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UNITED STATES  
GENERAL ACCOUNTING OFFICE

REPORT TO THE CONGRESS

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Status Report On The  
Cost Accounting Standards  
Program - Accomplishments  
And Problems

Cost Accounting Standards Board  
Department of Defense

This report discusses accomplishments of the Cost Accounting Standards Board, an agent of the Congress, in attempting to achieve increased uniformity in accounting practices among Government defense contractors and increased consistency in accounting of their costs. It describes the standards, rules, and regulations published by the Board, beginning July 1, 1972, and the activities of the defense agencies in securing contractor compliance.

GAO commends the Board and the defense agencies for their efforts to implement this highly complex program and to solve problems encountered but believes that some problems still remain. The report includes GAO's recommended solutions to these problems.

~~703509~~ 098206  
AUG. 20, 1976



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-39995

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

This report describes the current standards, rules, and regulations of the Cost Accounting Standards Board, the efforts to implement the cost accounting standards program, and problems which have been encountered. Public Law 91-379 established the Board with a mandate to promote uniform and consistent cost accounting practices among Government contractors.

Our work was done in accordance with our continuing responsibilities to determine the effectiveness of programs designed to protect the Government's interest in negotiating contract prices. We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of Defense; and other interested parties.

A handwritten signature in cursive script, reading "James B. Stacks".

Comptroller General  
of the United States

## C o n t e n t s

	<u>Page</u>
DIGEST	i
CHAPTER	
1 INTRODUCTION	1
2 STANDARDS, RULES, AND REGULATIONS OF THE COST ACCOUNTING STANDARDS BOARD	3
Contract coverage	3
The disclosure statement	4
The standards	5
Purpose and basic principles	5
Promulgated standards	5
Contract price adjustments	5
Types of adjustments	5
Contract offsets	6
3 IMPLEMENTATION OF COST ACCOUNTING STANDARDS, RULES, AND REGULATIONS	9
Implementation by defense agencies	10
Establishment of an ASPR Sub- committee	11
Establishment of central CAS groups	12
Formal CAS training	13
Time spent administering CAS	13
4 IMPLEMENTATION PROBLEMS-PAST AND PRESENT	15
Violations and settlements	15
Cost impact of noncompliances at contractor locations	18
Delays in resolving CAS issues	19
Lack of uniform management procedures	20
Difficulties encountered in coordinating activities among administrative contracting officers, procurement con- tracting officers, and auditors	21
Additional guidance needed for preparing and submitting cost impact proposals	22
Failure to follow Board's base- line for estimating cost impact	23

CHAPTER	<u>Page</u>
	Difficulties in identifying the universe of covered contracts 23
	Definition of a cost accounting practice needed 24
5	CONCLUSIONS, RECOMMENDATIONS, AND AGENCY COMMENTS AND OUR EVALUATION 25
	Conclusions 25
	Recommendations 26
	Agency comments and our evaluation 26
6	SCOPE OF REVIEW 29
 APPENDIX	
I	Letter dated May 19, 1976, from the Department of Defense 30
II	Principal Federal officials responsible for administering activities discussed in this report 37

ABBREVIATIONS

ACO	administrative contracting officer
ASPR	Armed Services Procurement Regulation
CAS	cost accounting standard
DCAA	Defense Contract Audit Agency
DCAS	Defense Contract Administration Services
DOD	Department of Defense
DPC	Defense Procurement Circular
ERDA	Energy Research and Development Administration
GAO	General Accounting Office
NASA	National Aeronautics and Space Administration
PCO	procurement contracting officer

COMPTROLLER GENERAL'S  
REPORT TO THE CONGRESS

STATUS REPORT ON THE  
COST ACCOUNTING STANDARDS  
PROGRAM--ACCOMPLISHMENTS  
AND PROBLEMS

Cost Accounting Standards Board  
Department of Defense

D I G E S T

This is GAO's first report on the cost accounting standards program. GAO decided there was a need to summarize for the Congress and other interested parties the functions, responsibilities and accomplishments of the Cost Accounting Standards Board, an agent of the Congress, and the defense agencies in implementing and administering the program. The report also includes GAO's observations relative to problems that have been encountered and solved as well as problems that remain.

Publication of the Board's standards, rules, and regulations has profoundly affected defense contractors and procurement offices. GAO believes the Board and the defense agencies should be commended for their efforts to implement this highly complex program. (See p. 25.)

COST ACCOUNTING STANDARDS--THEIR PURPOSE  
AND AGENCIES' RESPONSIBILITIES

The primary purpose of cost accounting standards is to achieve increased uniformity in accounting practices among Government contractors and consistency in accounting treatment of costs by individual Government contractors. Uniformity and consistency should

--improve understanding and communication,

--reduce disputes and disagreements, and

--facilitate equitable contract settlements.

(See p. 5.)

Through July 31, 1976, the Board had published 14 standards. Other standards were near completion and many subjects were being considered for possible development as standards. (See p. 5.)

The principal defense agencies reported to the Board, for calendar years 1973 and 1974, about 142,000 procurement actions subject to cost accounting standards, with a value of \$30.1 billion. (See p. 2.)

The responsibility of procurement agencies in securing compliance with the Board's requirements include

- incorporating all applicable Board requirements into procurement regulations;
- incorporating the cost accounting standards clause in all applicable contracts;
- evaluating the validity of claims by contractors for exemptions or exclusions from the requirements of cost accounting standards;
- receiving, reviewing, and determining the adequacy of disclosure statements of cost accounting practices;
- determining whether contractors have followed consistently their disclosed cost accounting practices and complied with promulgated standards; and
- making appropriate contract price adjustments because of (1) mandatory changes to accounting practices resulting from application of a new standard, (2) voluntary changes in accounting practices resulting from circumstances other than application of a new standard, or (3) failure to follow existing standards or disclosed practices.

The Defense Contract Administration Services and the Defense Contract Audit Agency are the Department of Defense units most heavily involved in administering the program.

Through its 1,400 administrative contracting officers, contract administrators, and price analysts, the Administration Services has cognizance over about 20,000 contractor

locations and administers an estimated 80 percent of all Department of Defense contracts.

Through its professional staff of 2,800 auditors, the Contract Audit Agency performs audit services for the military services. (See p. 11.)

IMPLEMENTATION PROBLEMS-  
PAST AND PRESENT

During the six years since enactment of Public Law 91-379, many problems have been encountered, especially by the Department of Defense in effectively administering the standards, rules, and regulations promulgated. The Defense Department has had to instruct and train hundreds of contract administrators and auditors relative to cost accounting standards requirements, establish an organization for addressing and solving problems encountered in applying and interpreting the standards, and gain the cooperation of hundreds of contractors. All of this has been accomplished with a high degree of skill and effectiveness and a minimum of disruption to other programs.

A major area of concern has been the timely resolution of contractor violations of cost accounting standards, rules, and regulations. The specific problems which have adversely affected resolutions of reported violations, along with solutions implemented or proposed included:

- Uncertainty over the definition of a cost accounting practice. The Board expects to remove this uncertainty by issuing a formal definition.
- Lack of uniform management procedures. The Defense Department has tried to solve this problem by establishing an orderly sequence of administrative steps for resolving noncompliance issues.
- Lack of a specific requirement for submitting cost impact proposals showing the estimated monetary damage resulting from contractors'

failure to follow cost accounting standards or their disclosed or established cost accounting practices and the lack of guidance on the content and format of such proposals. Revisions to regulations have clarified the requirement for submitting cost impact statements. However, there is still uncertainty concerning how to measure increased cost.

--Difficulties encountered in coordinating activities among the administrative contracting officers, the procurement contracting officers, and the auditors. Although efforts to solve these difficulties have been noted, continued attention will be required.

--Difficulty in identifying all contracts subject to cost accounting standards which are involved in a cost impact proposal. The Defense Department has taken action to improve the identification process but GAO believes more is needed.

--Failure to follow the Board's baseline for estimating cost impact resulting from changes to cost accounting practices or noncompliances with cost accounting standards requirements under fixed-price contracts.

#### RECOMMENDATIONS

The Secretary of Defense should direct the Cost Accounting Standards Steering Committee and Working Group to formulate uniform procedures and requirements related to

- identifying the universe of covered contracts affected by a cost impact proposal;
- preparing cost impact proposals, including the extent of supporting data required; and
- measuring increased cost.

The Secretary should also reemphasize to all offices involved in the administration of cost accounting standards the need for

effective coordination and for adherence to the Board's baseline for estimating cost impact. Where the Defense Department considers it impracticable to use the Board's baseline, the Secretary should propose to the Board an alternative. (See p. 26.)

#### AGENCY ACTIONS AND UNRESOLVED ISSUES

Although the Board did not provide written comments to GAO's draft report, GAO discussed its findings, conclusions, and recommendations with the Board members. The members' oral comments were favorable.

The Defense Department, in its comments, indicated that implementation of cost accounting standards has been more effective than portrayed by the draft report. (See pp. 26-27.)

Specific comments on the recommendations made to the Secretary of Defense follow.

--Relative to identifying the universe of covered contracts the Defense Department said that some action has been taken by two Defense activities to insure a complete identification of the universe of covered contracts and that additional action is being considered concerning several other Defense Department segments. GAO agrees that the action taken will be helpful but believes that there will still be inconsistencies in the records and data generated and in their use until uniform procedures and requirements are developed by the Cost Accounting Standards Steering Committee. (See p. 27.)

--The Defense Department concurred with GAO's recommendation for developing uniform procedures and requirements relative to preparing cost impact proposals. (See p. 27.)

--On the need for uniform procedures for measuring increased costs, the Defense Department stated that sufficient guidance

already existed. GAO believes that a need exists for developing specific techniques and methods for identifying cost impact on a uniform and consistent basis and is recommending that this be done. (See p. 28.)

--The Defense Department said effective coordination exists and that it will make sure this continues. GAO agrees that coordination has improved but believes that it requires continued emphasis. (See p. 28.)

--The Defense Department commented that it was instructing its students in cost accounting standards training courses to use current cost data to determine cost impact wherever possible rather than original cost estimates. If applied to noncompliance actions relating to fixed-price contracts, this practice would be contrary to the Board's rules and regulations which have the full force and effect of law. (See p. 28.)

## CHAPTER 1

### INTRODUCTION

On August 15, 1970, the Congress enacted Public Law 91-379 (84 Stat. 796), an amendment to the Defense Production Act of 1950 (50 U.S.C. App. 2168). This law established the Cost Accounting Standards Board (the Board) as an agent of the Congress independent of the executive departments to: UT: 0003a

- promulgate cost accounting standards (CASs) designed to achieve uniformity and consistency in cost principles followed by defense prime contractors and subcontractors under Federal contracts, and
- make, promulgate, amend, and rescind rules and regulations for implementing promulgated standards.

This is our first report on the cost accounting standards program. We perceived a need to summarize for the Congress and other interested parties the functions, responsibilities and accomplishments of the Board and the defense agencies in implementing the program.<sup>1</sup> The report also includes our observations on the problems encountered and solved, as well as problems that remain.

The Board's initial promulgation, effective July 1, 1972, included two broad CASs for use in connection with certain negotiated defense contracts and subcontracts. In addition, the document included requirements for major defense contractors, 1/ as a condition of contracting, (1) to disclose in writing their cost accounting practices and (2) to agree to a contract price adjustment for any increased costs paid by the United States because of the contractor's failure to comply with duly promulgated standards or to follow consistently its disclosed practices in pricing contract proposals and in accumulating and reporting contract performance cost data.

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1/As used in the report the term "contractors" refers to prime contractors and subcontractors and the term "contracts" refers to prime contracts and subcontracts unless otherwise specified.

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4  
5  
6  
5  
The Department of Defense (DOD), Atomic Energy Commis-743  
sion (now ERDA 1/), and the National Aeronautics and Space 60  
Administration (NASA), the principal agencies which award 36  
national defense contracts, issued regulations to implement  
the Board's requirements at the contracting level. Though  
not required to do so by Public Law 91-379, the General  
Services Administration extended the Board's regulations to 17  
certain nondefense contracts. The implementing regulations  
issued by these agencies also became effective July 1, 1972.

The principal defense agencies reported to the Board,  
for calendar years 1973 and 1974, that about 142,000 contract  
actions valued at \$30.1 billion were subject to CAS require-  
ments.

The scope of our study is described in chapter 6.

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1/The Atomic Energy Commission was abolished and its con-  
tracting activities were assumed by the Energy Research  
and Development Administration.

## CHAPTER 2

### STANDARDS, RULES, AND REGULATIONS OF THE

#### COST ACCOUNTING STANDARDS BOARD

The Comptroller General of the United States, as required by Public Law 91-379, serves as Chairman of the Cost Accounting Standards Board and appoints four additional members for 4-year terms. Two of the appointed members, one of whom is to be particularly knowledgeable of the cost accounting problems of small business, are from the accounting profession; one is a representative of industry; and one is from a Federal department or agency. An executive secretary and about 35 staff members plus 5 consultants, at an annual cost of about \$1.5 million, perform the day-to-day operations.

#### CONTRACT COVERAGE

The standards, rules, and regulations promulgated by the Board carry the full force and effect of law. They are binding on all relevant Federal agencies <sup>1/</sup> and on contractors for estimating, accumulating, and reporting costs in connection with the pricing, administration, and settlement of all negotiated national defense <sup>2/</sup> contracts in excess of \$100,000 (now \$500,000), with limited exceptions.

However, the Board has recognized that it may be necessary in the interest of timely procurement to waive in part or whole its requirements. From July 1, 1972, through June 30, 1975, the Board received 52 waiver requests and granted 43 waivers in connection with contracts having a total value of \$280 million. Eleven waivers were granted for contracts with domestic concerns that were sole-source producers in circumstances in which urgency of the procurement necessitated waiver of the cost accounting standard (CAS) clause. The remainder of the waivers granted were for contracts with foreign governments and firms.

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<sup>1/</sup>A "relevant Federal agency" is any Federal agency making a national defense procurement and any agency whose responsibilities include review, approval, or other action affecting such a procurement.

<sup>2/</sup>"National defense" is any program for military and atomic energy production or construction, military assistance to any foreign nations, stockpiling, space, and directly related activity.

THE DISCLOSURE STATEMENT

The disclosure statement describes a contractor's cost accounting practices. In particular, it defines a contractor's direct cost of contracts and discloses the methods used to distinguish direct cost from indirect costs and the method of allocating indirect costs.

A contractor must submit and have an approved disclosure statement before receiving a contract subject to CAS unless postaward submission has been authorized or waiver has been granted. In preparing contract proposals and during contract performance, the contractor must follow the practices set forth in the disclosure statement.

The requirement for a contractor to disclose in writing its cost accounting practices initially applied to those companies which, together with their subsidiaries and affiliated companies under common control, received net prime contract awards of negotiated national defense contracts totaling more than \$30 million during fiscal year 1971. This threshold was reduced to \$10 million, effective fiscal year 1972. A summary of the disclosure requirements is set forth in table 1 below.

Table 1

Summary Of Disclosure Statement Filing Requirements

<u>Fiscal period</u>	<u>Government contracts to be included in computation</u>	<u>Amount</u>	<u>Effective date</u>
		(millions)	
FY 1971	Net negotiated prime defense contracts	\$30	Oct. 1, 1972
FY 1972 and 1973	Defense prime contracts of the type subject to CAS	10	Apr. 1, 1974
FY 1974 and 1975	Defense prime contracts subject to CAS	10	Jan. 1, 1976
FY 1976	Defense prime contracts and subcontracts subject to CAS	10	Mar. 31, 1977
Following years	Defense prime contracts and subcontracts subject to CAS	10	Mar. 31, following fiscal year

## THE STANDARDS

### Purpose and basic principles

The Board defines a CAS as a statement that

- enunciates a principle or principles to be followed;
- establishes practices to be applied; or
- specifies criteria to be employed in selecting from alternative principles and practices in estimating, accumulating, and reporting costs of contracts subject to the Board's rules and regulations.

Regarding CASs, the Board's primary goal is to issue clearly stated standards to achieve (1) an increased uniformity in accounting practices among Government contractors and (2) consistency in accounting treatment of costs by individual Government contractors. The Board believes 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.

### Promulgated standards

From its inception through July 31, 1976, the Board has issued 14 standards. (See table 2.) Many other subjects are under consideration.

## CONTRACT PRICE ADJUSTMENTS

### Types of adjustments

Under the rules and regulations of the Board, a contract price adjustment can arise under three circumstances, as follows.

1. Noncompliance adjustment. If a contractor fails to comply with an applicable standard or to follow a disclosed practice and such failure results in any increased cost paid by the United States under the contract, then the contractor shall agree to an adjustment, with interest, to the contract price or cost allowance, as appropriate.

2. Mandatory change. If a contractor is required to change its disclosure statement or established cost accounting

practices, whether the established practices are covered by a disclosure statement or not, to comply with a newly effective standard, then the contractor shall agree to an equitable adjustment as provided in the "changes clause" of the contract if the change affects contract cost.

3. Other changes, sometimes referred to as voluntary changes. If a change, other than one required to comply with a newly effective standard, is made to a cost accounting practice, the contractor shall negotiate with the contracting officer the terms and conditions under which the change may be made. Either the Government or contractor may propose a change to a practice, but the contract adjustment arising from the change shall not result in increased costs paid by the United States.

If the Government and the contractor fail to agree on whether the contractor has complied with an applicable standard, rule, or regulation of the Board, and on the amount of contract adjustment, such failure is a dispute concerning a question of fact within the meaning of the disputes clause of the contract.

#### Contract offsets

Offsetting cost increases against cost decreases is permitted in the other changes described above when a contractor can establish that its failure to comply with applicable standards or disclosed practices was inadvertent rather than deliberate. In such cases the Board's regulations urge contracting officers, in the interest of administrative convenience, to require repayment of only the differences between estimated price increases and decreases, together with applicable interest. Offsets are not permitted if contractor's failure to comply is deliberate.

Table 2  
Cost Accounting Standards Promulgated as of  
July 31, 1976

Number of standard	Title of standard	Effective date of standard	Purpose of standard	Standard shall be followed or applied	Exemptions unique to the standard
401	Consistency in estimating, accumulating, and reporting costs	July 1, 1972	To insure that the contractor's practices used in estimating costs for a proposal are consistent with the accounting practices used in accumulating and reporting costs.	Upon receipt of first contract subject to the standard.	None.
402	Consistency in allocating costs incurred for the same purpose	July 1, 1972	To require that each type of cost is allocated only once and on only one basis to any contract or other cost objective.	Upon receipt of first contract subject to the standard.	None.
403	Allocation of home office expense to segments	July 1, 1973	To establish criteria for allocation of a home office expense to the segments of an organization based on the beneficial or casual relationship between the expenses and the receiving segments. The standard requires direct allocation of costs to the maximum extent practical and prescribes techniques for indirect allocation of costs not allocated directly.	Upon receipt of first contract not exempt from the standard. Contractor then must follow the standard as of the beginning of its next fiscal year after September 30, 1973.	Contractor did not receive in Federal fiscal year 1971 net negotiated prime contract defense awards totaling more than \$30 million, or is subject to Federal Management Circulars 73-8 or 74-4.
404	Capitalization of tangible assets	July 1, 1973	To require the contractor, for purposes of cost measurement, to establish and adhere to policies for capitalization of tangible assets. The standard establishes a maximum service life of not more than 2 years and a maximum acquisition cost of not more than \$500 as criteria for the writeoff of tangible assets.	Upon receipt of first contract subject to the standard. Contractor then must apply the standard to accrued expenditures for acquisition of tangible capital assets during its next fiscal year beginning on or after October 1, 1973.	None.
405	Accounting for unallowable costs	Apr. 1, 1974	To provide guidelines identifying costs described as unallowable and prescribing the accounting treatment afforded such costs. The standard does not govern allowability of costs but seeks to promote consistency in the accounting treatment of those costs when identified.	Upon receipt of first contract subject to the standard.	None.
406	Cost accounting period	July 1, 1974	To provide criteria for selecting the time periods to be used as cost accounting periods for contract cost estimating, accumulating, and reporting.	As of start of contractor's next fiscal year beginning after receipt of first contract subject to the standard.	None.
407	Use of standard costs for direct material and direct labor	Oct. 1, 1974	To provide criteria under which standard costs may be used for estimating, accumulating, and reporting costs of direct material and direct labor, and to provide criteria relating to the establishment of standards, accumulation of standard costs, and accumulation and disposition of variances from standard costs.	As of contractor's next fiscal year beginning after receipt of first contract subject to the standard.	None.
408	Accounting for costs of compensated personal absence	July 1, 1975	To improve, and provide uniformity in, the measurement of costs of vacation, sick leave, holiday, and other compensated personal absence for a cost accounting period.	As of the start of contractor's next fiscal year beginning after receipt of first contract not exempt from the standard.	Contractor is subject to Federal Management Circulars 73-8 or 74-4.
409	Depreciation of tangible capital assets	July 1, 1975	To provide criteria and guidance for assigning costs of tangible assets to cost objectives. The standard requires that the method of depreciation used be applied over the asset's estimated useful service life and reflect the pattern of consumption of the services rendered by the asset.	To all tangible capital assets acquired on or after the start of the contractor's next fiscal year beginning after receipt of first contract not exempt from the standard.	Contractor's compensation for use of tangible capital assets is based on use allowances as provided for by the provisions of Federal Management Circulars 73-8 or 74-4 or other appropriate Federal procurement regulations.
410	Allocation of business unit general and administrative expenses to final cost objectives	Oct. 1, 1976	To establish criteria for the allocation of business unit general and administrative expenses to business unit final cost objectives.	After the start of contractor's next fiscal year beginning after January 1, 1977.	Contractor subject to Federal Management Circulars 73-8 or 74-4.
411	Accounting for acquisition costs of material	Jan. 1, 1976	To provide criteria for the accounting for acquisition costs of material. The standard also includes provisions on the use of inventory costing methods.	To materials purchased or produced after the start of contractor's next fiscal year after receipt of first contract subject to the standard.	None.
412	Composition and measurement of pension cost	Jan. 1, 1976	To provide for determining and measuring the components of pension cost and for establishing the basis on which pension costs shall be assigned to cost accounting periods.	On or after the start of contractor's next cost accounting period beginning after receipt of first contract subject to the standard.	None.
414	Cost of money as an element of the cost of facilities capital	2/Oct. 1, 1976	To establish criteria for the measurement and allocation of the cost of capital committed to facilities as an element of contract cost.	For contracts awarded after the effective date.	Contractors where compensation for the use of tangible capital assets is based on use rates or allowances such as provided by FMC 73-8, FMC 74-4, ASPR 15-402-1(a) or similar regulations.
415	Accounting for the cost of deferred compensation	2/Jan. 1, 1977	To provide criteria for the measurement of the cost of deferred compensation and the assignment of such cost to cost accounting periods.	After the start of contractor's next cost accounting period beginning after receipt of a contract subject to the standard.	None.

2/Anticipated.

BEST DOCUMENT AVAILABLE

### CHAPTER 3

#### IMPLEMENTATION OF COST ACCOUNTING STANDARDS,

#### RULES, AND REGULATIONS

Public comment on the Cost Accounting Standards Board's initial proposals relating to cost accounting standards (CASS), rules, and regulations included recommendations that the Board play the major role in or assume complete responsibility for implementation. The Board did not accept these recommendations in promulgating its rules and regulations effective July 1, 1972, because it did not wish to displace the contracting and administrative procedures and prerogatives of the procurement agencies.

However, the Board reserved the right to issue its own regulations should too much diversity develop in implementation procedures. Similarly, the Board has announced that it may, at its discretion, respond to the requests for authoritative interpretations of its rules, regulations, and standards should widespread and serious questions develop.

Although procurement agencies are responsible for implementing the Board's rules, regulations, and standards, the Board helped facilitate initial implementation efforts. Specifically, the Board:

- Worked with agencies to issue initial administrative regulations.
- Established an Interagency Advisory Committee composed of procurement and controller representative of various agencies.
- Conducted in cooperation with Department of Defense (DOD) numerous 1-day orientation sessions for Government and industry personnel.
- Encouraged the agencies to present a single representative to industry by agreeing upon one representative to deal with a given contractor regarding application of the Board's requirements. The single representative approach to administering CASS, in the Board's opinion, would assure maximum effectiveness and consistent application of its rules, regulations, and standards.
- Encouraged established training organizations to assume the major training responsibility in Board materials.

The Board's staff provided materials for use in Civil Service Commission and American Institute of Certified Public Accountants training programs and undertook to provide lecturers for a training course conducted by the United States Army Logistics Management Center.

The Board has continued to encourage participation in its activities and cooperation with other Federal agencies and private organizations. For example, it seeks broad participation in the development of new CASs and invites public comment on its proposed rules and regulations. Liaison has been established with Federal and private organizations whose activities are related to those of the Board, and in June 1975 a public evaluation conference on promulgated standards was held to hear the views of industry representatives.

#### IMPLEMENTATION BY DEFENSE AGENCIES

Procurement agencies are responsible for securing contractor compliance with the Board's requirements. This responsibility includes

- incorporating all applicable Board promulgations into procurement regulations;
- incorporating the CAS contract clause in all covered contracts;
- evaluating the validity of claims by contractors for exemptions or exclusions from the requirements of CAS;
- receiving, reviewing, and determining the adequacy of disclosure statements;
- determining whether contractors have followed consistently their disclosed cost accounting practices and complied with promulgated standards; and
- making appropriate contract price adjustments because of (1) mandatory changes to accounting practices resulting from application of a new standard, (2) voluntary changes to accounting practices resulting from circumstances other than application of a new standard, or (3) failure to follow existing standards or disclosed practices.

The Defense Contract Administration Services (DCAS) and the Defense Contract Audit Agency (DCAA) are DOD units most

heavily involved in administering the CAS program. Through its 1,400 administrative contracting officers (ACOs), contract administrators, and price analysts, DCAS has responsibility for about 20,000 contractor locations, including 1,200 residencies, and administers an estimated 80 percent of all DOD contracts. The military departments, in contrast to DCAS, maintain 48 contractor residencies, excluding educational institutions. Through its 2,800 auditors, DCAA performs audit services for non-DOD as well as DOD agencies.

The Energy Research and Development Administration (ERDA) maintains cognizance over about 70 contractor locations through 23 ACOs and 130 field auditors. The National Aeronautics and Space Administration (NASA) has administrative cognizance over eight contractor sites, but virtually all related audit activity is performed by DCAA. The Department of Health, Education, and Welfare has cost negotiation and audit responsibility for most educational institutions.

Both DCAS and DCAA have recently revised their reporting systems to improve management control over CAS administration. The DCAS system entails quarterly reports submitted by field personnel showing the status of unresolved issues. Detailed information, including a description of the action taken to correct the problem and prevent its recurrence, is required for each issue which has been unresolved for more than 180 days. The DCAA system is designed to track and measure the magnitude of proposals for contract adjustments. Initial output of the automated system will include data on proposals reviewed in calendar year 1975.

#### Establishment of an ASPR Subcommittee

For about 20 months after the first implementing regulation was issued, CAS issues were addressed on an ad hoc basis. Eventually, the need for more systematic consideration of CASSs was recognized and in December 1973 DOD established an Armed Services Procurement Regulation (ASPR) Subcommittee on Cost Accounting Standards Board rules and regulations. The Subcommittee is responsible for the policies and procedures regarding the implementation and administration of CASSs, rules, and regulations. Its members, who convene on a part-time basis, include eight DOD representatives and, to promote uniformity in CAS administration throughout the Government, one representative from NASA, ERDA, and the General Services Administration.

A substantive policy and procedure regulation resulting from the Subcommittee's deliberations was Defense Procurement Circular (DPC) 74-5, dated March 4, 1975, which is part of

the Armed Services Procurement Regulation. This directive prescribes procedures for administering the CAS clause included in the Board's initial promulgation. Important features of DPC 74-5 include

- establishing an orderly sequence of administrative steps for processing CAS issues from the time a violation is cited until it is mutually resolved or placed in dispute,
- prescribing time frames for accomplishing those administrative steps,
- making explicit the contractor's responsibility to submit a detailed cost impact proposal showing the effect on costs of individual covered contracts that results from a change to cost accounting practices or the failure to comply with applicable standards and disclosed practices,
- requiring the cognizant ACO with assistance of the auditor to estimate cost impact if the contractor fails to submit a detailed proposal,
- reinforcing the single representative concept by requiring the procurement contracting officer (PCO) to delegate CAS administration to the cognizant ACO even for those contracts on which the PCO elects to retain other contract administration functions, and
- augmenting the information reported annually to the Board by requiring data on increased costs recovered through resolutions of contractor noncompliances.

#### Establishment of central CAS groups

In August 1975 DOD established the Cost Accounting Standards Steering Committee and the Working Group to focus high level attention on CAS problems and issues. Both groups convene on a part-time basis.

Members of the Working Group, which is chaired by an official of the Office of Assistant Secretary of Defense (Installations and Logistics), include representatives of the military services, DCAS, and DCAA. Objectives of the group include

- identifying CAS administration problems,
- evaluating the administrative practices of field offices,

--providing the assistance of policy level personnel directly to field offices for timely consultation and advice, and

--initiating proposals for revisions to procurement regulations.

The purpose of the Cost Accounting Standards Steering Committee, which is chaired by the Assistant Secretary of Defense (Installations and Logistics) and includes the Assistant Secretary of Defense (Comptroller); the Military Department Installations and Logistics Assistant Secretaries; and the Director, Defense Supply Agency, is to direct and support the activities of the Working Group.

As of April 30, 1976, the Cost Accounting Standards Steering Committee has held two meetings and has issued several guidance memorandums to the military services. The Cost Accounting Standards Working Group has held 20 meetings from its inception thru April 30, 1976.

#### Formal CAS training

To provide intensive CAS training, DOD established a 2-week CAS course at the Army Logistics Management Center, Fort Lee, Virginia. Persons who have attended the CAS course said they found it stimulating and informative. In addition, CAS problems identified during course sessions are brought to the attention of the Board and ASPR Subcommittee.

We have been recently told that many CAS workshops, each of 1-4 days duration, have been conducted by DCAA and DCAS representatives in various parts of the United States. We have also been assured that these workshops will continue in the future.

#### Time spent administering CAS

Complete data was not available regarding the total time spent on CAS by contract administration personnel. ACOs did not maintain time records of their CAS-related activities. However, detailed data was available for DCAA field auditors.

Table 3 summarizes the actual direct audit effort of DCAA for fiscal years 1974-75 and the programed effort for fiscal year 1976.

Table 3

DCAA'S Direct Audit Effort For Fiscal Years 1974-76

	1974 Actual <u>hours</u>	1975 Actual <u>hours</u>	1976 Programed <u>hours</u>
CAS effort:			
Disclosure statement reviews	62,600	38,239	42,009
Compliance reviews	95,000	71,100	68,657
Price adjustment reviews	5,800	18,919	40,868
Other	<u>12,900</u>	<u>28,383</u>	<u>39,834</u>
Total	<u>176,300</u>	<u>156,641</u>	<u>191,368</u>
Total audit effort	<u>4,235,600</u>	<u>4,190,118</u>	<u>4,187,740</u>
CAS as percent of total effort	4.2	3.7	4.6

As indicated in the table, DCAA anticipates spending 4.6 percent of its direct audit effort on CAS in 1976. Within the CAS effort, actual hours spent on reviews of contract price adjustments increased greatly in 1975. Another important increase is expected for 1976.

## CHAPTER 4

### IMPLEMENTATION PROBLEMS - PAST AND PRESENT

#### VIOLATIONS AND SETTLEMENTS

Questions have been raised about the many contractor violations of the cost accounting standards (CASs) requirements reported to the Board and the few cost impact proposals received and price adjustments effected. For calendar years 1973 and 1974, the defense agencies reported 882 contractor violations of standards and disclosed practices, but only 2 instances in which increased costs were recovered by the Government through contract price adjustments. The adjustments amounted to only \$17,086.

The information reported to the Board by the defense agencies has not fully reflected the efforts made to settle contractor violations or the scope of price adjustments and recoveries of contract costs. There were several reasons for this.

- First, for calendar years 1973 and 1974, the defense agencies were required only to report the number and value of equitable adjustments negotiated pursuant to contractors' applications of new standards. Reporting of increased costs recovered through resolution of noncompliances was not made a requirement until 1975.
- Second, some of the reported noncompliances have not significantly affected contract costs. In many of these cases, a cost impact proposal was not requested.
- Third, other noncompliances represent violations found in contract proposals which were resolved before contract award without submittal of a cost impact proposal, but with reductions in the proposed price when appropriate. Procurement offices have not been required to report these reductions in proposed prices as savings attributable to CAS.
- Fourth, the number of cost impact proposals will not equal the number of violations since in many cases a cost impact proposal will cover more than one violation.

To identify more fully the efforts of the Government to effect contract adjustments and recover contract costs, we surveyed the six regions of the Defense Contract Audit Agency

(DCAA). DCAA was asked to provide information on the number and magnitude of contract adjustment proposal reviews completed from January 1973 through December 1974, when seven standards were in effect. The information furnished shows that DCAA reviewed 156 proposals having estimated net costs recoverable by the Government totaling \$8.4 million. Of this total, DCAA reported that action had been taken to recover \$1.5 million, leaving \$6.9 million of estimated net costs unrecovered as of December 31, 1974. Within the unrecovered total, \$4.1 million was known to be pending action by the Government, while the status of action taken on \$2.8 million was not determined.

Further analysis of the data furnished shows that:

- Voluntary changes to accounting practices have been the largest source of cost recoveries, accounting for 38 percent of the contractor proposals and 62 percent of the estimated net amount recoverable.
- Eighty-seven percent of the proposals resolved as of December 31, 1974, entailed no change in costs.
- All 35 proposals made pursuant to applications of new standards that were resolved as of December 31, 1974, entailed no change in costs.

We also asked DCAA to furnish information about type and number of noncompliances cited in its formal audit reports issued during calendar year 1974. DCAA advised us that it reported noncompliances in 471 reports issued during that year. Table 4 classifies these noncompliances according to whether they were found during a proposal or a performance review.

Table 4  
Noncompliances with CAS cited by DCAA, Calendar Year 1974

Noncompliance cited	Noncompliances found during review of contract				Total	
	Proposal		Performance		Number	Percent
	Number	Percent	Number	Percent		
Standard 401	282	37	50	7	332	43
Standard 402	154	20	62	8	216	28
Standard 403	10	1	28	4	38	5
Standard 404	32	4	40	5	72	9
Standard 405	32	4	3	(a)	35	5
Standard 406	2	(a)	-	-	2	(a)
Standard 407	3	(a)	1	(a)	4	(a)
Disclosed or established cost accounting practice	29	4	38	5	67	9
Miscellaneous	-	-	5	(a)	5	(a)
<b>Total</b>	<b>544</b>	<b>71</b>	<b>227</b>	<b>29</b>	<b>771</b>	<b>100</b>

a/Less than 1 percent of total.

The Department of Defense (DOD), in commenting on our draft report, stated that the age of the data presented for calendar year 1973 and 1974 actions tends to dilute their importance. The data presented, however, was the most current available and was primarily intended to show that large dollar amounts are involved in these actions.

Also, most of the matters which were dealt with in our draft and which formed the basis for our conclusions and recommendations occurred in fiscal years 1975 and 1976.

DCAA has integrated its reviews of contractor compliance with CAS into its continuing audit activities. Suspected CAS violations are found principally during reviews of contractors' proposals and reviews of costs incurred during contract performance. DCAA does not usually initiate estimates of cost impact once a suspected noncompliance is discovered. It has been DCAA's position that preparing a cost impact proposal is the contractor's responsibility upon request of the cognizant administration contract officer (ACO). We agree, however, with DOD's comment that DCAA recognizes and is complying with the Armed Services Procurement Regulations (ASPR) requirement to assist the ACO in determining cost impact when the contractor refuses to do so.

The table shows that the large majority (71 percent) of the cited noncompliances were found during proposal reviews. Standard 401--Consistency in Estimating, Accumulating, and Reporting Costs--was violated most frequently (43 percent), and the single largest category (37 percent) was noncompliance with Standard 401 in contract proposals.

A violation found during a proposal review may or may not affect contracts being performed. It is the ACO's responsibility to determine whether existing contracts are affected. If the violation is restricted to a proposal for contract award, it is a potential noncompliance. The contractor may not be awarded the contract or the noncompliance may be resolved during contract negotiations, with appropriate price reductions.

The 471 audit reports encompass CAS violations of approximately 350 organizations. Of the total 771 violations cited in the 471 reports, 295 were reported as under consideration by the cognizant ACOs as of December 31, 1974. Of the remaining 476 violations, ACOs agreed with DCAA in 438 instances and disagreed in only 38.

Cost impact of noncompliances  
at contractor locations

We also reviewed 32 formal noncompliance determinations made by ACOs at two contractor locations under Air Force cognizance and five locations under the Defense Contract Administration Services (DCAS) cognizance.

Cost impact proposals were requested in connection with 31 of the noncompliances, including one potential noncompliance. In that instance, the ACO determined that the impact on the cost of the only contract affected by the noncompliance had been resolved by the procurement contracting officer (PCO) before the contract was awarded. Consequently, the ACO concluded that no contract adjustment was warranted.

Cost reductions did not result from the remaining 30 noncompliance determinations. Reasons cited for the lack of cost reductions are given below.

<u>Cognizant agency</u>	<u>Number of noncompliance determinations</u>	<u>Cost impact</u>
Air Force	26	In all cases, the ACO's noncompliance determinations included requests for cost impact proposals. However, Air Force and DCAA personnel stated that proposals were not warranted. The noncompliance issues involved a disclosed accounting practice which did not comply with a promulgated standard, and revision to the disclosure statement was sufficient to resolve the issue. In these cases the Air Force and DCAA found no significant effect on contract costs.
DCAS	1	Although a cost impact proposal was requested, it was never pursued. The ACO advised us that there was no cost impact. No documentation existed to support the ACO's opinion.
DCAS	2	The ACO requested cost impact proposals on all covered contracts. The contractor responded accordingly and stated that no adjustments

<u>Cognizant agency</u>	<u>Number of noncompliance determinations</u>	<u>Cost impact</u>
		to the contracts were warranted since the cost impacts were minor. DCAA evaluated the proposals that showed insignificant cost impact and recommended that additional data be obtained. The contractor agreed to review its proposals for possible supplementation or revision. No additional data was provided and no resubmittal was pursued because the ACO did not consider the cost impacts important.
DCAS	1	In response to a series of requests from the ACO, the contractor advised that no cost impact proposal was warranted. The contractor was asked to substantiate its position, but no detailed proposal was submitted. The contractor did submit disclosure statement revision and clarification on the noncompliance issue and a list of covered contracts. Based on a review of this data, DCAA and the DCAS price analyst were satisfied that there was no adverse impact on contract costs.

#### DELAYS IN RESOLVING CAS ISSUES

Questions have also been raised about the length of time required to settle noncompliance cases. In examining this matter, we found many CAS issues which had been outstanding for extended periods.

As of January 31, 1975, DCAS had on hand 211 audit reports. Included in these reports were approximately 280 alleged violations of the standards and disclosed practices.

Excluding 2 reports involving issues under appeal, the remaining 209 reports had been pending resolution for an average of 10 months as of January 1975. Thirty-three of the reports were pending action to correct the CAS violation or submission of a cost impact proposal. These reports had been outstanding an average of nearly 14 months.

Further, at one contractor location under Air Force cognizance, 14 issues were outstanding 18 to 20 months after the date of the audit reports. The ACO was taking 2 to 4 months to make a determination of noncompliance and the contractor was taking 2 to 3 months to respond to the ACO's determination notice.

We identified various problems which were delaying resolution of CAS matters or impeding the administrative process. Each is discussed below.

#### Lack of uniform management procedures

A Navy ACO, who had not yet made a formal determination, said his approach to securing compliance with CAS was by negotiating and cooperating with the contractor. The ACO felt that a formal determination and notice of noncompliance was a punitive act and believed it was better to work out issues informally. However, a Navy internal audit report concluded that the Navy resident staff, to secure compliance, may have had too many meetings and may not have done enough productive work.

What is the proper managerial approach to administering CAS? Should the ACO seek compliance through extensive bargaining and infrequent use of a formal noncompliance determination? Or should the determination of noncompliance be but one step in the administrative process?

Until DPC 74-5 was issued there was uncertainty about the proper sequence of administrative actions. Should cost impact be considered before or after a noncompliance determination is made? Should a change to the disclosure statement be reviewed for approval before or after the effects of the change on contract costs have been determined? At one time DCAS was instructing its personnel that a contractor should not be considered in noncompliance if the cost impact was immaterial. DPC 74-5, however, directs the ACO to make a determination before and apart from considering cost impact. At one contractor we visited, approval of changes to the disclosure statement was delayed until a detailed cost impact proposal was obtained. DPC 74-5 prescribes that disclosures of changes to accounting practices be reviewed for accuracy, currency, completeness, and compliance prior to submittal of a detailed cost impact proposal.

Efforts to formulate and prescribe uniform administrative procedures have evolved from intra-agency and inter-agency ad hoc discussions to the establishment of a formal

ASPR Subcommittee and, more recently, the establishment of two high level CAS groups within DOD.

The Subcommittee has contributed to improving CAS administration through its development and issuance of DPC 74-5. As a part-time body using lengthy rulemaking procedures, however, it may not be able to provide guidance directly to administrative field offices in a timely manner.

The establishment of a Cost Accounting Standards Steering Committee and Working Group composed of top-level DOD personnel affords the opportunity to provide guidance and to prescribe administrative procedures in a uniform and timely fashion.

We agree with the stated objectives of both DOD groups and are hopeful that the Cost Accounting Standards Working Group will have the resources for providing timely guidance directly to field offices. It is too early, however, to determine whether the Working Group, as a part-time body, will be able to meet that objective in addition to identifying CAS problems, evaluating administrative practices, and proposing revisions to procurement regulations.

Difficulties encountered in coordinating activities among the administrative contracting officers, procurement contracting officers, and auditors

CAS has had a unique effect on PCO-ACO responsibilities. Traditionally, the PCO has been responsible for receiving and reviewing contractor proposals and negotiating and awarding contracts while the ACO has been responsible for contract administration functions after contract award. This traditional distinction is modified by DOD's assigning the responsibility for securing contractor compliance with CAS to the ACO.

In its audit reports evaluating contractors' price proposals, DCAA cited outstanding CAS issues for consideration by the PCO. At one contractor residency under Navy cognizance, DCAA was following this practice although the ACO had not made any formal determinations on alleged violations. Although the audit reports did not question the proposals as a basis for contract negotiations, they asked the PCOs to identify in the negotiation memorandums those cost elements potentially subject to contract adjustments if the ACO would make a formal noncompliance determination. According to the Resident Auditor, PCOs have not been responsive to these requests.

The ACO believed DCAA's practice jeopardized the contract award process and his efforts to secure compliance through negotiations. The DCAA Resident Auditor said he felt obliged to inform PCOs of all facts affecting contract proposals and was concerned with future identification of cost impact where the universe of contracts potentially subject to adjustment is expanded by accumulation of unresolved CAS issues.

The activities of auditors, PCOs, or other administrative personnel support and supplement the ACOs' central role. Although the cognizant ACO represents all procurement agencies at a given contractor location, a contractor may have numerous locations under the cognizance of ACOs who are not necessarily employees of the same agency. Thus, coordination is required both horizontally across the procurement process and vertically within a contractor's organization if uniformity and consistency are to characterize CAS administration under the single representative concept.

DOD commented that there is currently increased communication between various field and headquarters elements on CAS matters and during joint training workshops on CAS, in addition to coordination activities of the ASPR CAS Subcommittee and the DOD Steering Committee and Working Group. DOD suggested that coordination among administrative activities has improved as a result of CAS. We agree but believe continuing efforts will be needed to maintain effective communication and cooperation between the diverse organizational elements involved.

#### Additional guidance needed for preparing and submitting cost impact proposals

Before the promulgation of DPC 74-5 a contractor was not explicitly required to submit a cost impact proposal showing the effect of a noncompliance or change to accounting practice on costs of individual contracts. Guidance was lacking regarding who was responsible for preparing estimates and what details a proposal should include. As a result, contractors were unresponsive to requests for proposals or submitted proposals which lacked supporting detail sufficient for audit evaluation.

One DCAA regional office official said that computations of cost impact can be extremely complex and time consuming when corporatewide accounting changes are made for multiplant companies involving hundreds of contracts and several different procurement agencies. In some cases acceptable proposals have been a year late, and at one

location over 2 years elapsed before the contractor submitted a proposal adequate for meaningful evaluation of changes to disclosed practices.

Although DPC 74-5 is expected to increase the number, meaningfulness, and timeliness of contractors' cost impact proposals, it does not require submittal if the contractor does not agree with the ACO's findings. In such cases, or if the contractor simply fails to submit a proposal when required, the auditor and the ACO are responsible for estimating cost impact. Moreover, DPC 74-5 does not prescribe techniques for estimating cost impact. Thus, some uncertainty still exists over how to measure increased cost.

#### Failure to follow Board's baseline for estimating cost impact

The magnitude of cost impact may vary depending on the baseline selected for estimating purposes. At one location the contractor used original contract estimates as the baseline in its impact proposals. At another location, however, the ACO requested that the contractor use incurred cost data available at the time the cost impact proposal was prepared. Both cost impact proposals involved fixed-priced contracts.

The Board's regulations are clear on this point and state in section 331.70(b) that, if during performance of any fixed-price contract the contractor fails to follow its disclosed practices or to comply with applicable CASS, any increased cost to the Government by reason of that failure must be measured by the differences between the cost estimates used in negotiations and the cost estimates that would have been used had the contractor proposed on the basis of the practices actually used during contract performance.

#### Difficulties in identifying the universe of covered contracts

At some offices we visited, DCAA had a time-consuming task of verifying whether all contracts in a cost impact proposal were subject to CAS. DCAA could not be certain whether any covered contracts had been excluded from the particular contractor listing. Some contracts containing the CAS clause, such as firm, fixed-price, competitively negotiated contracts not subjected to preaward audit, may or may not have been listed. Where many contracts are involved, the timely processing of a cost impact CAS action generally depends upon the existence of a record showing all covered contracts. This record could be maintained

by the ACO. We found no evidence, however, that this control existed to any substantial degree.

DOD commented that DCAA and DCAS have issued guidelines relative to the identification of covered contracts. The guidance was issued as a result of our preliminary findings and discussions with DCAA. The Army, Navy, and Air Force, however, have not yet issued similar guidance to their ACOs.

#### Definition of a cost accounting practice needed

At one contractor location over a year was spent resolving an alleged CAS violation while the Government and contractor debated these two questions: What constitutes a change to a cost accounting practice and to what degree should practices be disclosed?

DCAA suggested in its annual reports to the Board for both 1973 and 1974 that the Board address these questions. Moreover, presentations by industry representatives at the June 1975 Evaluation Conference on Promulgated Standards and Regulations support the need for a definition of a cost accounting practice.

Unless a cost accounting practice is defined, knowing when one has been changed can be difficult. The text of Public Law 91-379 appears to use the terms cost accounting "principles" and "practices" interchangeably.

After considering the annual reports by Federal agencies and the oral and written comments made by representatives of defense-industry and professional associations at the evaluation conference, the Board in July 1975 approved several high-priority projects. One of these projects, to define the meaning of cost accounting practice as used in the Board's regulations, is expected to be put into regulation form by January 1977.

## CHAPTER 5

### CONCLUSIONS, RECOMMENDATIONS, AND AGENCY COMMENTS

#### AND OUR EVALUATION

##### CONCLUSIONS

Promulgations issued by the Cost Accounting Standards Board have profoundly affected defense contractors and procurement offices. The Board and Department of Defense (DOD) should be commended for their efforts to implement this highly complex program.

During the six years since enactment of Public Law 91-379, many problems have been encountered, especially by DOD in effectively administering the standards, rules, and regulations promulgated. DOD has had to instruct and train hundreds of contract administrators and auditors relative to cost accounting standards (CASS) requirements, establish an organization for addressing and solving problems encountered in applying and interpreting the standards, and gain the cooperation of hundreds of contractors. All of this has been accomplished with a high degree of skill and effectiveness and a minimum of disruption to other programs.

A major area of concern has been the timely resolution of contractor violations of CASS, rules, and regulations. The specific problems which have adversely affected resolution of reported violations, along with solutions implemented or proposed, included:

- Uncertainty over the definition of a cost accounting practice. The Board expects to remove this uncertainty by issuing a formal definition.
- The lack of uniform management procedures. DOD has made an effort to solve this problem by establishing an orderly sequence of administrative steps for resolving noncompliance issues.
- The lack of a specific requirement for submitting cost impact proposals showing the estimated monetary damage resulting from contractors' failure to follow CASS or their disclosed or established cost accounting practices and the lack of guidance on the content and format of such proposals. Revisions to regulations have clarified the requirement for submitting cost impact statements. However, there is still uncertainty concerning how to measure increased cost.

- Difficulties encountered in coordinating activities among the administrative contracting officers, the procurement contracting officers, and the auditors. Although efforts to solve these difficulties have been noted, continued attention will be required.
- Difficulty in identifying all contracts subject to CASS which are involved in a cost impact proposal. DOD has taken action to improve the identification process but GAO believes more is needed.
- Failure to follow the Board's baseline for estimating cost impact resulting from changes to cost accounting practices or noncompliances with CASS requirements under fixed-priced contracts.

#### RECOMMENDATIONS

We recommend that the Secretary of Defense direct the Cost Accounting Standards Steering Committee and Working Group to formulate uniform procedures and requirements relative to identifying the universe of covered contracts affected by a cost impact proposal; preparing cost impact proposals, including the extent of supporting data required; and measuring increased cost.

We also recommend that the Secretary reemphasize to all offices involved in the administration of CASS the need for (1) effective coordination and (2) adherence to the Board's baseline for estimating cost impact. Where the Department considers it impracticable to use the Board's baseline, the Secretary should propose to the Board an alternative.

#### AGENCY COMMENTS AND OUR EVALUATION

A copy of our draft report was furnished to the Cost Accounting Standards Board. Although written comments were not provided, we discussed our findings, conclusions, and recommendations with the Board members at a meeting on April 1, 1976. Oral comments made by the Board members were favorable.

DOD commented on our draft report by letter dated May 19, 1976. (See app. I.) DOD's reply indicates that it believes its implementation of CASS has been more effective than portrayed by our draft report. In particular, DOD commented that the age of the data presented tends to dilute its importance and that revisions made to the draft report, after holding discussions with the Cost Accounting Standards Board staff, diminished the report's objectivity.

As to the age of the data, the events discussed in the report that provide the basis for our conclusions and recommendations generally occurred in fiscal years 1975 and 1976. Although the statistical data presented generally covered calendar years 1973 and 1974, it was the most current data available to us.

We revised the draft report as a result of suggestions received from the Board's staff. Chapters 4 and 5 were reorganized to provide a better understanding of the material presented. In addition, as discussed on page 32 of the DOD's reply, we deleted a section entitled "Meaning of increased costs and application of offsets," along with a corresponding recommendation. After discussing this matter with the Board's staff and reevaluating the data gathered, we concluded that our findings were of an isolated nature and, accordingly, did not warrant reporting. The handling of this matter conforms to our general policy of giving full consideration to all comments received on our work and making whatever changes we believe are justified. Other comments relating to revisions to the draft report and individual cases are discussed in the body of the report.

In commenting on our recommendation that the Cost Accounting Standards Steering Committee and the Working Group formulate uniform procedures and requirements for identifying the universe of covered contracts affected by a cost impact proposal, DOD stated that the Defense Contract Administration Services has established necessary records and the Office of the Secretary of Defense will determine whether the military services should also require contracting officers to maintain such records or whether contractors' records are adequate.

Although we believe the action taken and proposed will assist in the identification process, there will still be inconsistencies in the records and data generated and in their use. Also, we were recently advised that there is still a problem in identifying covered subcontracts. Accordingly, we suggest that the Secretary reconsider our recommendation for the development of a uniform solution by the Cost Accounting Standards Steering Committee.

DOD did generally agree with our recommendation for developing uniform procedures and requirements relating to preparing cost impact proposals. DOD stated that it recognized additional guidance may be needed and that this matter will be reviewed.

In regard to our recommendation for uniform guidance for the measurement of increased cost, we believe DOD misinterpreted our intent. DOD indicated that sufficient guidance already existed. This position appears to apply only to the baseline used to measure increased cost. However, our recommendation was directed toward the need for developing specific techniques and methods for identifying cost impact that could be applied on a uniform and consistent basis, regardless of who is charged with the responsibility for developing the estimates and negotiating an equitable settlement. Accordingly, we suggest that the Secretary reconsider this recommendation.

We recommend that the Secretary reemphasize to all offices involved in the administration of CASs the need for effective coordination. DOD commented that it did not believe the factual data presented in the report supported this recommendation. DOD also believes effective coordination exists and that it will insure that it continues. As discussed on pages 21 and 22, we believe there is still a need for improving the coordination and cooperation of the administrative contracting officers, the procurement contracting officers, and the auditors. We doubt, however, that sufficient improvement will take place until the importance of coordination is stressed by top management.

DOD also disagreed with our recommendation for reemphasized adherence to the baseline established by the Board for estimating cost impact.

DOD stated that the baseline established by the Board applies only to cases in which a contractor fails to comply with disclosed practices or CASs under firm fixed-price contracts. We agree that the regulation specifically covers noncompliance actions relating to fixed-price contracts and have clarified the point on page 23. However, the Board's staff has stated that the Board's statement published in 4 CFR 331.70 makes it clear that current estimates of costs to complete may not be used to determine the cost impact of voluntary changes in fixed-price contracts. We agree with this position.

DOD commented that it was instructing its students in CASs training courses to use current cost data to determine cost impact wherever possible rather than original cost estimates. If applied to noncompliance actions relating to fixed-price contracts, this practice would be contrary to the Board's rules and regulations which have the full force and effect of law.

CHAPTER 6

SCOPE OF REVIEW

7 We visited Defense Contract Administration Services (DCAS) <sup>1384</sup>  
and the Defense Contract Audit Agency (DCAA) field and head- <sup>473</sup>  
quarters offices and 10 contractor locations performing na-  
tional defense contracts. One of the 10 contractor loca-  
tions was under the contract administration cognizance of  
a Naval Plant Representative Office, two were under Air Force  
Plant Representative Offices, and seven were under DCAS'  
district offices. DCAA had audit responsibility for all 10  
contractor locations.

We analyzed the responses to data questionnaires sent  
to the six regional DCAA offices. We spoke with staff mem-  
bers of the Cost Accounting Standards Board and officials  
of the Department of Defense, Energy Research and Develop-  
ment Administration, and National Aeronautics and Space  
Administration. We also reviewed the Board's rules and  
regulations, procurement regulations, and related documents  
and records.

9 - 35  
13 - 1



**ASSISTANT SECRETARY OF DEFENSE**  
**WASHINGTON, D.C. 20301**

INSTALLATIONS AND LOGISTICS

19 MAY 1976

Mr. R. W. Gutmann  
 Director, Procurement and  
 Systems Acquisition Division  
 General Accounting Office  
 Washington, D.C. 20548

Dear Mr. Gutmann:

We have reviewed your draft report titled, Cost Accounting Standards - Problems Involved in Implementing and Administering the Program (B-39995), OSD Case 4292. We have also reviewed the revised Chapters 4 through 6 which were received somewhat later.

The GAO draft report is based on field visits in fiscal year 1975 and various requests for data during and subsequent to that period. Although the report contains references to events which occurred in 1975 and 1976, it is important to note that data related to noncompliance issues and cost impact proposals represent CY 1973 and 1974 actions. The age of the data tends to dilute its significance.

The findings of the GAO review were first presented in a preliminary discussion paper sent to the CAS Board for comments on 16 July 1975. The formal draft was distributed on 26 February 1976. After a meeting with the CAS Board staff, the GAO distributed revised Chapters 4 through 6 and Appendix I of the draft. The revisions deleted recommendations to the CAS Board and give added emphasis to criticism of DoD, particularly regarding coordination of CAS activity with appropriate DoD components and measurement of cost impact for CAS price adjustments. As a result, we believe the final report has lost the objectivity that was contained in the 26 February 1976 draft report.

Our comments on the report (attached) follow in the same order as the items appear in the report.

Sincerely,

**JOHN J. BENNETT**  
 Principal Deputy Assistant Secretary of Defense  
 (Installations and Logistics)



Attachment  
 a/s

DoD Comments on GAO Draft Report - Cost Accounting Standards -  
Problems Involved in Implementing and Administering the Program  
(B-39995)

[See GAO note 1, p. 36.]

[See GAO note 2, p. 36.]

COMMENT 2: Page 16 includes the statement, "It has been DCAA's position that preparation of a cost impact proposal is the contractor's responsibility upon request of the cognizant ACO." The statement is correct. However, DCAA recognizes and is complying with the ASPR requirement to assist the ACO in determining the cost impact should the contractor refuse to submit a price adjustment proposal.

COMMENT 3: In the discussion of reasons for delays in resolving CAS issues, one caption called "Coordination Among Administrative Activities" was changed to "Ineffective Coordination Among Administrative Activities." The caption is not descriptive of the content of the section, which was not changed in the revision, and does not support the allegation. The first and last paragraphs in the section merely describe the central role of the ACO in CAS administration. The middle two paragraphs describe an instance where an ACO takes exception to the DCAA policy of advising PCOs of reported noncompliances that relate to a particular procurement action. In such cases, auditors request the PCO to identify in the negotiation memorandum the adjustment, if any, made in the negotiated price to reflect the impact of the noncompliance practice. The illustration has no bearing upon coordination. Resolution of the CAS issue is not delayed because of either the auditor's reporting policy or an ACO's disagreement with that policy.

If coordination is to be criticized, as the addition of "ineffective" to the caption implies, at least some comment seems appropriate regarding the CAS networks established by DCAA, DCAS, and Military Services; the increased communication between various field and headquarters elements on CAS matters; the joint training workshops on CAS; and the coordination activities of the ASPR CAS Subcommittee and the DoD Steering Committee and Working Group. Given proper perspective, a more likely finding is that coordination among administrative activities has improved as a result of CAS.

COMMENT 4: Your original report draft section entitled "Meaning of Increased Cost and Application of Offsets" explained that there are differing opinions regarding the meaning of "increased cost" and the application of offsets. Your report cited one question which we believe requires clarification. This is the question of whether the Board's definition of increased cost of firm fixed-price contracts, within the context of noncompliance, also applies within the context of changes to accounting practices. Our discussions with CAS Board staff personnel indicate they believe the definition applies to all situations. We have been following that concept, but find considerable opposition from contractors because the definition provided in 4 CFR 331.70 relates particularly to a noncompliance situation.

Other questions raised in this section of your original draft could also be resolved by the CAS Board, but it may not be essential for the Board to do so. We are addressing these problems within the DoD and will provide our own interpretations and guidance to our field personnel where necessary.

COMMENT 5: The section of the original draft report entitled "Definition of the Baseline for Estimating Cost Impact" was renamed "Failure to Follow Board's Baseline for Estimating Cost Impact." We believe the revised caption is misleading and the discussion in the revised section is based on a false premise.

Your report explains that the magnitude of cost impact may vary depending on the baseline selected for estimating purposes. You indicate observations of the uses of original cost estimates at one location and incurred cost data at another location. Your conclusion that there has been a failure to follow the Board's baseline for estimating cost impact is based upon a conclusion that "the board's regulations are clear on this point." We disagree with both of these conclusions.

The Board's regulations address the subject of "increased costs" and impact measurement only in Section 331.70. This section contains guidance that relates only to the baseline to be used for estimating cost impact of noncompliances. It clearly references paragraph (a)(5) of the contract clause, which deals with noncompliance price adjustments, and discusses increased cost measurement applicable "if the contractor fails during contract performance to follow his disclosed practices or to comply with applicable Cost Accounting Standards."

Your report says that the Board's regulations "state in Section 331.70(b) that if during contract performance, the contractor fails to follow its disclosed practices or to comply with applicable cost accounting standards,

any increased cost to the Government by reason of that failure must be measured by the difference between the cost estimates used in negotiations and the cost estimates that would have been used had the contractor proposed on the basis of the practices actually used during contract performance." This is held out as the Board's baseline for estimating cost impact for all situations. It is inconsistent not only with the generally accepted method of computing the impact of contract changes, as illustrated in Armed Services Pricing Manual No. 1, but also with other provisions in Section 331.70(b). That paragraph of the Board's regulations begins "In negotiated firm fixed-price type contracts, however, 'increased costs' cannot be interpreted in terms of a higher level of costs reimbursed during contract performance, since in such contracts the price to be paid would normally be the price agreed to." Following this is the statement quoted in your report. A careful reading of Sections 331.70(a) and (b) supports the position that a higher level of costs reimbursed during contract performance may be used to measure "increased costs" on other than firm fixed-price contracts. In other words, the baseline described in the GAO report would not be applicable to noncompliance price adjustments on cost reimbursement contracts.

In the absence of Board pronouncement to the contrary, usual procedures for pricing contract changes should be followed for mandatory and negotiated changes. Both entail revision of the Disclosure Statement prior to the effective date of the change. Both are prospective in nature accomplished with the interests of the Government in mind. The baseline for estimating cost impact in both should be the current estimate of costs to complete from the date of the change to the completion of the contract. This baseline eliminates extrinsic matters from the determination of the impact of the accounting change upon contract costs. The only difference between the mandatory and negotiated changes is the Board's regulation that negotiated changes may not result in a net increase in costs paid by the Government.

Further than this, the CAS Working Group has made a preliminary review of the use of original estimates to determine the cost impact of noncompliances on firm fixed price contracts and is of the opinion that in these cases also the current estimate of cost to complete should be the baseline used whenever practicable. Otherwise the contractor and contracting officer will be required to start from an original contract price for which there was no initial agreement on cost elements and track through any price adjustments due to contract modifications, to eventually negotiate a figure for the cost impact. This will tend to protract negotiations and requires the parties to deal with cost data of questionable validity. The use of current data, on the other hand, would greatly facilitate negotiations and permit use of the most valid data available. We recognize that this may require revision of the present CAS regulations and DoD will request such a change if such action is considered to be appropriate.

COMMENT 6: Your report comments on the difficulties in identifying the universe of covered contracts. It should be noted that DCAA issued guidance to its auditors on 1 July 1975 to obtain the ACO's confirmation of the accuracy of the list of CAS-covered contracts submitted by the contractor with its cost impact proposal. DCAS has since issued guidance to its ACOs to confirm the contractors' lists and advise the DCAA auditors.

In addition to the foregoing comments the following additional responses are provided with respect to the specific issues and problems, and to the recommendations, all of which appear on page 28 of the revised draft report.

#### Issues and Problems

Issue: "Uncertainty over the definition of Cost Accounting practice. The Board expects to solve this problem by issuing a formal definition."

The ASPR Committee has been concerned about the need for definitions of "Cost Accounting Practice" and "Cost Accounting Change." Preliminary work has been done on developing DoD definitions and publishing these definitions in the ASPR. However, such action would not be taken unless the CAS Board's definitions are expected to be delayed for an extended time period.

Issue: "The lack of uniform management procedures. The Defense Department has made an effort to solve this problem by the establishment of an orderly sequence of administrative steps for the resolution of noncompliance issues."

As indicated in the GAO report, the DoD has published guidance (DPC 74-5) which has effectively eliminated doubts concerning the actions required to process noncompliance and other CAS type issues.

Issue: "The lack of a specific requirement for submission of cost impact proposal and the lack of guidance on the content and format of such proposals. Revisions to regulations have clarified only the requirement for submitting cost impact statements. There is still uncertainty over how to measure increased cost."

We concur with the GAO observation that revised regulations, i. e., those contained in DPC 74-5, embodied a specific requirement for contractors to submit cost impact proposals. With respect to the measurement of increased

cost we are presently teaching students in the CAS training course at the Army Logistics Management Center to use current cost data rather than original cost estimates wherever possible (see our discussion under Comment 5). We plan to promulgate written guidance on this in the near future.

Issue: "Ineffective coordination of activities among ACOs, PCOs, and auditors."

We do not believe that this conclusion is supported by the findings in the report. It is observed that the report cites only one isolated instance of "ineffective coordination" at a Navy residency. Yet it attempts to base general conclusions concerning all PCO-ACO-Auditor relationships on what appears to be a sample of one.

Our preceding Comment 3 discusses this issue more fully.

Issue: "Difficulty in the identification of all contracts subject to CAS which are involved in a cost impact proposal."

Issue: "Failure to follow the Board's baseline for estimating cost impact."

The above two issues are discussed in Comments 6 and 5, respectively.

Our position on the recommendations in the report are generally included in the preceding comments but they are summarized below for convenience.

Recommendation: The CAS Steering Committee and Working Group should be directed to formulate uniform procedures and requirements relative to:

- "identifying the universe of covered contracts affected by a cost impact proposal,"

#### DoD Position

DCAS has established such identifying records. OSD will determine whether the Military Services should also require ACOs to maintain such records or whether contractors' records are adequate.

- "preparing cost impact proposals, including the extent of supporting data required,

#### DoD Position

DPC 74-5 establishes the requirement for impact proposals and the minimum requirements as to content. We concur that additional guidance may be

needed as to the extent of supporting data. We will review this area and determine what guidance is needed.

- "measuring increased cost."

DoD Position

We conclude that current data for cost to complete should be the normal method for measuring increased cost. The use of original negotiation estimates should only be used as a last resort.

Recommendation

"We also recommend that the Secretary of Defense reemphasize to all offices involved in the administration of cost accounting standards the need for (1) effective coordination and (2) adherence to the Board's baseline for estimating cost impact."

DoD Position

We believe effective coordination now does exist and we shall ensure that it continues. We do not consider that the CAS Board has established a baseline for estimating cost impact except where firm fixed price contracts are involved in noncompliances. We do not consider this baseline to be the best alternative and are considering preparation of a new recommendation to the CAS Board for a change to permit use of current cost data.

- GAO note:
1. This was deleted since it pertains to a minor point which was excluded from this report.
  2. Page references in this appendix refer to the draft report and do not necessarily agree with the page numbers in final report.

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ADMINISTERING ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF DEFENSE:		
Donald H. Rumsfeld	Nov. 1975	Present
James R. Schlesinger	July 1973	Nov. 1975
William P. Clements, Jr. (acting)	May 1973	June 1973
Elliot L. Richardson	Jan. 1973	Apr. 1973
Melvin R. Laird	Jan. 1969	Jan. 1973
CHAIRMAN OF THE COST ACCOUNTING STANDARDS BOARD:		
Elmer B. Staats	Aug. 1970	Present
BOARD MEMBERS:		
Herman W. Bevis	Feb. 1971	Present
Robert K. Mautz	Feb. 1971	Present
Robert C. Moot	Feb. 1971	Feb. 1975
Charles A. Dana	Feb. 1971	Feb. 1975
Terence E. McClary	Mar. 1975	Present
John M. Walker	Mar. 1975	Present
EXECUTIVE SECRETARY OF THE COST ACCOUNTING STANDARDS BOARD:		
Arthur Schoenhaut	Mar. 1971	Present

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