

# 14. COST ACCOUNTING STANDARDS

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## 14.1 INTRODUCTION

The Cost Account Standards (CAS) were implemented in order to instill consistency in accounting practices of contractors performing government contracts. Acquisition personnel must be familiar with the standards not only in order to understand Defense Contract Audit Agency (DCAA) reports regarding CAS findings but also how they may affect their contracts. This chapter will familiarize the reader with CAS. Background information may be found at 48 CFR 9903 and the specific standards at 48 CFR 9904. An online site for this information is <http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/FARapndx1.htm>.

This chapter will provide a greater understanding of these Cost Accounting Standards by covering the following topics:

- Background & history,
- CAS versus cost principles,
- Applicability,
- Types of coverage,
- Disclosure statements,
- Administration, and
- Implementation.

## 14.2 BACKGROUND & HISTORY

### 14.2.1 General

CAS result from concerns over the pricing and accounting practices of government contractors. There was no consistency within and between contractors' cost accounting practices, making it difficult to conduct standard audits. In 1968, Congress asked the General Accounting Office (GAO) to study the feasibility of establishing and applying CAS to provide greater uniformity in cost accounting as a basis for negotiating and administering procurement contracts. Congress subsequently established the Cost Accounting Standards Board (CASB), which in turn instituted the CAS.

CAS was designed to achieve uniformity and consistency in the measurement, assignment, and allocation of costs to Government contracts. The standards were based on examinations of common cost accounting practices throughout the industry. Advice and comments were sought from Government agencies, industry, and professional accounting associations. CAS does not provide rigid, inflexible procedures. In fact, most standards provide numerous options in accounting techniques. CAS does establish limits and constraints

on what is considered appropriate, allowing the CAS to meet the goal of providing consistency and uniformity in cost accounting. Listed below are the standard definitions of the three areas of Cost Accounting.

**The Three Areas of Cost Accounting (48 CFR 9903.302-1)**

**Measurement of cost** involves the methods and techniques used in defining the components of cost, determining the basis of cost measurement, and establishing criteria for use of alternative cost measurement techniques. Examples of cost measurement are listed below:

- The use of historical cost, market value, or present value;
- The use of standard or actual cost; or
- The designation of items of cost which must be included or excluded from tangible assets or pension cost.

**Assignment of cost to cost accounting period** refers to the method used in determining the amount of cost to be assigned to individual cost accounting periods. Examples are the requirements for use of accrual basis or cash basis accounting.

**Allocation of cost to cost objectives** refers to the method of determining direct and indirect allocation of cost. Examples of allocation issues are listed below:

- The accumulation of costs;
- The determination of whether to charge costs direct or indirect; or
- The determination of the composition of cost pools and their allocation bases.

### 14.3 SUMMARY OF THE COST ACCOUNTING STANDARDS

Table 14-1 lists the 19 CAS. The asterisks (\*) denote the standards that apply when a contractor is subject to modified coverage only (discussed in section 14.6).

**Table 14-1 Cost Accounting Standards**

#	Title
401*	Consistency in Estimating, Accumulating, and Reporting Costs
402*	Consistency in Allocating Costs Incurred for the Same Purpose
403	Allocation of Home Office Expenses to Segments
404	Capitalization of Tangible Assets
405*	Accounting for Unallowable Costs
406*	Cost Accounting Period
407	Use of Standard Costs for Direct Material and Direct Labor
408	Accounting for Costs of Compensated Personal Absence
409	Depreciation of Tangible Capital Assets
410	Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives
411	Accounting for Acquisition Costs of Material
412	Composition and Measurement of Pension Cost
413	Adjustment and Allocation of Pension Cost
414	Cost of Money as an Element of the Cost of Facilities Capital
415	Accounting for the Cost of Deferred Compensation
416	Accounting for Insurance Costs
417	Cost of Money as an Element of the Cost of Capital Assets under Construction
418	Allocation of Direct and Indirect Costs
419	<i>Reserved</i>
420	Accounting for Independent Research and Development and Bid and Proposal Costs

### 14.4 COST ACCOUNTING STANDARDS VERSUS COST PRINCIPLES

CAS and cost principles are not one and the same. As previously mentioned, CAS addresses cost accounting--the measurement, assignment, and allocation of costs to Government contracts. The cost principles address cost allowability. Cost allowability is a procurement matter and is a function of law, regulation, or individual contracts. Costs may be allocable but unallowable.

Some of the cost principles have directly incorporated certain cost accounting standards. If costs related to these principles are not accounted for in accordance with CAS, then the cost is unallowable. Table 14-2 shows the link between certain principles and CAS.



Table 14-2. CAS Versus Cost Principles

Cost Principle	CAS		
Consistency (general principle)	401	402	
Accounting for Unallowable Costs (general principle)	405		
Cost Accounting Period (general principle)	406		
Compensation for Personal Services	412	413	415
Cost of Money	414	417	
Depreciation	409		
Independent Research & Development and Bid & Proposal costs	420		
Insurance & Indemnification	416		

## 14.5 APPLICABILITY

All contractors and subcontractors must use Cost Accounting Standards (CAS) according to 48 CFR Part 99 for estimating, accumulating, and reporting costs in connection with pricing, administering, and settling disputes concerning all negotiated prime and subcontract procurements over \$700,000, except for contracts or subcontracts exempted by these regulations. The following categories of contracts and subcontracts are exempt from all CAS requirements:

- Negotiated contracts and subcontracts of \$700,000 or less. For purposes of this paragraph, an order issued by one segment to another segment must be treated as a subcontract;
- Contracts and subcontracts with small businesses;
- Contracts and subcontracts with foreign governments or their agents or instrumentalities or (insofar as the requirements of CAS other than 9904.401 and 99.402 are concerned) any contract or subcontract awarded to a foreign concern;
- Contracts and subcontracts in which the price is set by law or regulation;
- Firm fixed-priced and fixed-price with economic price adjustment (provided that price adjustment is not based on actual costs incurred), time-and-materials and labor-hour contracts and subcontracts for acquisition of commercial items;
- Contracts or subcontracts of less than \$7.5 million, provided that, at the time of award, the business unit of the contractor or subcontractor is not currently performing any CAS-covered contracts or subcontracts valued at \$7.5 million or greater;
- Contracts and subcontracts to be executed and performed entirely outside the United States, its territories, and possessions; and
- Firm fixed-price contracts or subcontracts awarded on the basis of

adequate price competition without submission of cost or pricing data.

If a contract requires the prime contractor to follow CAS, the CAS requirement must be passed down to its subcontractors, unless they meet one of the listed exemptions. Vice versa, if a prime contractor need not follow CAS, neither do its subcontractors.

The applicability to contract modifications is similar. If CAS applies to the initial contract, it also applies to contract modifications. Vice versa, if the initial award is not covered, neither are contract modifications.

## 14.6 TYPES OF COVERAGE

One of two types of coverage may apply: full or modified. Full coverage requires compliance with the entire set of standards in effect on the date of contract award. Modified coverage requires compliance with only four of the nineteen standards--401, 402, 405, and 406. The criteria for determining the appropriate coverage is as follows: (48 CFR 9903.201-2)

### 1. **Full coverage** applies when a contractor business unit:

- Receives a single CAS-covered contract of \$50 million; or
- Received \$50 million or more in net CAS-covered awards during its preceding cost accounting period.

2. **Modified coverage** applies to a covered contract of less than \$50 million awarded to a business unit that received less than \$50 million in net CAS-covered awards in the immediately preceding cost accounting period.

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

**Business unit** is any segment of an organization or an entire business organization which is not divided into segments. (48 CFR 9904.410-30)

**Segment** is one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. (48 CFR 9904.410-30)

**Net awards** means the total value of negotiated CAS-covered prime contract and subcontract awards, including potential value of contract options received during the reporting period minus cancellations, terminations, and other related credit transactions. (48 CFR 9903.301)

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

## 14.7 DISCLOSURE STATEMENTS

"A Disclosure Statement is a written description of a contractor's cost accounting practices and procedures." [48 CFR 9903.202-1(a)]. It is used as a means to measure the consistency and compliance of a contractor's day-to-day cost accounting with applicable CAS. Table 14-3 summarizes the type of information found in Disclosure Statements (Form CASB DS-1).

**Table 14-3. Information Contained in Disclosure Statement**

Part	Category	Type of Information
0	Cover Sheet and Certification	<ul style="list-style-type: none"> <li>• Company address and contact name.</li> <li>• Certification of statement accuracy.</li> </ul>
I	General Information	<ul style="list-style-type: none"> <li>• Sales and industry data.</li> <li>• Description of cost accounting system.</li> <li>• Integration of cost accounting system with financial accounting system.</li> <li>• Capability of producing unit or job costs.</li> <li>• Fiscal year.</li> </ul>
II	Direct Costs	<ul style="list-style-type: none"> <li>• Method of charging direct materials.</li> <li>• Method of charging direct labor.</li> <li>• As applicable, method of direct material and labor standard costing and variance disposition.</li> <li>• Treatment of interorganizational transfers.</li> </ul>
III	Direct versus Indirect	<ul style="list-style-type: none"> <li>• Criteria for determining how costs are charged or allocated to cost objectives.</li> <li>• Treatment of specific transactions involving direct labor, direct material, and miscellaneous costs.</li> </ul>
IV	Indirect Costs	<ul style="list-style-type: none"> <li>• The number and types of indirect cost pools to include general and administrative (G&amp;A), the composition of cost pools, and the allocation base.</li> <li>• Number of and how service center costs are allocated to expense pools.</li> <li>• Method of charging costs to direct and indirect objectives; composition of allocation base.</li> <li>• Allocation of IR&amp;D/B&amp;P to cost objectives.</li> </ul>
V	Depreciation and Capitalization Practices	<ul style="list-style-type: none"> <li>• Method of depreciation.</li> <li>• Method of determining useful lives and residual value.</li> <li>• Comparison to methods used for tax and financial purposes.</li> <li>• Criteria for capitalization.</li> <li>• Treatment of costs incurred in procurement of assets.</li> </ul>
VI	Other Costs and Credits	<ul style="list-style-type: none"> <li>• Method of charging and crediting compensated personal absence.</li> <li>• Treatment of severance payments and supplemental unemployment.</li> </ul>
VII	Deferred Compensation and Insurance Cost	<ul style="list-style-type: none"> <li>• Listing and description of the contribution basis of the three pension plans which cover the greatest number of employees.</li> <li>• Listing and description of the contribution basis of the three deferred compensation plans which cover the greatest number of employees.</li> <li>• Description of purchased insurance and treatment of self-insurance programs.</li> </ul>
VIII	Home Office Expenses	<ul style="list-style-type: none"> <li>• Description of home office expense pools and method of allocation.</li> <li>• Description of home office expenses.</li> <li>• Sales information.</li> </ul>



### 14.7.1 FAA Submittal Requirements

Per FAA's AMS clause 3.2.3-1 "Cost Accounting Standards -Notices and Certification" (October 2011), Disclosure Statements are required as per CAS rules (<https://conwrite.faa.gov/CWClauseList.cfm?Show=Num,Title,Text,Pers,UCF,IBR&CatNum=3.2.3>).

Case Study 14-1 provides an example of the deadlines related to disclosure statement submission.

#### CASE STUDY 14-1. WHEN TO SUBMIT A DISCLOSURE STATEMENT

##### Background:

- Suppose in January 2012 ABC Company submits a proposal, valued at \$750,000 regarding the FAA's new, advanced, do-everything radar (ADDER).
- In its most recent completed cost accounting period, Contractor Fiscal Year (CFY) 2011, (ABC's fiscal year is the same as the calendar year), ABC accumulated \$50 million of net awards.

##### Conclusions:

The ABC Company is not required to submit a Disclosure Statement until the end of the first 90 days of 2012, approximately the end of March. If the FAA makes the award before March, ABC is still not required to submit the statement until the end of the 90-day period. Conversely, if the FAA awards the contract after March, ABC must submit the statement to the FAA or its cognizant ACO before the award of the first CAS-covered contract, regardless of whether or not the ADDER award has been made.

Business units subject to modified coverage do not normally submit Disclosure Statements. The exception to the rule is if the unit is a contributing segment. Each segment of a business unit with costs of over \$700,000 included in the price or estimated cost must submit their own Disclosure Statement unless the contract falls under one of the stated exemptions listed. A segment may also be exempt from submission if the segment's CAS-covered awards in the previous cost accounting period were less than \$10 million and less than 30 percent of the total sales for that segment. Case Study 14-2 provides an example of when a business unit must submit its own disclosure statement.



### CASE STUDY 14-2. WHEN A BUSINESS UNIT MUST SUBMIT A DISCLOSURE STATEMENT

**Background:**

- Suppose the ABC Company in the previous example represented an interorganizational transfer in a larger proposal submitted by WeR'Big, Inc.
- The value of the transfer is \$710,000 and the value of the proposal is \$51 million.

**Conclusions:**

ABC Company must submit a Disclosure Statement unless it is specifically exempted or the value of covered contracts awarded in the previous cost accounting period, the year 2011, was less than 30 percent of total sales and less than \$10 million.

**NOTE:**

In order to qualify for the disclosure exemption, a contributing segment must meet both tests, percent sales and dollar threshold, unless a specific exemption listed would otherwise apply.

All home or group offices that allocate costs to segments performing CAS-covered contracts must submit Part VIII of the Disclosure Statement.

#### 14.7.2 Adequacy versus Compliance

A disclosure statement must be both adequate and compliant. It must adequately describe the contractor's cost accounting practices, and the cost accounting practices, in turn, must comply with CAS.

The contract auditor is responsible for conducting the adequacy and compliance reviews. Under the adequacy review, the audit focuses on whether the disclosure statement is current, accurate, and complete. The auditor reports the results of the review to the cognizant administrating contracting officer (ACO) who then issues a determination on adequacy. The cognizant ACO is often but not always an employee of DOD's Defense Contract Management Agency (DCMA). The individual will represent the agency with whom the contractor does the most business. If inadequate, the contractor must submit a revised statement. The FAA should not award a contract unless a Disclosure Statement is deemed adequate by the cognizant ACO, although the CO may waive the requirement for adequacy if it is in the best interest of the FAA and/or the Government as a whole.

Once the ACO determines the statement to be adequate, the contract auditor conducts a review to check if disclosed cost accounting practices comply with CAS and cost principles. The auditor also reports the results of this review to the cognizant ACO who then makes a determination on compliance. CAS compliance issues are addressed by the cognizant ACO.

### 14.7.3 Miscellaneous Disclosure Statement Issues

If the contractor notifies the CO that the disclosure statement contains privileged and confidential information, such as trade secrets and commercial or financial information, the FAA cannot release the statement outside the Government (48 CFR 9903.202-4).

Disclosure statement requirements apply in equal force to subcontractors as well as prime contractors. Although the prime or higher tier subcontractor is responsible for CAS administration of their subcontractors, the subcontractor may submit the statement directly to its cognizant ACO if the statement contains confidential or privileged information. (Pre-award determination of adequacy is not required.)

## 14.8 COST ACCOUNTING STANDARDS ADMINISTRATION

Administration of CAS can be time consuming when the contractor is found noncompliant, the contractor wants to make a change, or the standards themselves are changed. This section will discuss price adjustments necessary to effect accounting changes. It will also further address the topic of who is responsible for CAS administration.

### 14.8.1 Price Adjustments

There are three situations that may require price adjustments:

- New or revised CAS requiring cost accounting practice changes;
- Voluntary changes to cost accounting practices; and
- Noncompliance with CAS/failure to follow disclosed practices. The actions taken for each of these are similar, but sufficiently different to merit individual discussion.

**Change in cost accounting practice** is any alteration in a disclosed or established accounting method or technique which is used for allocation of costs to cost objectives, assignment of cost to cost accounting periods, or measurement of cost. (48 CFR 9903.302-1,2)

- A change in practice has not occurred if the initial adoption of a practice coincides with the first time a cost is incurred or a function is created. [48 CFR 9903.302-2(a)]
- Elimination (partial or total) of a cost or the cost of a function is not a change in practice. [48 CFR 9903.302-2(a)]
- Revision of a practice for a previously immaterial cost is not a change in practice. [48 CFR 9903.302-2(b)]

#### New or Revised CAS

Once a covered contract is awarded, a new or revised CAS standard becomes applicable to a fully covered contractor on or after the effective date. It applies prospectively to all current fully CAS-covered contracts from the award date of the new covered contract. For example, if a new standard is effective May

1, 2010-, and a covered contract is awarded August 20, 2011, the new standard is applicable to all current fully CAS-covered contracts beginning August 20, 2011.

Once the new or revised standard is effective, the contractor must submit a description of the accounting change required (most often submitted in a revised Disclosure Statement), the potential impact of the change, and a general dollar magnitude of the change within 60 days of the effective date of the change or another date as agreed upon. The ACO reviews the change and makes determination of materiality, adequacy, and compliance. The contractor must submit a more detailed cost proposal within 60 days or other agreed-upon date of the determination. The proposal should identify each fully CAS-covered contract and subcontract (contracts and subcontracts containing the clause "CAS").

### Voluntary Change

The contractor may unilaterally change its accounting practices. The contractor must submit a description of the proposed change (proposed revision to Disclosure Statement), the potential impact, and general dollar magnitude of the change not less than 60 days prior to implementing the change. The ACO reviews the change and makes determination of materiality and adequacy. The contractor must submit a cost impact proposal within 60 days of the determination. The proposal must identify all CAS-covered contracts and subcontracts (full and modified coverage).

There are two possible outcomes to voluntary changes. 1.) The contractor makes the change at no increased cost to the Government, assuming it is CAS compliant. The proposal in this scenario will detail the shifts in cost between contracts necessary to ensure there is not an overall cost increase for the Government as a whole. 2.) The second possible outcome is that the change is made at increased cost to the Government if the ACO finds the change is desirable and not detrimental to the Government. There is little guidance or criteria to measure and judge "desirable and not detrimental," but greater cost is not the key factor or else there would not be an allowable alternative to the "no increased cost" outcome. The cost proposal for this latter scenario would depict the cost increase among affected contracts.

### CAS Noncompliance/Failure to Follow Cost Accounting Practices

The ACO issues an initial finding of noncompliance whenever the auditor or an equivalent party discovers the contractor is either not complying with some specific CAS or is not consistently following its disclosed practices. (The finding of noncompliance may follow a review of disclosure statement and/or proposed accounting change.) The contractor must submit a description



of the accounting change necessary to comply with CAS (revised disclosure statement), the potential impact of the changes, and a general dollar magnitude of the change. If the contractor is not consistently following disclosed practices, a description and/or revised statement may not be needed if the contractor's corrective action is to follow its originally disclosed practice.

The contractor has 60 days to submit the information described above unless it disagrees with the finding. If the contractor disagrees, it has 60 days to present rebuttal arguments and evidence. The ACO must consider the arguments and issue a final determination of compliance or noncompliance. The contractor must submit a cost impact proposal within 60 days of a final determination of noncompliance. The proposal must identify the cost impact for each CAS-covered contract and subcontract (full or modified) from the date of failure to comply with CAS or it must follow disclosed practices until the date the problem is corrected. Interest is applicable to any increased cost due to the noncompliance or failure to follow disclosed practice.

#### Common Aspects of Price Adjustments

There are four common aspects of all price adjustments.

1. The general dollar magnitude and the cost impact proposal must delineate the shift of costs between CAS-covered contracts by contract type. This is due to the different treatment required in negotiating equitable adjustments for each type of contract.
2. The ACO should not adjust prices if the cost impact is immaterial. What is considered material or immaterial depends on the situation. The following criteria are guidelines (48 CFR 9903.305) for determining materiality. No one criterion is determinative in and of itself.
  - The absolute dollar amount--the larger the dollar amount, the more likely that it is material.
  - The amount of contract cost compared to the amount under consideration--the greater the proportion of the considered amount versus the contract cost, the more likely it is material.
  - The relationship between a cost item and a cost objective. Direct cost items, especially if they are part of an allocation base for indirect costs, will have more impact than the same amount for indirect costs.
  - The impact on funding--there is more impact if the change influences the distribution of costs between Government and commercial cost objectives.



- The cumulative impact of individually immaterial items--do they offset one another, or do they accumulate in one direction (increase or decrease)?
  - The administrative cost of processing the price adjustment modification shall be considered versus the amount to be recovered--if administrative costs exceed the amount, the less likely it is material.
3. The cognizant ACO (with audit assistance) is responsible for evaluating and negotiating price adjustments on behalf of all affected Government agencies. The ACO should invite affected COs to participate in negotiations.. The ACO will execute contract modifications to contracts within the ACO's own agency. The ACO will prepare and send negotiation memorandums to all affected agencies, so that they may execute modifications for the amounts negotiated. Finally, the ACO should furnish copies of the negotiation memorandum to the cognizant ACO of the next higher tier subcontractor or prime contractor if a subcontract is affected.
  4. There are enforcement measures the ACO can take if the contractor does not submit either the general dollar magnitude or cost impact proposal.
    - The ACO may withhold up to 10 percent of each payment due to a contractor from its prime CAS-covered contracts until the proposal is submitted. An ACO can do this by resetting recommended contractor indirect billing rates or by asking contracting officers to directly withhold up to 10% from payments due a contractor on its prime CAS-covered contracts. The total withheld amount cannot exceed the general dollar magnitude of the anticipated price adjustment. If the contractor does not provide the general dollar magnitude, the ACO can estimate it with audit assistance.
    - If the contractor and the ACO fail to agree on a price adjustment, the ACO may unilaterally establish the adjustment subject to dispute procedures. The ACO can make the unilateral adjustment if the contractor fails to submit proposals after reaching the general dollar magnitude ceiling.

### 14.8.2 Effecting the Price Adjustment

The price adjustment is straightforward in most circumstances. The modification should lower or raise the estimated cost of cost-type contracts or the price of fixed-price arrangements. The adjustment is a little more difficult when it comes to effecting voluntary changes at no increased cost to

the Government. The ACO must ensure the contractor does not recoup any cost increase.

### 14.8.3 Administration Responsibility

CAS and accounting changes impact many agencies. As a result, CAS administration rests with the ACO cognizant of a particular contractor business unit. The administration of CAS by one individual is necessary for efficient and effective resolution of CAS changes. If each CO administering a CAS-covered contract made a determination of compliance or resolved disputes, one business unit would face conflicting interpretations of a single CAS or different opinions on voluntary accounting changes. The burden would be enormous on both the contractor and on the Government, and administrative costs would soar.

CAS administration duties often rest with another agency outside of the FAA. Accordingly, some contractors follow CAS as statutorily mandated. Other contractors follow CAS and other procurement matters in accordance with the FAA AMS. The CO and analyst must be aware of the particular situation and assist the ACO in assessing and evaluating the impact of CAS changes if requested.

A change in accounting practice is not always straight-forward. Case Study 14-3 shows how increased costs due to a change in the grouping of costs is not an accounting change requiring an equitable adjustment.

**CASE STUDY 14-3. WHAT CONSTITUTES AN ACCOUNTING PRACTICE CHANGE****Background:**

Martin Marietta Corporation (MMC) (now part of Lockheed Martin Corp.) in the early 1980's had three intermediate home offices. All of its Government contracts were worked out of five segments reporting to the Aerospace headquarters (ASH) home office. Indirect expenses incurred by ASH were collected and grouped into three categories and allocated among three bases:

<u>Pool</u>	<u>Base</u>
Marketing	Sales
Foreign marketing	Foreign sales
Residual	Total Cost Input

In 1986, MMC eliminated ASH. Some of the five segments that had reported to ASH reported directly to corporate headquarters. Others reported to a newly created intermediate home office, Information & Communications Systems Headquarters (I&CSH). The former ASH cost pools were split among the pools at corporate and among the pools at I&CSH. The method in which MMC now allocated the indirect expenses to the two home offices was the same as the method used prior to the elimination of ASH. MMC filed a cost impact proposal for the accounting practice changes it had made. DCAA, however, found the impact to be immaterial, and no price adjustment was made. MMC did not include any changes in the grouping of costs in its cost impact proposal.

The transfer of management functions from ASH to I&CSH resulted in increased costs on a FAA contract. While the method used was the same as previously used the result was that an increased percentage of the indirect expenses were allocated to I&CSH. The FAA CO determined that the reorganization amounted to a change in accounting practice and did not allow any increased costs. MMC requested a decision from DoD because it did not consider the FAA CO to be cognizant in CAS matters. The DoD CO found that the reorganization resulted in a change to accounting practices. MMC appealed to the Armed Services Board of Contract Appeals (ASBCA).

**ASBCA Decision:**

The ASBCA decided in favor of MMC. The board distinguished changes between those in cost and segment groupings and those in allocation methods. MMC's reorganization was the former, and therefore, did not constitute an accounting practice change. The Government appealed to the Court of Appeals for the Federal Circuit (CAFC).

**CAFC Ruling:**

The court affirmed the ASBCA decision and ruled in favor of MMC. The court found that MMC had not changed its method or technique of allocating costs. It still used the "beneficial or causal relationship" test in allocating its indirect costs. Chief Judge Glenn Archer stated, "We conclude that the phrase 'change to a cost accounting practice,' as used in FAR and MMC's CAS-covered contracts, refers to changes in the proportional measurement, assignment, or allocation of costs."



**CASE STUDY 14-3. (Cont'd)**

The Secretary's (*Secretary of Defense*) contention that merely changing the size of cost pools or the grouping of segments as a result of a reorganization causes a cost accounting practice change that must be rejected. Organizational changes alone do not create a change in a cost accounting practice. Under the Secretary's definition, any change to the size or composition of cost pools or grouping of segments, no matter how small, would technically be a change to a cost accounting practice requiring the contractor to submit a cost impact proposal. This definition would require a contractor to file an enormous number of proposals because, as the CASB recognized, there are many changes required in a 'dynamic business environment.' This construction is inconsistent with the CASB's understanding that business changes of themselves are not changes in cost accounting practices." (Sec. of Defense v. Martin Marietta Corp., CAFC, No 93-1164, 2/10/95)

**14.9 COST ACCOUNTING STANDARDS IMPLEMENTATION**

The five clauses implementing CAS within the FAA Acquisition Management System (FAA AMS) clauses are clauses 3.2.3-1 through 3.2.3-5. If a CO believes that a contract is subject to CAS, he or she should include "Cost Accounting Standards Notices and Certification" (FAA AMS clause 3.2.3-1) in the appropriate SIR. This provision provides the following:

1. Offeror certifies submission or exemption from submission of Disclosure Statement by doing one of the following:
  - Original and one copy certifying submission of statement to cognizant and one copy to cognizant contract auditor concurrent with submission of proposal;
  - Certifying previous submission of statement to ACO;
  - Certifying to monetary exemption (below full coverage threshold and not otherwise required to submit statement as a performing segment on a fully covered contract); or
  - Certifying to interim exemption.
2. Offeror certifies to modified coverage as appropriate; and
3. Offeror identifies accounting changes required by award of contract.

The SIR and contract should include the clause "Cost Accounting Standards" (FAA AMS clause 3.2.3-2) if the contract is subject to full coverage or the clause "Disclosure and Consistency of Cost Accounting Practices" (FAA AMS clause 3.2.3-3) if the offeror certifies its eligibility for modified coverage.



The clause “Administration of CAS” (FAA AMS clause 3.2.3-5) is included in the contract if it is subject to full or modified coverage.

#### 14.10 Summary

The CO and analyst should be familiar with CAS, when it applies and the types of contracts covered. Disclosure statements are required for all CAS contracts with full coverage and for modified coverage under certain circumstances. The disclosure statement is an important means to measure consistency and compliance with applicable CAS. The CO and analyst must also be cognizant throughout the process of the effects of 1.) new or revised CAS practices, 2.) voluntary changes to cost accounting practices or 3.) non-compliance. In essence, the CO and analyst should be able to converse with DCAA and support others on CAS related matters. See DCAA Contract Audit Manual (CAM) Chapter 8, at [www.dcaa.mil](http://www.dcaa.mil)

Be advised when using DCAA CAM to ignore all references to DFARS as these are for the Department of Defense FAR Supplement to which FAA is not subject.