

COST ACCOUNTING STANDARDS BOARD
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ELMER B. STAATS
Chairman

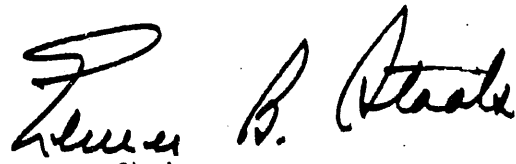


ARTHUR SCHOENHAUT
Executive Secretary

December 28, 1978

To the President of the Senate and the
Speaker of the House of Representatives

In accordance with Section 719(k) of the Defense Production
Act of 1950, as amended, I respectfully submit the progress report
of the Cost Accounting Standards Board for the year ended
September 30, 1978.


Chairman

Enclosure
(As stated)

COST ACCOUNTING STANDARDS BOARD

PROGRESS REPORT

TO THE

CONGRESS

FISCAL YEAR 1978

INTRODUCTION

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 Act directs the Board to promulgate cost accounting standards to achieve uniformity and consistency in the cost accounting principles followed by defense contractors and subcontractors under Federal contracts.

The Comptroller General of the United States is designated by Public Law 91-379 as Chairman of the Cost Accounting Standards Board. Pursuant to that Law, the Chairman, Elmer B. Staats, appoints four other members to serve on the Board for a term of four years each. The Board Members at September 30, 1978, were:

- Herman W. Bevis, formerly the Senior Partner, Price Waterhouse & Co., Certified Public Accountants
- Gordon Shillinglaw, Professor of Accounting, Graduate School of Business, Columbia University
- Fred P. Wacker, Assistant Secretary of Defense (Comptroller)
- John M. Walker, Senior Vice President and Corporate Treasurer, Texas Instruments, Incorporated

This report describes the activities of the Board for the fiscal year ending September 30, 1978. Attachment A summarizes the major

regulations and Standards in effect as of September 30, 1978. Attachment B presents the Board's actual expenditures for fiscal years 1977 and 1978, and estimated expenditures for fiscal year 1979.

COST ACCOUNTING STANDARDS

A Cost Accounting Standard dealing with accounting for insurance costs was promulgated on September 20, 1978. The Standard provides criteria for the measurement of insurance costs, the assignment of such costs to cost accounting periods, and the allocation of insurance costs to cost objectives.

Insurance premiums are generally recognized as a part of the normal cost of a contractor's business. This Standard provides criteria for distinguishing between deposits, which are funds supplied in advance for the convenience of the insurer, and earned premiums, which serve to measure the insurance cost applicable to a particular cost accounting period. The Standard provides criteria for determining the accounting techniques to be used in connection with premium payments, deposits, refunds, and reserves. The Standard also provides criteria for the measurement of the contract costs related to those risks retained by the contractor and not covered by purchased insurance.

The Board's promulgations become effective after the expiration of a period of 60 calendar days of continuous session of the Congress, unless during that period there is passed by the two Houses a concurrent resolution stating in substance that the Congress does not favor the proposed promulgation. This Standard was submitted to the 95th Congress,

but the Congress did not remain in session the requisite period. The Standard will be submitted to the 96th Congress and it is expected that the Standard will become effective on July 10, 1979.

STATUS OF PROJECTS IN PROCESS

A number of research projects, many of which may result in Cost Accounting Standards, were in various stages of completion at year end. Major effort was devoted to the research on five proposed Cost Accounting Standards related to the allocation of indirect costs. The five proposed Standards were published in the FEDERAL REGISTER on March 16, 1978. They were published at the same time so that interested parties could consider their total impact and provide comments thereon. Eighty-six sets of comments have been received and are in the process of being analyzed. The five proposed Standards are summarized in Items 1 through 5 below:

1. Distinguishing Between Direct and Indirect Costs--This study covers the accounting concepts and principles governing consistent classification of costs as direct or indirect, and the bases for making distinctions.
2. Accounting for Cost of Service Centers--Research on this subject involves the development of concepts for use in the accounting for the cost of service centers.
3. Allocation of Material-Related Expenses--This subject deals with the criteria for creation of pools of expenses and selection of allocation bases pertaining to material-related expenses. The scope includes the functions traditionally associated with the flow of materials, such as

material planning and control, purchasing, receiving and stores, internal and external transportation, distribution, etc.

4. Allocation of Manufacturing, Engineering, and Comparable Overhead Costs--This project covers the allocation of pools of manufacturing, engineering, and comparable overhead costs.

5. Allocation of Indirect Costs--This subject deals with criteria for the accumulation of other indirect costs in indirect cost pools and selection of appropriate allocation bases for such pools of cost.

6. Independent Research and Development and Bid and Proposal Costs--This project covers the accounting for costs of performing independent research and development and for costs of preparing bids and proposals. A proposed Standard was published in the FEDERAL REGISTER for comment on July 28, 1978, and responses are being analyzed.

7. Cost of Money as an Element of the Cost of Assets Under Construction--Cost Accounting Standard 414 is applicable to facilities which are in use. This research project examines into the possibility of extending the cost of money concept to assets under construction. A research issues paper was distributed in May 1978. Responses received are being analyzed.

8. Capacity-Related Costs--A staff study of accounting problems relative to contract changes disclosed some important accounting issues related to the cost of idle facilities and idle capacity. Research is being performed into the accounting concepts involved. An issues paper was distributed in November 1978.

9. Allocation of Selling and Marketing Costs--This project deals with the allocation of selling and marketing costs at all levels of a contractor's organization. An issues paper was distributed in September 1978.

10. Joint Product Costing--Research is being conducted on problems involved in accounting for joint products. The project covers matters such as the allocation of raw material and manufacturing costs where a number of products are being produced concurrently (e.g., allocation of crude oil and refining costs to petroleum products). An issues paper on this subject is being developed.

11. Capitalized Assets - Leases Between Related Parties--This project involves a review of Standard 404 in light of materials that have been more recently promulgated. The project will evaluate the adequacy of criteria to determine when assets acquired by less-than-arm's-length leases should be capitalized.

12. Capitalized Assets - Gains at Disposition--This project involves a review of the provisions of Standard 409 in light of materials that have been more recently promulgated. The project will consider whether to modify the present limitation on recognition of gain on sale of capital assets.

13. Other Potential Standards--The staff continues to work on a group of other topics which may later become the subject of Cost Accounting Standards. Among the more significant in this group are the following:

- a. Accounting for Intracompany Transfers
- b. Accounting for the Impact of Inflation

- c. Accounting for Special Facilities
- d. Cost of Money as an Element of the Cost of Operating Capital

14. Other Topics--The following projects were also given attention during the year. Although these projects are not likely to result in Cost Accounting Standards, they may result in revisions to current Board publications.

- a. Revision of the Disclosure Statement--This project considers the feasibility of revising the Disclosure Statement to (1) incorporate changes recommended by agencies and contractors, (2) restate questions so information on continuation sheets can be more simply prepared, (3) clarify definitions, and (4) add, delete, and/or revise questions in parts now covered by Standards. Visits have been made to contractors and Government personnel and a revised Disclosure Statement is being prepared.
- b. Review of Part 331 of Board Regulations--The Board initiated a comprehensive review of its regulations set forth in Title 4 of the Code of Federal Regulations, Part 331. This review covers all aspects of the Board's administrative and contract coverage regulations for the implementation of Cost Accounting Standards.
- c. Costs and Benefits--The Board has always recognized various practical difficulties involved when considering the benefits which can be expected from Standards and the likely costs of implementation. During 1978 the Board engaged a panel of

four distinguished independent accountants and economists to consider procedures which might be helpful to the Board in evaluating costs and benefits of proposed Standards.

- d. Standards in Operation--The primary purpose of this review is to determine whether each Standard functions as it is supposed to. A related objective is to determine which, if any, Standards should be amended or revised to improve their effectiveness, what additional Standards may be needed, and what other actions can be taken by the Board to enhance the effectiveness of its promulgations.

DISCLOSURE OF COST ACCOUNTING PRACTICES

Public Law 91-379 requires that contractors shall disclose in writing their cost accounting practices and agree to follow those disclosed practices consistently. The Board has established requirements for the submission of Disclosure Statements by contractors based on prime contract and subcontract awards received by a company and its subsidiaries. At present, a contractor is required to submit a Disclosure Statement if it is a company or a segment of a company which received total awards of national defense prime contracts and subcontracts subject to Cost Accounting Standards in excess of \$10 million during its preceding cost accounting period. Further, any other contractor which receives a single award of \$10 million or more subject to Cost Accounting Standards must submit a Disclosure Statement as a condition of receiving that award.

As of September 30, 1978, reporting units of 261 companies have sent 1,617 Disclosure Statements to the Board. Responses in these Disclosure

Statements are maintained by the Board in a computerized data bank. This information is available in aggregate statistical form to anyone requesting such data.

EFFECTIVENESS OF BOARD PROMULGATIONS

Federal agencies report to the Board, each year, on the effectiveness of its promulgations. Twelve agencies submitted reports to the Board for calendar year 1977. These reports are used by the Board to identify problem areas that indicate the need for new or revised Standards, rules, or regulations.

Agencies reported that more detailed and accurate reporting data are being submitted in contract proposals thereby increasing confidence in the accuracy of the proposals. Agencies also reported observing greater visibility of cost and pricing data in cost proposals. Further, agencies reported that contract administration time has increased because Disclosure Statements and issued Standards have provided additional information about the contractor's cost accounting and estimating practices which is beneficial in the analysis and negotiation of overhead rates and in assessing the impact of cost decisions.

The Association of Government Accountants (AGA) conducted a survey to elicit opinions regarding its members' perception of Cost Accounting Standards. A questionnaire was sent to 2,750 AGA members for this purpose and 1,626, or 66 percent, responded. The questions related to clarity of individual Standards; cost control, visibility and disagreements; and aspects of the contracting process. In most instances, Cost

Accounting Standards were perceived to be reasonably clear and understandable. More than 75 percent of the respondents expressing a knowledge of Cost Accounting Standards stated their belief that the Standards have improved consistency and uniformity of contractor cost accounting practices. The report on the survey concluded that, on balance, the Cost Accounting Standards appear to have exerted a positive effect on contractor cost accounting practices and the Government/contractor procurement process.

Agencies also report to the Board any recoveries of costs as a result of application of Standards, rules and regulations. Agencies reported recoveries as a result of (1) adjustments to contracts because of changes in cost accounting practices initiated by contractors, (2) determinations of noncompliance with Standards, (3) reductions in contractors' proposals, and (4) decreases through equitable adjustments to existing contracts because of the application of new Cost Accounting Standards.

The agencies' reports show that there were 865 noncompliance determinations considered by contracting officers in 1977; there were 702 such determinations considered in 1976. Of the 865 determinations, 510 were resolved during the year as compared to 412 resolved during 1976. There were 355 unresolved determinations as of December 31, 1977, as compared to 290 unresolved determinations as of December 31, 1976.

Consistent with its continuing responsibility to evaluate the effectiveness of its Standards, rules and regulations, the Board conducted its second Evaluation Conference on October 12 and 13, 1977. As was the case for the first Conference held in 1975, this Conference was designed to give individuals and organizations an opportunity to meet and discuss

with Board Members their views of the Board's operations and promulgations. The Conference was widely publicized, including an announcement in the FEDERAL REGISTER, and was attended by over 300 people. Oral presentations were made by 15 individuals. In addition, 12 organizations submitted statements for the record and several individuals took advantage of the opportunity to raise questions or to express their views from the floor. A complete transcript of the proceedings was made available through the Government Printing Office.

A number of the Board's projects can be traced to the comments and recommendations received at the Conference. The Board's continuing efforts to improve the evaluation of the costs of and the benefits from Standards were aided by a number of recommendations on this subject. Similarly, the Board is currently considering revising the Disclosure Statement as suggested at the Evaluation Conference. Also, a review of the Board's regulations dealing with certain aspects of contract coverage was undertaken in response to suggestions made by a number of conferees. In addition, the Board responded to recommendations for open meetings by opening its meetings to the public when it considers final promulgation of major items.

EXEMPTIONS AND WAIVERS

EXEMPTIONS

During the past year, the Board exempted two categories of contracts from its rules, regulations and Standards. The first category was contracts awarded to colleges and universities and the second was contracts awarded to foreign governments and foreign concerns.

On March 18, 1978, the Board published in the FEDERAL REGISTER a proposed modification to its regulations to exempt most educational institutions subject to Federal Management Circular (FMC) 73-8. After considering comments on the proposal and other available information, the Board amended its regulations effective August 1, 1978, to exempt contracts made with an educational institution whose cost principles are subject to FMC 73-8, except contracts that are to be performed by a Federally Funded Research and Development Center operated by such an institution.

During the past year, the Board, at the request of the Department of Defense and of various foreign governments, undertook a study of the application of its Standards to contracts awarded to foreign governments and foreign concerns for performance substantially outside of the United States. There have been an increasing number of such contracts under the national defense policy of co-production with NATO countries. The Board discussed foreign accounting practices and the application of the Board's Standards with representatives of a number of foreign countries, particularly with those involved in the F-16 co-production program and with the Government of the Federal Republic of Germany. On July 31, 1978, the Board published in the FEDERAL REGISTER a proposed modification to its regulations which would permit exemption of contracts with foreign concerns from Standards other than Cost Accounting Standards 401 and 402. After considering the comments received in response to this proposed exemption, the Board established an exemption from its rules, regulations and Standards for contracts and subcontracts awarded to foreign governments

and their agencies and instrumentalities, and from Standard 403 and subsequent Standards for contracts and subcontracts awarded to foreign concerns. This amendment to the Board's regulations became effective on November 3, 1978.

WAIVERS

The Board's regulations provide that a waiver may be granted for a particular contract or subcontract from all or a portion of the requirements of the Cost Accounting Standards Board's rules, regulations and Standards if the Board determines there is adequate justification. During the past year the Board acted favorably on the following requests for waiver:

<u>Agency</u>	<u>Contractor</u>	<u>Requirement</u>	<u>Amount</u> (Millions)
USN	Ministry of Defence (UK)	Pegasus Engine Support for FY 1978	\$6
NASA	European Space Agency	Demultiplexer	1.5
USAF	Fabrique Nationale (Belgium) (Waiver of CAS 408 and subsequent Standards)	F-16 Engine Maintenance	5.2

The Board's regulations also authorize the head of a procurement agency to waive the requirement for filing of a Disclosure Statement under certain circumstances. The Board has been notified of one such waiver during the past year.

<u>Agency</u>	<u>Contractor</u>	<u>Requirement</u>	<u>Amount</u>
USN	Delco-Remy, Division of GMC	Batteries	\$649,500

MAJOR RULES, REGULATIONS AND COST ACCOUNTING STANDARDS
PROMULGATED BY THE COST ACCOUNTING STANDARDS BOARD
AS OF SEPTEMBER 30, 1978

DESCRIPTION	EFFECTIVE DATE
1. Contract Coverage	July 1, 1972
2. Minimum amount for covered contracts increased from \$100,000 to \$500,000.	January 1, 1975
3. Criteria for Materiality	October 4, 1977
4. Exemption of Small Business and Modified Coverage for Certain Classes of Business Units	March 10, 1978
5. Definition of "Cost Accounting Practice" and "Change in a Cost Accounting Practice"	March 10, 1978
6. Exemption for Educational Institutions	August 1, 1978
7. Exemption for Foreign Governments and Contractors	November 3, 1978
8. Disclosure Statement	July 1, 1972
9. Disclosure Statement - Lowering floor for filing to new awards of \$10 million	April 1, 1974
10. Standard 401 - Consistency in Estimating, Accumulating and Reporting Costs	July 1, 1972
11. Interpretation No. 1 to Standard 401	July 1, 1972
12. Standard 402 - Consistency in Allocating Costs Incurred for the Same Purpose	July 1, 1972
13. Interpretation No. 1 to Standard 402	July 1, 1972
14. Standard 403 - Allocation of Home Office Expenses to Segments	July 1, 1973
15. Standard 404 - Capitalization of Tangible Assets	July 1, 1973
16. Standard 405 - Accounting for Unallowable Costs	April 1, 1974
17. Standard 406 - Cost Accounting Period	July 1, 1974

	DESCRIPTION	EFFECTIVE DATE
18.	Standard 407 - Use of Standard Costs for Direct Material and Direct Labor	October 1, 1974
19.	Standard 408 - Accounting for Costs of Compensated Personal Absence	July 1, 1975
20.	Standard 409 - Depreciation of Tangible Capital Assets	July 1, 1975
21.	Standard 410 - Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives	October 1, 1976
22.	Standard 411 - Accounting for Acquisition Costs of Material	January 1, 1976
23.	Standard 412 - Composition and Measurement of Pension Cost	January 1, 1976
24.	Standard 413 - Adjustment and Allocation of Pension Cost	March 10, 1978
25.	Standard 414 - Cost of Money as an Element of the Cost of Facilities Capital	October 1, 1976
26.	Standard 415 - Accounting for the Costs of Deferred Compensation	July 10, 1977
27.	Standard 416 - Accounting for Insurance Costs (This Standard was submitted to the 95th Congress but the Congress did not remain in session sufficient time for the 60-day period for the Standard to take effect. The Standard will be submitted to the 96th Congress and it is expected that it will become effective on	July 10, 1979)

SCHEDULE OF ACCRUED EXPENDITURES,
OBLIGATIONS INCURRED, AND AMOUNTS APPROPRIATED

	<u>1977</u> <u>Actual</u>	<u>1978</u> <u>Actual</u>	<u>1979</u> <u>Estimated</u>
	-----Thousands-----		
Accrued Expenditures:			
Personnel Compensation	\$1,145	\$1,120	\$1,215
Personnel Benefits	98	97	103
Travel and Transportation	57	68	70
Rent, Communications and Utilities	131	132	158
Printing and Reproduction	9	17	20
Other Services	69	26	185
Supplies and Materials	5	7	6
Equipment	<u>1</u>	<u>1</u>	<u>1</u>
Total Accrued Expenditures	\$1,515	\$1,468	\$1,758
Adjustment for Undelivered Orders	<u>96</u>	<u>36</u>	<u>-0-</u>
Total Obligations Incurred	\$1,611	\$1,504	\$1,758
Unobligated Balance	<u>89</u>	<u>333</u>	<u>92</u>
Total Appropriation	<u>\$1,700</u>	<u>\$1,837</u>	<u>\$1,850</u>