been developed in response to various needs other than contract costing. Generally accepted accounting principles allow alternatives in presenting an organization's financial condition; not all alternatives are appropriate for contract costing purposes. The result is that the applicable procurement regulations do not provide capitalization criteria which can be used as a basis for determining the cost of fixed assets applicable to accounting periods and to Government contracts.

The General Accounting Office (GAO) Feasibility Study identified the following capitalization problems: "Contractors have considerable latitude of choice as to whether to expense or capitalize the cost of such items as office equipment; machinery; tools; and plant repairs; rehabilitation; and rearrangement. There is a tendency on the part of some contractors to charge the cost of capital assets to expense rather than to defer such costs to future periods. This happens despite established corporate policy to the contrary." The GAO found that "consideration should be given to the development of criteria for setting the minimum dollar limitations of property to be capitalized.

A preliminary analysis of the topic of fixed-asset accounting was made by the Board, and a number of issues were identified. Comments on this analysis were obtained from outside parties in response to an extensive mailing. The Board also developed and circulated a questionnaire on tangible fixed-asset accounting practices. The replies to the questionnaire

facilitated the preparation of a preliminary draft of the Standard on Capitalization of Tangible Assets which was, in turn, widely distributed for comment. Following this research, a proposed Standard was published in the Federal Register of October 5, 1972, with an invitation for interested parties to submit their views to the Board. Responses were received from 107 sources. All of the comments were carefully considered by the Board prior to the promulgation of the Standard in the Federal Register of February 27, 1973.

The Standard on Capitalization of Tangible Assets establishes the beginning point for fixed-asset accounting. The Board believes that this Standard enhances objective selection of capitalization practices to assure more equitable contract costing. It also should minimize controversy and disputes related to capitalization.

The Standard provides criteria for establishing contractor capitalization policies which will achieve the proper identification and capitalization of the cost to acquire tangible assets. A contractor must adhere to a written capitalization policy that is reasonable and consistently applied and which designates economic and physical characteristics for capitalization of tangible assets. For this purpose, the Standard requires a minimum service life criterion of not more than 2 years and a minimum acquisition cost criterion of not more than \$500.

Many contractors already have policies which comply with the criteria in the Standard and therefore will experience little cost impact. Some contractors will have to establish or modify capitalization policies, and for those contractors there may be some costs. However, benefits through improved contract administration will be available. 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. One of the major benefits of this Standard is the provision of a more uniform

basis which the Government and contractors may use in dealing with depreciation expense. The Board has concluded, therefore, that this Standard will provide benefits which outweigh the probable costs of implementation.

CURRENT STUDIES

Selection of specific areas for research and possible development of Cost Accounting Standards is based primarily on (1) relationship to the objectives of Public Law 91-379, (2) significance of observed costing problems, and (3) relationship to other work of the Board. The Board has sought and obtained advice about the importance of various problems which are involved in contract cost accounting. The research projects selected are at various stages of development and may result in one or more Standards on each subject. Preliminary proposals and research papers have been widely circulated for some, and not for others.

1. Accounting for Unallowable Costs--A proposed Standard on this subject was published in the Federal Register on March 30, 1973, soliciting comments from all interested parties. The purpose of this proposed Standard is to facilitate contract negotiation, audit, administration and settlement of prime contracts and subcontracts by establishing guidelines covering: (a) identification by contractors of specific costs which are unallowable at the time such costs first become defined or authoritatively designated as unallowable; and (b) the cost accounting treatment to be accorded such identified costs. The Board received 67 sets of comments on the Federal Register publication which are being considered along with research data previously gathered in reaching decisions on an appropriate Standard.

2. Depreciation--This subject covers techniques for determining depreciation costs and identifying gains or losses upon disposition of capital assets. Comments received in response to a preliminary draft Standard which was distributed in March 1973 are being analyzed.

3. Standard Costs--This subject deals with the use of pre-established measures for estimating, accumulating, and reporting contract costs under prescribed circumstances. A preliminary draft Standard was distributed for comment in June 1973.

4. Cost Accounting Period--This subject covers the selection of the accounting period to be used for allocation of indirect costs, especially when the period of contract performance does not coincide with the contractor's fiscal year or a multiple thereof. Responses to a preliminary draft Standard distributed in April 1973 are being considered.

5. Costs of Authorized Employee Absences--This subject covers appropriate techniques for recognizing costs of labor for time not actually worked, e.g., vacation, sick and holiday pay. A preliminary draft Standard is being discussed with liaison committees of professional organizations.

6. Allocation of Business Unit General and Administrative Expenses to Cost Objectives--This subject covers criteria for identification and allocation to cost objectives of the heterogeneous grouping of expenses commonly described as general and administrative expenses. A preliminary draft Standard is being discussed with liaison committees of professional organizations.

7. Material Costs--This subject covers the charging of material costs to inventory accounts, overhead accounts, or directly to contracts. Responses to an issues paper and the results of visits to contractors' plants are being analyzed.

8. Scrap--This subject covers consideration of the accounting treatment for scrap, manufacturing wastes, and rejected work. A research paper dealing with the classification and definition of terms related to this subject was mailed to interested parties for comment in March 1973.

9. Termination Accounting--This subject is being explored with contractors and Government

agencies to ascertain appropriate accounting principles and practices applicable to contracts which are terminated for the convenience of the Government.

10. Pension Costs--This subject covers the problems pertinent to accounting for costs of contractor pension plans, including the allocation of these costs to contracts. An issues paper has been distributed to interested organizations for comment.

11. Special Facilities--Research has been initiated related to the allocation of the costs of various specialized facilities.

12. Allocation of Burden--The early research effort on this subject covers allocation of pools of indirect costs such as manufacturing and engineering overhead.

13. Cost of Capital--Preliminary research on this subject covers consideration of the cost accounting treatment of the cost of capital employed in contract performance.

14. Deferred Incentive Compensation--This research study involves inquiry into criteria for cost accounting techniques related to contractor profit-sharing and bonus arrangements. This research effort has just begun.

15. Other Labor-Related Costs--This subject covers costs such as those of employee health, welfare and morale activities and recruiting, training, and collective bargaining. Initial research has started.

16. Direct and Indirect Charging--This study will cover the accounting concepts and principles governing consistent classification of costs as direct or indirect, for purposes of allocation to cost objectives. Research to date has been limited

to staff analysis of fundamental cost allocation concepts.

17. Independent Research and Development and Bid and Proposal Costs--Initial research of this subject has dealt with the accounting treatment to be accorded to a contractor's cost of performing independent research and development and its costs of preparing bids and proposals for Government contracts.

18. Current Value or Price-Level Accounting--This research involves a continuing study of concepts and practices for cost measurement in times of changing price levels.

19. Terminology--The Board has undertaken a continuing effort to develop definitions for those terms which may be used in Cost Accounting Standards. Definitions used in Standards promulgated by the Board appear in Part 400 of the Board's regulations.

SUMMARY OF REPORTED EFFECTIVENESS

OF BOARD PROMULGATIONS

The Board has a continuing responsibility to evaluate the effectiveness of the Standards, rules, and regulations which it promulgates. The Board believes that its evaluation process can be aided best by obtaining reports from Federal agencies. Each agency has incorporated a reporting requirement into its procurement regulations providing that reports, on a calendar year basis, will be submitted to the Board within 120 days from the end of the year. The first report, however, covered only the period July 1, 1972, through December 31, 1972.

Reports have been received from the defense agencies summarizing their experience with Board promulgations. A number of civil agencies have also submitted reports to the Board but stated that their limited experience did not provide a sufficient basis for commenting on Board promulgations.

Defense agencies reported on their experience with reviews of Disclosure Statements for adequacy. The reports showed the frequency with which a response to each Disclosure Statement item was inadequately prepared by contractors. The items in the Disclosure Statement requiring narrative responses were cited as having the greatest frequency of inadequate responses.

The reports include subjective comments concerning Board promulgations. One agency stated that:

"Our own limited audit experience and discussions with DCAA cognizant auditors clearly show that contractors are experiencing greater care in proposal preparation, apparently to avoid a violation of the Standards. Also improvements have been noted in the presentation of proposals, including contractor cooperation

in submitting sufficient detail to aid in proposal reviews. Finally, the submission and review of Disclosure Statements has resulted in an adequate description of the practices followed by a contractor."

Another agency stated that it could not yet judge the effect of Cost Accounting Standards on contractors' proposals, cost estimation, contract negotiation or contract administration. It added that:

"However, it is believed that further experience with the Standards will show improvements in these areas."

The Department of Defense described a problem existing in interpreting the term "change" set forth in Section 351.12(d) of the Board's regulations pertaining to the requirement for revision of completed Disclosure Statements. The Board has advised the Department that it intended that changes and amendments to Disclosure Statements under that section would apply to Statements after a determination of adequacy has been made by the agency.

The Board believes that future reports on effectiveness of Board promulgations will provide the Board with much needed information. It recognizes, however, that the responsibility to determine compliance with Board requirements rests with the agencies concerned and with the General Accounting Office.

EXEMPTIONS AND WAIVERS

Pursuant to Section 719(h)(2) of the Defense Production Act of 1950, as amended, the Board has continued to consider the granting of exemptions to classes or categories of contractors or contracts when it determines such exemptions are appropriate and consistent with the purposes of the Board's basic legislation. Also, the Board has established a procedure whereby waiver of Board requirements may be granted under certain circumstances for particular contracts or subcontracts.

EXEMPTIONS

In its Statement of Operating Policies, Procedures and Objectives, March 1973, the Board stated that an exemption would require establishing that the administrative burden of following a Standard is grossly disproportionate to the benefits which could be expected, or failure to grant an exemption will prevent the orderly and economical acquisition on a timely basis of supplies and services essential to the needs of the Government.

During fiscal year 1972, the Board exempted certain small business contracts, and contracts awarded under Section 8(a) of the Small Business Act, and it established a phased basis for requiring contractors to submit Disclosure Statements.

In the current year, the Board, at the request of the Department of Defense, reviewed for the possibility of exemption the nature, purpose, and special circumstances of three classes of contracts. As a result, exemptions have been issued for (1) any contract made with a labor surplus area concern pursuant to procedures providing for a partial set-aside for such concern; (2) any contract awarded to the Canadian Commercial Corporation in accordance with the terms of the agreement of July 27, 1956, as amended, between the Department of Defence Production (Canada) and the U.S. Departments of the Army, the Navy, the Air Force, and

the Defense Supply Agency; and (3) until June 30, 1973, any contract awarded to Western Electric Company for materials, supplies, or services which are standard items of the Bell System. The Department of Defense requested that the exemption for the Western Electric Company be made permanent. The Board denied the request pending analysis of additional information being developed.

The Board has previously stated its intention to consider exemptions from individual Cost Accounting Standards. The Board has determined it to be appropriate to limit applicability of the Standard dealing with the allocation of home office expenses initially to companies which received net awards of negotiated national defense prime contracts during Federal fiscal year 1971 totaling more than \$30 million, and to make it inapplicable for the time being to contracts with State and local governments and colleges and universities.

Most nondefense procurements have been made subject to Cost Accounting Standards by the Federal Procurement Regulations, issued by the General Services Administration. Consequently, any necessary exemptions for such contracts are obtained through procedures established in the Federal Procurement Regulations. The Board has offered its assistance to non-defense agencies in establishing their exemption procedures and regulations.

WAIVERS

The Board believes that from time to time there may be urgent situations in which the Board should have available a mechanism to grant an immediate waiver from all or a portion of the requirements of the Cost Accounting Standards Clause. This would be particularly true where a 30-day publication of a proposed exemption would unduly delay an urgent procurement. The Board consequently designed its regulations to permit it in appropriate cases to grant a waiver promptly after receipt of a fully documented request from a procuring agency.

Under that waiver authority, the requesting agency must supply to the Board a statement that no other source of supply can meet the agency's need on a timely basis, a statement of any alternative methods of fulfilling program needs and the agency's reasons for rejecting the alternatives, a statement of the steps being taken by the agency to establish other sources of supply for future procurements of the products or services for which a waiver is requested, a full description of the procurement in question, and any other information which the agency believes may aid the Board in evaluating the request for a waiver.

Whenever an agency meets these requirements, the Board will respond promptly to requests for waivers. The Board also believes that it should retain direct control of this case-by-case waiver authority, rather than delegate it to the procuring agencies.

The Board has undertaken to submit, within 30 days after acting on any request for a waiver, a full report of the request and the action thereon to the Chairmen of the Committee on Banking and Currency of the House of Representatives, the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate, and the Joint Economic Committee of the Congress of the United States.

The Board granted five requests for partial or total waivers during the past year, which are described in the table below. Each of those requests was documented by the Federal agency making the request as involving a procurement from a sole source, and in each case, that the urgency and essentiality of the procurement precluded any alternative to making the procurement proposed. The Board's action in each case was taken in time to avoid any interference with the proposed procurement.

<u>Agency</u>	<u>Contractor</u>	<u>Contract</u>	
		<u>Requirements</u>	<u>Amount</u>
1. DOD	Hanspeter Moser Processing, Switzerland	Modular Nitra- tion Plant Equipment	\$370,000
2. DOD	Ministry of Defence of the United Kingdom	Special Equip- ment	\$170,000
3. DOD	Motoren und Turbinen Union and Philips, subcontractors of The Boeing Company	Diesel Engine and Internal Communications System	\$399,000
4. NASA	Department of Supply of the Commonwealth of Australia	Launch Support Assistance	\$250,000
5. NASA	General Electric Company	Rehabilitation of Wind Tunnel	\$267,000

In addition to the overall waiver actions, the Board anticipated that circumstances could arise which would make it impractical to secure a required Disclosure Statement in accordance with the contract clause and other regulations of the Board. Where these circumstances were found to exist by the agency head, the Board in Section 331.3(c)(3) of its regulations enabled him to authorize award of a contract without securing a Disclosure Statement. Authorizations issued under this provision of the Board's regulation must be reported to the Board within 30 days. The Board has been notified that the requirement for submission of a Disclosure Statement has been waived by Government agencies acting under this authority for the following contract actions:

<u>Agency</u>	<u>Contractor</u>	<u>Contract</u>		<u>Date of notice to CASB</u>
		<u>Requirement</u>	<u>Amount</u>	
Navy	Hastings-Raydist, Inc. a subsidiary of Teledyne, Inc.	Naviga-tion system	\$1,384,425	Dec. 1, 1972
Air Force	Delco-Remy, a division of General Motors Corporation	Batteries	\$ 905,402	Mar. 30, 1973

ADMINISTRATIVE MATTERS

For fiscal year 1973, the Congress appropriated \$1,650,000 for the operation of the Board. Of this amount, \$1,353,000 was obligated, and the remainder, \$297,000, lapsed on June 30, 1973. The principal reason for the saving in fiscal year 1973 is that, instead of contracting for certain outside services, the Board decided that its professional staff should develop certain computer applications which will permit analysis of the effects of a contemplated Cost Accounting Standard on existing cost accounting practices of defense contractors. Also, the Board has been highly selective in recruiting its professional staff and did not fill all of the 25 professional positions for which funds were requested and appropriated for the fiscal year. The Board is pleased to have been able to effect savings in funds appropriated for each year of Board operations.

In fiscal year 1974, the Board has requested appropriations of \$1,500,000. This amount is \$150,000 less than the amount appropriated for fiscal year 1973.

A comparative schedule of accrued expenditures, obligations incurred, and amounts appropriated for fiscal years 1972, 1973, and 1974 is shown on the following page.

SCHEDULE OF ACCRUED EXPENDITURES,
OBLIGATIONS INCURRED, AND AMOUNTS APPROPRIATED

	<u>1972</u>	<u>1973</u>	<u>1974</u>
	<u>Actual</u>	<u>Actual</u>	<u>Estimated</u>
	————(thousands)————		
Accrued expenditures:			
Personnel compensa- tion	\$ 681	\$ 880	940
Personnel benefits	52	69	80
Travel and transporta- tion	56	56	170
Rent, communications, and utilities	16	148	25
Printing and reproduc- tion	1	16	20
Other services	58	282	250
Supplies and materials	10	9	10
Equipment	<u>75</u>	<u>4</u>	<u>5</u>
Total accrued ex- penditures	949	1,464	1,500
Adjustment for undelivered orders	<u>100</u>	<u>-111</u>	<u>-</u>
Total obligations incurred	1,049	1,353	1,500
Unobligated balance	<u>451</u>	<u>297</u>	<u>-</u>
Total appropria- tion	<u>\$1,500</u>	<u>\$1,650</u>	<u>\$1,500</u>

BACKGROUNDS OF COST ACCOUNTING STANDARDS BOARDTHE BOARDSTAATS, Elmer B., Chairman

Elmer B. Staats is Comptroller General of the United States. He was appointed to that position by President Johnson on March 8, 1966, after 26 years' service in the Federal Government. Mr. Staats joined the Bureau of the Budget in 1939 serving in various capacities prior to his appointment by President Truman as Deputy Director in 1950. He served in that position under Presidents Truman, Eisenhower, Kennedy and Johnson. Mr. Staats is a native of Kansas and a graduate of McPherson College, McPherson, Kansas. He has an M.A. degree from the University of Kansas and a Ph.D. degree from the University of Minnesota. He was a fellow of the Brookings Institute from 1938 to 1939, is a member of Phi Beta Kappa, an honorary member of Alpha Kappa Psi, and received the Rockefeller Public Service Award in 1961. Mr. Staats received distinguished service awards from the University of Kansas (1966) and the University of Minnesota (1964) and the honorary degrees of Doctor of Public Service from the George Washington University, Doctor of Laws from McPherson College, and Doctor of Administration from the University of South Dakota. He is currently serving on the Board of Trustees of American University in Washington and McPherson College in Kansas.

BEVIS, Herman W., Member

Mr. Bevis served with Price Waterhouse & Co., Certified Public Accountants, from 1933 to 1969 and was Senior Partner from 1961. Mr. Bevis was Executive Director of the Banking and Securities

Industry Committee, 1970-1972. He is a member of the New York State Society of Certified Public Accountants, and the American Institute of Certified Public Accountants; he was formerly a member of the Institute's Accounting Principles Board. Mr. Bevis, of Greenwich, Connecticut, served as member of the President's Task Force on Improving the Prospects of Small Business which reported to the President in March 1970. He was a consultant in financial management for the United States Air Force from 1952 to 1958. He is a graduate of Southwestern at Memphis and the Harvard Graduate School of Business Administration and is the author of numerous books and articles on accounting and financial management.

DANA, Charles A., Member

Mr. Dana, of Newton Centre, Massachusetts, is Director of Government Accounting Controls of Raytheon Company. Prior to 1960 when he assumed that position, he served in various capacities in Raytheon Company: Project Business Manager, Engineering Laboratories; Assistant Manager, Cost and Schedule Control, Equipment Engineering Division. He has been active in various industry associations concerned with Government contracting and is well known as an author and lecturer. He was a member of the Defense Industry Advisory Committee Working Group on Cost Principles, 1964-1968. In 1970 he was a recipient of the Howard H. Cork Memorial Award of the National Security Industrial Association. He is a graduate of Boston University and the Harvard Graduate School of Business Administration.

MAUTZ, Robert K., Member

Mr. Mautz is a partner in the firm of Ernst & Ernst, Certified Public Accountants. He was formerly Weldon Powell Memorial Professor of Accountancy at the University of Illinois where he taught accounting from 1948 to 1972. Mr. Mautz,

of Rocky River, Ohio, is a member of the American Institute of Certified Public Accountants, has served on its Committee on Auditing Procedure, and was a member of the Commission on the Study of the Common Body of Knowledge for CPAs from 1963 to 1966. He has served as President of the American Accounting Association and as editor of its Accounting Review from 1958 to 1961. He is a graduate of the University of North Dakota and the University of Illinois and is the author of many books and articles on accounting.

MOOT, Robert C., Member

Mr. Moot is Vice President-Finance of AMTRAK. He had been Assistant Secretary (Comptroller) of the Department of Defense from August 1, 1968, to March 31, 1973. In this latter position, he was responsible for developing and supervising financial management policies in the Department of Defense. From June 1965 to December 1966, Mr. Moot was Deputy Assistant Secretary of Defense for Logistics Services. From August 1, 1967, to August 1, 1968, Mr. Moot was Administrator of the Small Business Administration. In that agency, he was responsible for directing loan programs and procurement assistance programs for small business. Before entering the Federal Service, Mr. Moot, who lives in Annandale, Virginia, held accounting and marketing positions in private industry. He is the recipient of the Department of Defense Distinguished Civilian Service Award, the Defense Supply Agency Exceptional Civilian Service Award, and the Small Business Administration Distinguished Civilian Service Award. In 1971, Mr. Moot received the Rockefeller Public Service Award for Administration.

PROFESSIONAL STAFF

ABEL, Rein, Ph.D., CPA

Mr. Abel comes to the Cost Accounting Standards Board from the Wharton School of the

University of Pennsylvania where he served as an assistant professor of accounting. His prior work experience includes several years with a national public accounting firm and some industrial cost accounting experience in England. Mr. Abel has a B.Sc. (Econ.) degree from the London University, a Diploma in Business Administration from the London School of Economics and M.B.A. and Ph.D degrees from the Columbia University. He is a member of Beta Gamma Sigma, American Accounting Association, American Institute of Certified Public Accountants, New York State Society of Certified Public Accountants, Pennsylvania Institute of Certified Public Accountants and the Institute of Cost and Management Accountants (U.K.).

ADAMS, Clark G.

Mr. Adams, an attorney, has a broad and comprehensive background in contract administration within the aerospace industry. He worked most recently with the Rockwell International Corporation (North American Rockwell) where he directed the contracts management activities for the corporation's Los Angeles division and held the position of Director of Contracts Management.

Mr. Adams was directly responsible for the negotiation and administration of contracts for the B-70 and B-1 aircraft. Mr. Adams received his B.S. in Law and J.D. degrees from the University of Utah. He is also active in the National Contract Management Association, having been its president in 1966, and currently serving on its board of directors.

BELL, Elmer S.

Mr. Bell comes to the Cost Accounting Standards Board from the aerospace industry where he held various positions of increasing responsibility. His last position was Assistant Controller of TRW Systems Group, Redondo Beach, California, where he participated in negotiations of overhead rates with Government representatives.

Mr. Bell received a B.A. degree in Business Administration and Accounting from Chapman College, Orange California. He has attended the Graduate School of the University of California at Los Angeles. Mr. Bell is a member of the Federal Government Accountants Association.

BODENHEIMER, Bertold, CPA

Mr. Bodenheimer brings to the Cost Accounting Standards Board extensive experience in the contract auditing field. He worked as a Contract Auditor and an Assistant Branch Chief of the Air Force Auditor General's Office and was a Project Manager of the Defense Contract Audit Agency (DCAA). Most recently, Mr. Bodenheimer was DCAA's representative to, and served as Chairman of, the ASPR, Part 2, Section XV, Standing Subcommittee. This subcommittee is responsible for developing principles and procedures for use in supply and research contracts with commercial organizations. Mr. Bodenheimer received a B.S. degree in Accounting from the University of Maryland. In 1969, he attended the Executive Seminar Center, Kings Point, New York.

DELMORE, John R., CPA

Before entering Government service, Mr. Delmore had several years' experience with the public accounting firm of Arthur Andersen & Co., and as Chief Accountant and Controller in private industry. With the Government, before joining the Board, Mr. Delmore was an Assistant Director, General Accounting Office; Assistant Commissioner, Public Housing Administration; Director of Audits, Department of Commerce; and Special Assistant to the Assistant Controller for Auditing, Atomic Energy Commission. Mr. Delmore has a B.S. degree in Business Administration from Marquette University where he was elected to Beta Alpha Psi, Beta Gamma Sigma, and Alpha Sigma Nu.

He also graduated from the Federal Executives Institute. He is a member of the American Institute of Certified Public Accountants, the Wisconsin Society of Certified Public Accountants, and the American Accounting Association.

DiGUISEPPI, James L., CPA

Mr. DiGuisseppi was formerly an Associate Director in the Defense Division of the General Accounting Office (GAO). In that capacity, he was responsible for planning, directing, and carrying out GAO's accounting and auditing functions including contract examination in the Department of the Navy. Subsequently, his responsibilities were broadened to cover all of GAO's activities involving manpower matters in the Department of Defense. Mr. DiGuisseppi received a B.S. degree in Accounting from Bucknell University, undertook graduate studies at the American University, and attended the Program for Management Development at the Graduate School of Business Administration, Harvard University. He is a member of the American Institute of Certified Public Accountants and the Federal Government Accountants Association.

FUKUDA, Albert N., CPA

Mr. Fukuda has had extensive experience as an auditor with the Army Audit Agency and later with the Defense Contract Audit Agency (DCAA). In August 1968, he was assigned as a Special Assistant to the Deputy Director of DCAA. In this role, Mr. Fukuda was responsible for performing research for and rendering assistance to the General Accounting Office team that was studying the feasibility of developing uniform Cost Accounting Standards. Mr. Fukuda received a B.S. degree in Accounting from Kwansai University, Japan, and an A.B. degree in accounting from San Francisco State College. He is a member of the American Institute of Certified Public Accountants and the Federal Government Accountants Association.

JACKSON, Kenneth M.

Mr. Jackson is an attorney with broad experience in the field of contract management. Prior to coming to the Cost Accounting Standards Board, Mr. Jackson was Manager of Contracts for Dynalelectron Corporation, Washington, D.C. In addition to his responsibilities for the contract management function, he served as Chairman of the Procurement Regulation Committee of the National AeroSpace Services Association (NASSA). As NASSA's representative, he served on the Operating Committee of the Council of Defense and Space Industry Associations (CODSIA), and was Chairman, 1969-70. Mr. Jackson was the Project Officer for CODSIA on the General Accounting Office study of Cost Accounting Standards, and he testified on the subject during the Senate hearings thereon. Mr. Jackson received B.A. and J.D. degrees from Southern Methodist University. He is a member of the Texas, Federal and American Bar Associations and is a Fellow in the National Contract Management Association.

LEVINE, Philip A.

Prior to coming to the Cost Accounting Standards Board, Mr. Levine was Controller of the Ferromont Division of Dynamics Corporation of America in Bridgeport, Connecticut. In this capacity he was responsible for all of the financial functions of the division. Mr. Levine has also had broad financial and contractual responsibilities with other companies and had also worked for defense agencies. Mr. Levine attended Princeton University and received a B.B.A. degree in Accounting from the City University of New York. He is a member of the National Contract Management Association and the American Arbitration Association.

LI, David H., Ph.D., CPA

Mr. Li comes to the Cost Accounting Standards Board from the University of Washington where he

had been serving as a Professor of Accounting. He received a B.A. degree in Economics from St. John's University, Shanghai, and an M.B.A. degree in Industrial Management from the Wharton School, University of Pennsylvania. His doctoral work at the University of Illinois included a dissertation on approaches to uniformity in accounting for industrial enterprises. He held controllership and research positions with industrial, service, and educational organizations, and was on the audit staff of two national public accounting firms. He is a member of the American Accounting Association, American Institute of Certified Public Accountants, Federal Government Accountants Association, and National Association of Accountants. He is the author of four books and many articles on management/cost accounting and computerized information systems.

McCLENON, Paul R., CPA

Mr. McClenon has had diverse experience in the accounting, analytical, and academic fields. Prior to coming to the Cost Accounting Standards Board, he was a Senior Cost Analyst for the Rand Corporation of Santa Monica, California. Mr. McClenon had diversified experience with Government agencies and with a national public accounting firm. Mr. McClenon has an A.B. degree in Public Administration from the George Washington University and an M.B.A. degree in Accounting from the Wharton School of Finance, University of Pennsylvania. He is a member of Phi Beta Kappa and belongs to the American Accounting Association, the American Institute of Certified Public Accountants, the Federal Government Accountants Association, and the Pennsylvania Institute of Certified Public Accountants.

McCORMICK, J. Jett

Mr. McCormick, an attorney, has a broad background in contract management in the defense industry. Before coming to the Cost Accounting

Standards Board, he was with General Dynamics Corporation, where he was Director of Contracts at its Pomona Division, responsible for contracts, pricing, and legal activities. Prior to that, he was Director of Contracts and Material for its Dynatronics Operation. He has also been with the Navy Office of General Counsel. He received an A.B. degree from Princeton University and a J.D. degree from the University of Virginia. He has been admitted to practice in Virginia and is a member of the Federal Bar Association and the National Management Association.

MINKIN, Noah

Immediately prior to joining the staff of the Cost Accounting Standards Board, Mr. Minkin was an Attorney-Advisor for the U.S. Postal Service. He has held legal positions in other Government agencies, including the Department of Defense and the General Services Administration. Mr. Minkin has a B.S. degree and an L.L.B. degree from the University of Wisconsin. Mr. Minkin was selected for the Wisconsin Law Review and had a Research Fellowship in Public Utility Law. He is a member of the Federal Bar Association and was admitted to practice before the Wisconsin Supreme Court and the U.S. District Court, Western District, Wisconsin.

PARKER, William, CPA

Mr. Parker comes to the Cost Accounting Standards Board from the Committee on Aeronautical and Space Sciences, United States Senate, where he was a professional staff member and acted as Minority Counsel. In the course of his work, Mr. Parker became intimately involved with the problems of and authorizations for the National Aeronautics and Space Administration. In addition, he had extensive dealings with a variety of defense contractors and trade associations. Prior to his employment with the Committee, Mr. Parker was an Assistant Director in the General Accounting Office and worked with a wide

variety of Government agencies and activities. Mr. Parker has a B.S. degree in Accounting from New York University. He is a member of the American Institute of Certified Public Accountants and the National Association of Accountants.

ROSEN, Louis I., CPA

Mr. Rosen comes to the staff from the University of Maryland, where he served as an Instructor in Accounting. He received an M.B.A. degree from the University of Maryland and a J.D. degree from the University of Maryland School of Law. Currently, he is completing his dissertation for a D.B.A. degree at the University of Maryland. He is a member of Beta Gamma Sigma and Beta Alpha Psi and belongs to the American Institute of Certified Public Accountants and the Maryland Association of Certified Public Accountants. He is also a member of the Bar of the State of Maryland.

SACKS, Bernard, CPA

Mr. Sacks was formerly an Assistant Director in the Civil Division of the General Accounting Office (GAO). He was responsible for all of the accounting and auditing work for GAO in the Department of Transportation, and immediately prior to coming to the Cost Accounting Standards Board, was in charge of GAO's work at the Department of Agriculture. Mr. Sacks attended Cornell University and the University of West Virginia. He received a B.B.A. degree in Accounting from the City University of New York and did graduate work at New York University. Mr. Sacks belongs to the American Institute of Certified Public Accountants, the National Association of Accountants, and the Federal Government Accountants Association.

SCHOENHAUT, Arthur, CPA

Mr. Schoenhaut brings to the Cost Accounting Standards Board (CASB) outstanding experience in accounting. From 1967 until accepting the position as CASB Executive Secretary in April 1971, he was Deputy Controller of the Atomic Energy Commission. Prior to that time, he was with the General Accounting Office serving as Deputy Director of its Civil Division from 1964 until 1967. Mr. Schoenhaut received his B.B.A. degree from the City University of New York, attended the Graduate School of Education of New York University, and is a graduate of the Advanced Management Program of the Harvard Graduate School of Business. He is a Certified Public Accountant and a member of the American Institute of Certified Public Accountants, and the Federal Government Accountants Association.

SHAPIRO, Nelson H., CPA

Mr. Shapiro brings to the Board a variety of backgrounds in accounting. He was most recently with the public accounting firm of Peat, Marwick, Mitchell and Co., and, as manager in the Dallas office, provided consulting service to Government contractors. Prior to his association with Peat, Marwick, Mitchell, he spent 7 years with audit agencies of the Federal Government. Prior to his Federal service, Mr. Shapiro was Treasurer and Controller of the General Automatic Products Corporation in Baltimore, Maryland. Mr. Shapiro was graduated from the University of Baltimore with a B.S. degree in Accounting. He is a member of the American Institute of Certified Public Accountants, the Maryland Association of Certified Public Accountants, the Federal Government Accountants Association, and the National Contract Management Association.

SJOSTEN, Stanley M.

Mr. Sjosten brings to the Cost Accounting Standards Board broad industry experience in Government contract accounting. For many years he was Comptroller of Melpar, Inc. His most recent employment was as a consultant for the M-R Division (formerly Melpar Division) of American Standard, Inc. He also did consultant work for the Aerospace Industries Association of America, Inc., and was employed by the National Security Industrial Association as Project Director of that Association's widely distributed Defense Acquisition Study. While the General Accounting Office (GAO) feasibility study was being developed, he was a member of the Council of Defense and Space Industry Association's task group on Uniform Cost Accounting Standards, established to provide industry viewpoints to GAO. Mr. Sjosten received a B.B.A. degree in Accounting from the University of Minnesota and is a member of the National Association of Accountants.

STRAITH, Robert S., CPA, P.E.

Mr. Straith brings to the Board the wide range of experience which he obtained in 14 years of diversified professional management consulting with national firms of CPAs. Prior to entering the consulting profession, Mr. Straith held responsible accounting and controllership positions in the automotive and in the mortgage-banking industry. Mr. Straith has B.B.A. and M.B.A. degrees from the University of Michigan where he was elected to membership in Beta Gamma Sigma and Phi Kappa Phi. Mr. Straith is both a CPA and a Registered Professional Industrial Engineer. He is a member of the American Institute of Industrial Engineers, the California Society of Certified Public Accountants, the American Accounting Association, the Federal Government Accountants Association, and the

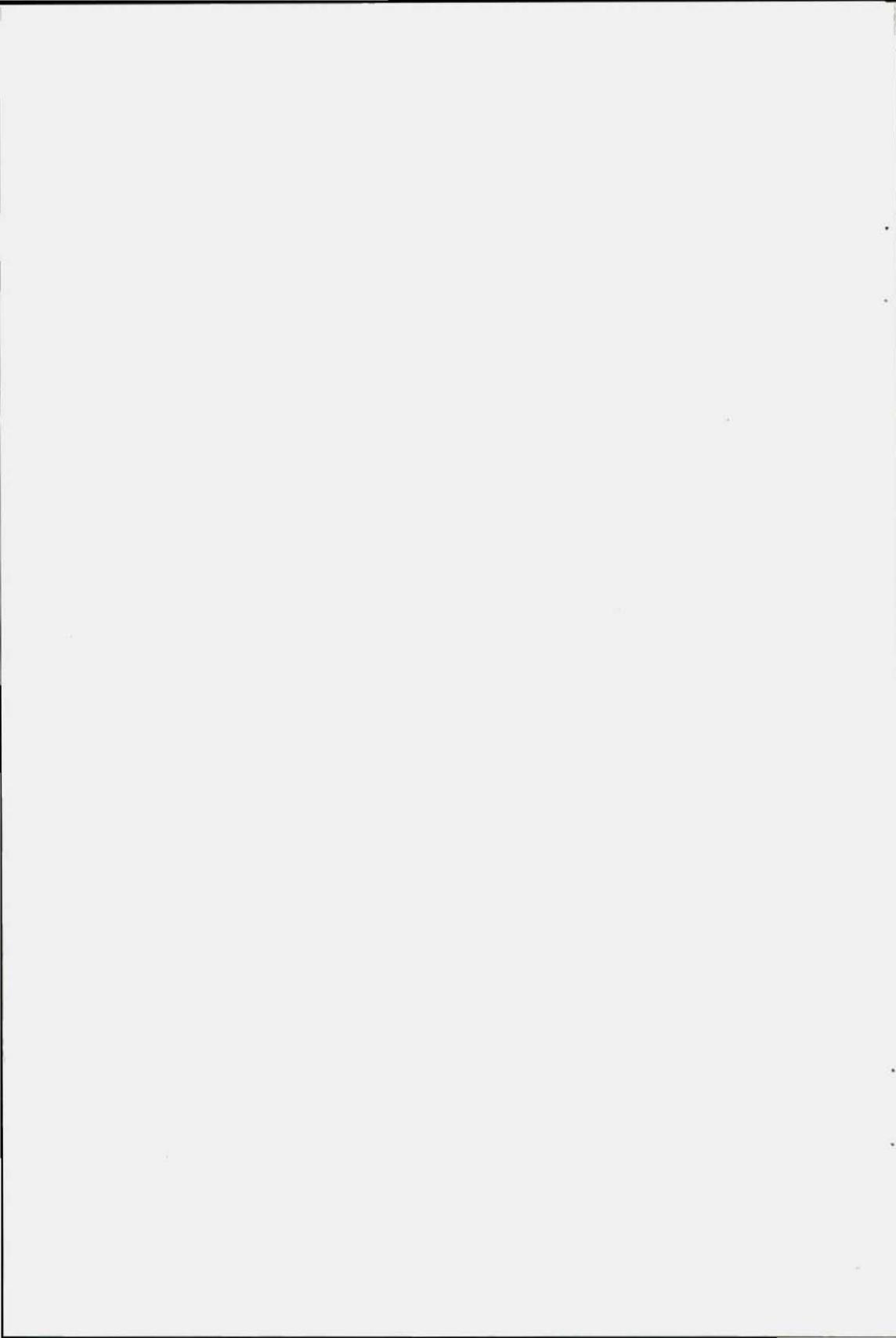
American Institute of Certified Public Accountants where he most recently served as a member of its Committee on Statistical Sampling.

VAN CLEVE, Harry R., Jr.

Mr. Van Cleve brings to the Board exceptional expertise in the field of Government law, including procurement matters. He has had increasingly responsible legal positions with the Department of Defense, the Peace Corps, and the General Services Administration, where he was the General Counsel. Mr. Van Cleve was graduated from the University of Southern California with a B.A. degree, and received an L.L.B. degree from the Harvard Law School. He is a member of Phi Beta Kappa and the State Bar of California and has served for several years as a member of the Board of Advisors of the National Contract Management Association.

YOCUM, Harry F., Jr.

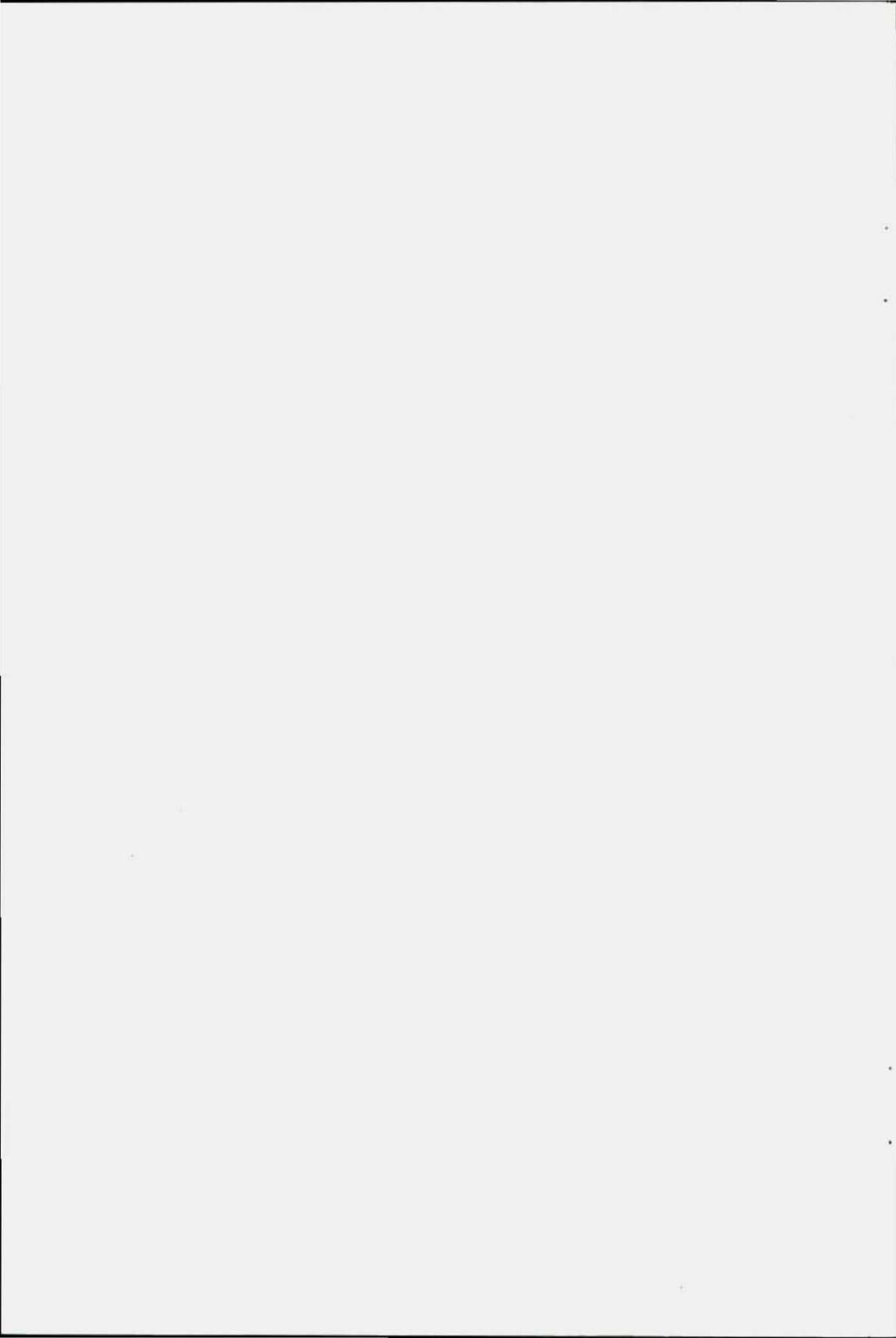
Prior to coming to the Cost Accounting Standards Board, Mr. Yocum was a programmer-analyst for Westinghouse Tele-Computer Systems Corporation at the Atomic Energy Commission. He was responsible for the programming, analysis, maintenance and operation of major systems in the budget and financial areas of operations. Mr. Yocum attended Villanova University and received a B.S. degree in Business Administration from the University of Maryland and is a member of the Association for Computing Machinery.



COST ACCOUNTING STANDARDS BOARD

STATEMENT
OF
OPERATING POLICIES, PROCEDURES
AND
OBJECTIVES

MARCH 1973



OBJECTIVES

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 as specific as the Cost Accounting Standards Board considers necessary to accomplish its purpose.

With respect to Cost Accounting Standards, the Board's primary goal is to issue clearly stated Cost Accounting 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 in accounting are desirable to the extent they improve understanding and communication, reduce the incidence of disputes and disagreements, and facilitate equitable contract settlements.

UNIFORMITY

Uniformity relates to comparison of two or more accounting entities and the Board's objective in this respect is to achieve likeness under like circumstances. The Board recognizes the impossibility of defining or attaining absolute uniformity, largely because of the problems related to defining like circumstances. The Board will, nonetheless, seek ways to attain a practical degree of uniformity in cost accounting.

Uniformity is achieved when contractors with the same circumstances (with respect to a given subject) follow the practice appropriate for those circumstances. Any increase in uniformity will provide

more comparability among contractors whose circumstances are similar.

The Board does not seek to establish a single uniform accounting system or chart of accounts for all the complex and diverse businesses engaged in defense contract work. On the other hand, if the Board were to be satisfied that circumstances among all concerned contractors are substantially the same, the Board would not be precluded from establishing a single accounting treatment for use in such circumstances.

CONSISTENCY

Consistency pertains primarily to one accounting entity over periods of time. Like uniformity, the attainment of absolute consistency can only be measured when like circumstances can be defined. The Board believes that consistency within an entity, from one time period to another, can be improved, thereby enhancing the usefulness of comparisons between estimates and actuals. It will also improve the comparability of cost reports from one time period to another where there are like circumstances.

ALLOCABILITY AND ALLOWABILITY

Allocability is an accounting concept affecting the ascertainment of contract cost; it results from a relationship between a cost and a cost objective such that the cost objective appropriately bears all or a portion of the cost. To be charged with all or part of a cost, a cost objective should cause or be an intended beneficiary of the cost.

Allowability is a procurement concept affecting contract price and in most cases is expressly provided in regulatory or contractual provisions. An agency's policies on allowability of costs may be derived from law and are generally embodied in its procurement regulations. A contracting agency may include in contract terms or in its procurement regulations a provision that it will refuse to allow

certain costs, incurred by contractors, that are unreasonable in amount or contrary to public policy. In accounting terms, those same costs may be allocable to the contract in question.

Cost Accounting Standards should result in the determination of costs which are allocable to contracts and other cost objectives. The use of Cost Accounting Standards has no direct bearing on the allowability of individual items of cost which are subject to limitations or exclusions set forth in the contract or are otherwise specified by the Government or its procuring agency.

It should be emphasized that contract costs, with which Cost Accounting Standards are involved, are only one of several important factors which should be involved in negotiating contracts. Therefore, the promulgation of Cost Accounting Standards, and the determination of contract costs thereunder, cannot be considered a substitute for effective contract negotiation. At the same time, it should be emphasized that, where contract costs are required to be determined and Cost Accounting Standards are applicable, the latter are determinative as to the costs allocable to contracts. It is a contracting agency's prerogative to negotiate the allowability of allocated costs, but not the allocation itself.

The Cost Accounting Standards Board will establish Standards to:

1. Measure the amount of costs which may be allocated to covered contracts,
2. Determine the accounting period to which costs are allocable, and
3. Determine the manner in which allocable costs can be allocated to covered contracts. The resulting cost measurements and allocation determinations are binding on both the contractor and the contracting agency, as indicated above.

FAIRNESS

The Board considers a Cost Accounting Standard to be fair when, in the Board's best judgment, the Standard provides for allocating costs without bias or prejudice to either party to affected contracts.

The results of contract pricing may ultimately be regarded as fair or unfair by either or both parties to that contract. But if the Cost Accounting Standards utilized in the negotiation, administration, and settlement of the contract provided the contracting parties with accounting data which are representative of the facts, the Standards themselves are "fair" regardless of the outcome of the contract.

MATERIALITY

The Board believes that the administration of its rules, regulations, and Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of cost. Although this rule of common sense is already practiced by the Government, the Board recognizes that, in particular Standards, a specific "materiality" statement may be useful; and, in such cases, it will include one.

The Board expects that, in implementing its promulgations, it is appropriate to consider the following criteria in determining whether a transaction or a decision about an accounting practice is material in the context of any Board issuance:

1. The absolute dollar amount involved. The larger the dollar amount, the more likely it is that a decision involving it will be material.
2. The amount of total contract cost compared with the amount under consideration. The larger the portion of the total contract cost which is represented by the item or the decision under consideration, the more likely it is to be material.

3. The relationship between a cost item and a cost objective. Decisions about direct cost items, especially if the amounts are themselves part of a base for distribution of indirect cost, will normally be more material than like decisions about indirect costs.
4. The impact on Government funding. Decisions about accounting treatment will be more material if they influence the distribution of costs between Government and non-Government cost objectives than if all cost objectives have Government financial support.
5. The relationship to price. When contract pricing is based upon estimated cost, decisions about cost accounting treatment in estimates are more material than comparable decisions about treatment of actual costs. When contract pricing is based on actual costs, decisions about accounting treatment for actual costs are more material than comparable decisions about estimates.
6. The cumulative effect of individually immaterial items. It is appropriate to consider whether individual variances (a) tend to offset one another or (b) tend to be in the same direction and hence to accumulate into a material amount.

These criteria should be considered together; no one criterion is wholly determinative of immateriality. In particular Standards the Board will give consideration to defining materiality in specific dollar amounts and/or specific percentages of impact on operations covered by the entire Standard or any provision thereof whenever it appears feasible and desirable to do so.

VERIFIABILITY

Verifiability is generally accepted as a goal for information used in cost accounting. Contract cost accounting systems should provide for verifiability. Contract costs should be auditable by examination of appropriate data and documents supporting such costs or by reference to the facts and assumptions used to assign the costs to the contract. Contractor records of contract costs should be reconcilable with the general books of account.

OPERATING POLICIES

The following descriptions of policies show a number of important considerations which will be relevant to the Board as it seeks the objectives discussed previously.

RELATIONSHIP TO OTHER AUTHORITATIVE BODIES

A number of authoritative bodies have been established to issue pronouncements affecting accounting and financial reporting. The Cost Accounting Standards Board views its work as relating directly to the preparation, use, and review of 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. Furthermore, its Cost Accounting Standards have the force and effect of law.

There are many accounting areas of interest to the Board which are also of interest to others for financial and tax accounting purposes, such as: the measurement of costs in general; determination of the amount assigned to a resource to be consumed in operations; allocation of the cost of resources consumed to time periods; and allocation of direct labor, direct material, and factory overhead to the goods and services produced in a period.

Promulgations by the Cost Accounting Standards Board may involve the areas of interest of other authoritative bodies. Contract cost accounting often deals with the same expenditures and the same problems of allocation to time periods as are of interest in financial and income tax accounting.

The Cost Accounting Standards Board seeks to avoid conflict or disagreement with other bodies having similar responsibilities and will through continuous liaison make every reasonable effort to do so. The Board will give careful consideration to the pronouncements affecting financial and tax

reporting, and in the formulation of Cost Accounting Standards it will take those pronouncements into account to the extent it can do so in accomplishing its objectives. The nature of the Board's authority and its mission, however, is such that it must retain and exercise full responsibility for meeting its objectives.

NONDEFENSE APPLICATIONS

The Board's jurisdiction extends only to certain national defense procurements, pursuant to the Defense Production Act of 1950 (50 USC App. 2152), as amended. Industry has long advocated uniformity of contract cost principles among all Government agencies; it has criticized nondefense agencies for following cost principles different from those of the Department of Defense alleging that such differences hindered effective contracting and caused added costs to the Government. The Board is gratified that the Federal Procurement Regulations have, through administrative decision, extended Cost Accounting Standards to contracts of nondefense agencies.

The Board is of the opinion that uniformity among all Government agencies in contract costing is a highly desirable objective. It is, therefore, the Board's view that extension of Board pronouncements to nondefense agencies would be markedly beneficial both to the agencies concerned and to their contractors. Companies with a mixture of defense and non-defense contracts will be benefited substantially by having a single set of cost accounting principles applicable to all their Government contracts.

A contractor could have a portion of his work not required to be costed in accordance with Cost Accounting Standards. Not wishing to maintain two or more cost accounting systems, he may choose to follow Cost Accounting Standards for all costing. The Board, in developing and promulgating Cost Accounting Standards, will bear in mind this potential wider application.

SINGLE GOVERNMENT REPRESENTATIVE

To assure maximum uniformity of interpretation of its promulgations, the Board believes that it is highly desirable to have Federal agencies agree upon a single representative to deal with a given contractor regarding application of the requirements of the Board. Because of its conviction of the merit of such a procedure, the Board recommended that the agencies arrange for a single contracting officer for each contractor, or major component thereof, to be designated to negotiate as needed to achieve consistent practices relating to the Standards issued by the Board.

As a result, agencies have established procedures by which a Government contractor may be certain that only one contracting officer will deal with him to resolve issues that may arise under the contractor's Government contracts concerning the application of Cost Accounting Standards, rules, and regulations.

The Board is optimistic about the benefits to be derived by both the Government and contractors from this single-representative system and will continue to encourage and assist Government agencies in assuring that the system matures and functions effectively.

RESPONSIBILITIES FOR COMPLIANCE

The basic responsibility for securing compliance by contractors with Board promulgations rests with the relevant Federal contracting agencies. They are responsible for such things as:

1. Incorporating all applicable CASB promulgations into their procurement regulations;
2. Including the contract clause in all covered contracts;
3. Receiving Disclosure Statements;

4. Reviewing and approving the adequacy of such Statements;
5. Reviewing contractors' records to determine whether or not contractors have (a) followed consistently their disclosed cost accounting practices and (b) complied with promulgated Cost Accounting Standards;
6. Making appropriate contract price adjustments because of changed accounting practices, failure to follow existing Standards, or the issuance of new Standards; and
7. Evaluating the validity of claims by contractors for exemptions, under criteria established by the Board, or exclusions as established by P.L. 91-379.

It should be noted that Section 719(j) of the Act gives to any authorized representative of the head of the agency concerned, of the Board, or of the Comptroller General of the United States, the right to examine and make copies of any documents, papers, or records relating to compliance with Board promulgations.

Another element of compliance concerns the manner in which relevant contracting agencies implement the requirements established by the Board. Special and recurring reviews of agencies' compliance with Board promulgations should be performed by the agencies' internal review staffs and by the U.S. General Accounting Office.

The Board must retain responsibility for evaluating the effectiveness of the Standards, rules, and regulations that it promulgates. Most of the Board's evaluative needs can be met by reviewing reports from contracting and audit organizations. To this end, the Board and the major contracting agencies have worked cooperatively to establish reporting requirements which have been embodied in the agencies' procurement regulations.

INTERPRETATIONS

The Board notes the existence of contractual and administrative provisions for the resolution or settlement of disputes arising under a contract, and the Board will not intervene in or seek to supersede such provisions. When there are widespread and serious questions of the Board's intention or meaning in its promulgations, the Board may at its discretion respond to requests for authoritative interpretations of its rules, regulations, and Cost Accounting Standards. Such interpretations will be published in the FEDERAL REGISTER and will be considered by the Board as an integral part of the rules, regulations, and Standards to which the interpretations relate. This formalized procedure does not preclude unofficial consultation between inquirers and the Executive Secretary and members of the Board's staff.

EXEMPTIONS

The Board is authorized by law to grant exemptions to such classes or categories of contractors or contracts as it determines are appropriate and consistent with the purposes sought to be achieved by the Board's basic legislation. The Board has exempted certain classes of contracts and recognizes that individual Cost Accounting Standards may, by their nature, be inapplicable or inappropriate to certain classes or categories of contractors or contracts.

In addition, in recognition of certain unusual circumstances which could require exemptions on a case-by-case basis, the Board has established a mechanism by which exemptions, where justified, can be granted for special classes of contracts and subcontracts.

The Board anticipates that it will grant exemptions only in rare and unusual cases. In reviewing a request for an exemption, the Board would be persuaded that an exemption is justified only if:

1. The administrative burden is grossly disproportionate to the benefits which could be expected, or
2. Failure to grant an exemption will prevent the orderly and economical acquisition on a timely basis of supplies and services essential to the needs of the Government.

The Board notes that the granting of an exemption would reduce the extent to which the primary goals of increased uniformity and consistency are achieved.

THE PROCESS OF DEVELOPING STANDARDS

Initial development of Board proposals begins with extensive background research. It includes examining Government procurement regulations and authoritative literature on a particular subject under consideration, reviewing pronouncements of other authoritative accounting and regulatory groups, reviewing pertinent Board of Contract Appeals and court cases, and conferring with representatives of various Government agencies, Government contractors, and industry and professional associations.

On the basis of this research and extensive studies of existing contractor practices, a preliminary version of a Board proposal is developed for discussion purposes and distributed to scores of Government agencies, industry and professional associations, individual contractors, and others knowledgeable in cost accounting. The Board conducts field tests of the application of the proposed Standard. It holds meetings or exchanges correspondence with all who express interest in providing views on the subject. The views and comments thus obtained are given careful consideration and drafts of proposed material are modified as appropriate.

To obtain the views of as many concerned persons as possible, a draft is published as a proposed Standard in the FEDERAL REGISTER for comment. The Board views this initial publication as an integral part of its research program and encourages all interested persons, including members of the general public, to submit comments. The Board, after publication of the proposal, again contacts a number of contractors and Government representatives to further discuss all aspects of the proposed Standard, with special emphasis on the anticipated administrative costs of implementation and the probable benefits of adoption of the Standard.

Standards, rules, and regulations promulgated by the Board must await the expiration of 60 calendar days of continuous session of the Congress following the date they are sent to the Congress. The Board's promulgations become effective not later than the start of the second fiscal quarter beginning after the expiration of not less than 30 days after a second publication in the FEDERAL REGISTER, unless the Congress passes a concurrent resolution stating in substance that it does not favor the proposed Standards, rules, or regulations. The Board's promulgations have the full force and effect of law.

CONSIDERATION OF EXISTING PRACTICES

To be effective, Cost Accounting Standards must have both theoretical validity and practical applicability. So that practical considerations will not be overlooked, the Board seeks reliable information about current practices in a variety of ways. Disclosure Statements, questionnaires, intensive discussions with contractors, responses to FEDERAL REGISTER publication of proposed Standards, and study of published research results all supply useful information about current practice.

The Board's purpose in this is, first, to establish what practice is; second, to discover the reasons supporting different practices in apparently similar circumstances; and third, to determine the appropriate criteria for the selection of practices in given circumstances. There is no presumption that the most common practice is or is not the most desirable practice.

COMPARING COSTS AND BENEFITS

The Congress provided, in section 719(g) of the act which establishes the Board, that in promulgating Cost Accounting Standards "...The Board shall take into account the probable costs of implementation compared to the probable benefits."

The Board views costs and benefits in a broad sense. All disruptions of contractors' and agencies' practices and procedures are viewed as costs. Diligent research into current practice is helpful in appraising the probable cost impact of proposed Standards. Benefits include anticipated reductions in the number of time-consuming controversies stemming from unresolved aspects of cost allocability. The Board also expects that benefits will be achieved through simplified negotiation, administration, audit, and settlement procedures. Finally, and most importantly, the availability of better cost data stemming from the use of Cost Accounting Standards will permit improved comparability of offers and facilitate better negotiation of resulting contracts.

Prior to making a final promulgation decision, the Board makes specific inquiries into the likely costs of implementing proposed Standards, both for contractors and for affected agencies of the Government. In this inquiry, an effort is made to distinguish transitional costs from those that may persist on a recurring basis. The Board then weighs the relative benefits and costs in determining the desirability of promulgation.

The Board is interested in data which will enable it to gauge the impact of a proposed Standard on the amount of costs that will shift to or from Government contracts as a result of one or more Standards. The Board recognizes that a fair Cost Accounting Standard may result in a shift of cost from the Government to contractors or from contractors to the Government. In formulating Standards, the Board will not regard such shifts of costs as determinative.

COST ALLOCATION CONCEPTS

The Board's primary goal is increased uniformity and consistency in treatment of costs as they are related to negotiated defense contracts. Set forth herein are discussions of a number of important concepts which the Board will use in developing Cost Accounting Standards.

Cost accounting for negotiated Government contracts has long been on the basis of full allocation of costs, including general and administrative expenses and all other indirect costs. The allocation of all period costs to the products and services of the period is not a common practice either for public reporting or for internal management purposes; yet this has long been the established cost principle for costing defense procurement. The Board will adhere to the concept of full costing wherever appropriate.

A cost objective is "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." This definition has been promulgated by the Board.

Cost accounting systems are developed to provide a means for assigning all costs to appropriate cost objectives. Under the full costing concept, all costs initially allocated to intermediate cost objectives are reallocated to final cost objectives. Costs which are identified for special treatment (unreasonable costs, or costs unallowable for other reasons) may be assigned to final cost objectives established for that purpose.

Even with the foregoing concept, there are occasional difficult questions as to whether specified units of an organization or its work should be allocated cost on a full costing basis. The Board will attempt to identify and dispose of such questions in individual Cost Accounting Standards.

DIRECT IDENTIFICATION OF COSTS

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 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. Therefore, Cost Accounting Standards developed by the Board will reflect the desire for direct identification of cost and at the same time provide safeguards (such as those of 4 CFR 402) to assure consistency and objectivity in allocating costs incurred for the same purpose.

HIERARCHY FOR ALLOCATING COST POOLS

Costs not directly identified with final cost objectives should be grouped into logical and homogeneous expense pools and should be allocated in accordance with a hierarchy of preferable techniques. The costs of like functions have a direct and definitive relationship to the cost objectives for which the functions are performed and the grouping of such costs in homogeneous pools for allocation to benefiting cost objectives results in better identification of cost with cost objectives.

The Board believes there is a hierarchy of preferable allocation techniques for distributing homogeneous pools of cost. The preferred representation of the relationship between the pooled cost and the benefiting cost objectives is a measure of the activity of the function represented by the pool of cost. Measures of the activities of such functions ordinarily can be expressed in such terms as labor hours, machine hours, or square footage. Accordingly, costs of these functions can 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 can be a measurement of the output of the supporting function. Output is measured in terms of units of end product produced by the supporting functions, 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.

Where neither activity nor output of the supporting function can be measured practically, a surrogate for the beneficial or causal relationship should be selected. Surrogates used to represent the relationship are generally measures of the activity of the cost objectives receiving the service. Any surrogate used should be a reasonable measure of the services received and should vary in proportion to the services received.

Pooled costs which cannot readily be allocated on measures of specific beneficial or causal relationship generally represent the cost of overall management activities. These costs should be grouped in relation to the activities managed and the base selected to measure the allocation of these indirect costs to cost objectives should be a base representative of the entire activity being managed. For example, the total cost of plant activities managed might be a reasonable base for allocation of general plant indirect costs. The use of a portion of a total activity, such as direct labor costs or direct material costs only, as a substitute for a total activity base, is acceptable only if the base is a good representative of the total activity being managed.

OTHER CONCEPTS

The Board is interested in all accounting concepts. The Board takes this opportunity to invite interested parties to furnish it with reports of competent research into matters which might be expected to impact contract cost accounting. Three conceptual issues already suggested are described briefly below:

1. Going concern and termination. Most contract costing practices are based on the assumption that the contract is an episode in the continuing business activity of the contractor. When a contract is terminated for the convenience of the Government, there is a need to establish the cost impact of the decision to terminate. Some of the normal cost accounting practices for contractual performance may require modification in the event of termination of a contract.

2. Current value accounting. The accounting profession in the United States has generally used recorded historical costs as the basis for reports of the financial results of operations for given fiscal periods and the financial status at given times. Similarly, recorded historical costs have served as the basis for measuring the cost of performance in negotiated defense contracts.

Many accountants today support the belief that, in periods of continuing inflation or deflation, the reliance on historical costs in the preparation of conventional financial statements can be misleading. Considerable research has been done on the theory and measurement of "real" business income. The Board is interested in all aspects of measurement of cost of contractual performance including concepts of measurement on the basis of current value or price-level accounting.

3. Cost-of-capital. The Board is aware of the well-established Government policy that interest is not an allowable item of cost for determination of price under negotiated defense contracts. This

position is exemplified by the provision of the Armed Services Procurement Regulation, ASPR 15-205.17, that "interest on borrowings (however represented), bond discounts, [and] costs of financing and refinancing operation...are unallowable..." The Board is also aware of the view that effective performance under negotiated defense procurement depends in part on giving explicit consideration to the capital committed to contracts. In this connection, the Board has noted the Defense Department's concern with this issue and in particular that Department's profit-on-capital proposal.





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