OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Part 9903

Cost Accounting Standards Board; Changes in Cost Accounting Practices

AGENCY: Cost Accounting Standards Board, Office of Federal Procurement Policy, OMB.

ACTION: Supplemental notice of proposed rulemaking.

SUMMARY: The Cost Accounting Standards Board (CASB) invites a supplemental round of comments on proposed amendments to the regulatory provisions contained in chapter 99 of title 48. The proposed amendments being promulgated today, when issued as a final rule, would revise the current definitions, exceptions and illustrations governing changes in cost accounting practices and add a new subpart 9903.4, Contractor Cost Accounting Practice Changes and Noncompliances. The proposed subpart would establish contractor notification requirements for changes in compliant cost accounting practices and delineate the process for determining and resolving the cost impact of either a compliant change in cost accounting practice or a noncompliant practice on covered contract and subcontract prices and/or costs. For covered contracts and subcontracts awarded to an educational institution, the proposed subpart includes a waiver provision that would permit the establishment of a uniform set of requirements for the notification and resolution of compliant changes to established cost accounting practices and/or the correction of noncompliant practices that affect covered contracts, covered subcontracts and other Federally sponsored agreements.

Due to the complexity of the proposed coverage, the Board has decided to request an additional round of public comments prior to the promulgation of a final rule. In preparing this notice, the Board considered the public comments received in response to the original Notice of Proposed Rulemaking (NPRM) that was promulgated on September 18, 1996 (61 FR 49196). Potential commenters need not resubmit their previously submitted concerns and suggestions. Specifically, the Board desires comments on the revisions being proposed for the first time to the extent such comments do not duplicate previously submitted comments. The Board is also requesting additional comments to determine to what extent, if any, there may be support for the establishment of new provisions that would exempt certain cost accounting practice changes from the Board's contract price and cost adjustment requirements (For details, see Section F., Additional Public Comments).

DATES: Comments must be submitted in writing, by letter, and should be received by September 12, 1997.

ADDRESSES: Comments should be addressed to Mr. Rudolph J. Schuhbauer, Project Director, Cost Accounting Standards Board, Office of Federal Procurement Policy, 725 17th Street, NW, Room 9001, Washington, DC 20503. Attn: CASB Docket No. 93–01N(2). To facilitate the CASB's review of your submitted comments, please include with your written comments a three point five inch (3.5″) computer diskette copy of your comments and denote the format used. A format that is compatible with WordPerfect 6.1 or 5.1 is preferred. The submission of public comments via the internet by ''e-mail'' will not satisfy the specified requirement that public comments must be submitted in writing, by letter, as receipt of a readable data file is not assured.

FOR FURTHER INFORMATION CONTACT: Rudolph J. Schuhbauer, Project Director, Cost Accounting Standards Board (telephone: 202–395–3254).

SUPPLEMENTARY INFORMATION:

A. Regulatory Process

The CASB's rules, regulations and Standards are codified at 48 CFR Chapter 99. Section 26(g)(1) of the Office of Federal Procurement Policy Act, 41 U.S.C. § 422(g), requires that the Board, prior to the establishment of any new or revised Cost Accounting Standard (CAS), complete a prescribed rulemaking process. The process generally consists of the following four steps:

(1) Consult with interested persons concerning the advantages, disadvantages and improvements anticipated in the pricing and administration of Government contracts as a result of the adoption of a proposed Standard (e.g., promulgation of a Staff Discussion Paper (SDP)).

(2) Issue an Advance Notice of Proposed Rulemaking (ANPRM).

(3) Issue a Notice of Proposed Rulemaking (NPRM).

(4) Promulgate a final rule.

This promulgation supplements previously completed step 3 of the four step process.

B. Background

Prior Promulgations

Many commenters have identified the Board's regulatory coverage on ''changes in cost accounting practice'' as a matter requiring clarification and/or further coverage. The CASB requested public comments from interested parties on this topic in a SDP published in the **Federal Register** on April 9, 1993 (58 FR 18428) and in an ANPRM published on April 25, 1995 (60 FR 20252). On September 18, 1996, the CASB, in an NPRM published in the **Federal Register** (61 FR 49196), proposed to amend the Board's current coverage governing changes in cost accounting practices. That original NPRM, hereafter referred to as the ''prior NPRM,'' included proposed amendments to conform the language contained in the contract clauses for ''Full'' and ''Modified'' coverage, specify certain Federal agency responsibilities, and expand the criteria for desirable change determinations. A new subpart was also proposed to delineate the actions to be taken by the contracting parties when a contractor makes a compliant change to a cost accounting practice or follows a noncompliant practice.

Public Comments

Of the thirty-five sets of public comments received in response to the prior NPRM, nineteen were provided in a timely manner. The public comments were received from contractors, professional associations, Federal agencies, accounting organizations, educational institutions, and other individuals. A number of commenters supported the proposed amendments contained in the prior NPRM. Some did not. The more significant comments and concerns expressed by commenters are summarized below.

The contractor community concluded that the Board's existing definitions of the terms ''cost accounting practice'' and ''change to a cost accounting practice'' need not be amended because, in their view, CAS 418 (at 48 CFR 9904.418) provides the Government with adequate protection when disparate cost pools are combined or split-out. As discussed below, under Section E, Public Comments, contractors advocated that the Board's existing rules and regulations be retained and applied based on their interpretations of what the existing rules and regulations require. Their interpretations were, however, selective and did not cover the entire spectrum of possibilities under the Board's existing rules and regulations.

Contractors believe that the proposed definitional revisions (if adopted) will increase the number of cost accounting practice changes that would have to be administered as contrasted with the practices currently followed in implementing the Board's existing rules. Consequently, they opined that the overall administrative burden imposed by the Board's rules will increase.

Some commenters believe that the Truth in Negotiations Act, the Board's Standards, and novation agreements provide adequate protection for organizational changes and resulting shifts in costs allocated to CAS-covered contracts.

On the other hand, Federal commenters indicated that they were in general agreement with, and supported, the Board's proposed amendments. One agency commented that the revised language will assist contracting parties in addressing both changes in cost accounting practices and the cost impact process.

Both the contractor community and the Government agency representatives generally supported the Board's proposal to establish a new subpart to streamline the notification and cost impact process associated with compliant cost accounting practice changes and noncompliances.

After consideration of the public comments received, the Board concluded that contractors and Federal officials continue to interpret the Board's rules and regulations governing a change in cost accounting practice differently. The Board disagrees with the view put forth by several commenters that the Board's existing rules are adequate and therefore there is no need for the Board to do anything as it can rely on the ''protection'' provided by the existing provisions at 9904.418–50(b). To resolve the described issues and concerns, the Board herein proposes to amend chapter 99 as follows:

—*Definitions:* Revise the definitions, explanations and illustrations governing cost accounting practice changes, for purposes of making it explicit that a change in the methods and techniques used to accumulate cost in indirect cost pools for allocation to final cost objectives constitutes a change in cost accounting practice. The revisions will make explicit that the combination of existing pools, the split-out of an existing pool, or the transfer of an existing function from one pool to one or more different cost pools constitutes a change in cost accounting practice.

—*Exceptions:* Retain, with certain modifications, the existing exceptions for circumstances that are not considered to be a change in cost accounting practice.

—*Cost Impact Process:* Add a new subpart 9903.4 to establish the notification process to be followed by a contractor making compliant changes in cost accounting practices. It would also establish the process for the submission of cost impact data for compliant changes and noncompliances, and the contract price and cost adjustment process for resolving the resulting cost impacts on individual CAS-covered contracts and subcontracts.

The various comments, as well as the concerns, expressed by the commenters are discussed in greater detail under Section E., Public Comments. The Board Members and the CASB staff express their appreciation for the divergent views, constructive technical comments and editorial suggestions provided by the commenters. Many of the expressed concerns and editorial suggestions aided the CASB's deliberations and have been incorporated into the proposed amendments being issued today.

Benefits

In the Board's judgment, regulatory guidance is needed to encourage consistency in the treatment of cost accounting practice changes and to reduce the amount of time required to resolve these actions. The Board believes that the application of the proposed provisions, as set forth in this supplemental NPRM, will clarify what constitutes a change in cost accounting practice and facilitate the notification, cost impact and contract price and cost adjustment processes attributable to changes in compliant cost accounting practices and noncompliant practices.

Consequently, the potential for disagreements over what constitutes a change in cost accounting practices should be significantly reduced.

Although the added rules and regulations being proposed for subpart 9903.4 are detailed and extensive, the Board remains convinced that they are necessary to promote consistency, equity and timeliness in the handling of cost impact proposal actions related to changes in accounting practices and noncompliances. The Board's proposed amendments, when promulgated as a final rule, are expected to result in the reduction of administrative costs currently being experienced by contractors and Federal officials when contractor changes in cost accounting practices and noncompliances are processed.

Significant benefits and administrative cost savings should also evolve from the finalization of the Board's proposed expansion of the criteria and coverage applicable to ''desirable changes,'' particularly with respect to practice changes resulting from actions taken to improve the efficiency and effectiveness of a contractor's operations. The proposed coverage should encourage, not discourage, such organizational changes in the future. As a result, these proposed regulatory amendments should generally further the goal of acquisition streamlining and reform, and should lead to much greater simplification of the contract administration process as related to the administration of Cost Accounting Standards. These goals have been endorsed by the so-called ''Section 800'' Panel (Report of the Acquisition Law Advisory Panel to the United States Congress, January 1993).

Proposed Amendments

A brief description of the proposed amendments follows:

Part 9903, Contract Coverage

In subpart 9903.2, CAS Program Requirements, subsection 9903.201–4 is amended to conform certain language in the ''Full'' and ''Modified'' contract clauses and to clarify the provisions governing changes made to a contractor's established cost accounting practices and changes made to correct noncompliant practices. Subsection 9903.201–6 is amended to establish criteria on when the Government shall determine that a contractor proposed change in cost accounting practice is desirable and not detrimental. Subsection 9903.201–7 is revised to specify certain cognizant Federal agency responsibilities for administering CAS-covered contracts and subcontracts.

In subpart 9903.3, CAS Rules and Regulations, section 9903.301 is amended to incorporate definitions for the terms ''Function'' and ''Intermediate cost objective.'' In subsection 9903.302–1, Cost Accounting Practice, the definition is amended to incorporate language changes and to add clarifying guidance. Subsection 9903.302–2, Change to a cost accounting practice, is revised to make explicit the types of changes that are to be regarded as a change in cost accounting practice. The illustration of a change in cost accounting practice at 9903.302–3(c)(3) is replaced by a new illustration. In 9903.302–3(c) and in 9903.302–4, several illustrations have been included to provide additional guidance regarding the revised definitions of the

terms ''cost accounting practice'' and ''change in cost accounting practice.''

A new subpart 9903.4 is added to establish the notification and cost impact resolution process to be followed by a contractor and the cognizant Federal negotiator when a CAS-covered contractor or subcontractor changes a compliant cost accounting practice, fails to comply with an applicable Standard or fails to consistently follow its established cost accounting practices.

Summary Description of Proposed CAS Coverage

In subpart 9903.2, the proposed amendments, when promulgated as a final rule, will:

Conform the contract clause language for ''Full'' and ''Modified'' coverage. The contract clause provisions are also revised to clarify the actions required when a contractor or a subcontractor is required to change a cost accounting practice or elects to replace an established practice with another compliant cost accounting practice. Also specified are the corrective actions required when a contractor's estimated cost proposal was based on a noncompliant practice and/or actual contract cost accumulations were based on a noncompliant practice.

Provide criteria for determining when a contractor proposed change in cost accounting practice shall be determined to be a desirable change that is not detrimental to the Government.

Require Federal agencies, in accordance with agency procedures, to:

—Establish internal policies and procedures for administering CAS-covered contracts when the agency is and is not the cognizant Federal agency for contractors performing agency contracts.

—Designate the agency office or official responsible for administering the agency's CAS-covered contracts and subcontracts.

—Delegate contracting authority to designated agency officials, as required, for the negotiation of cost impact settlements and associated contract price or cost accumulation adjustments.

—Concurrently settle, on a Government-wide basis, the cost impacts on all CAS-covered contracts and subcontracts affected by a contractor's or subcontractor's change in cost accounting practice or noncompliant practice.

In subpart 9903.3, proposed for inclusion in 9903.301, are two definitions to clarify the terms ''Function'' and ''Intermediate cost objective.'' The proposed amendments to 9903.302–1(c), allocation of cost to cost objectives, make explicit the methods and techniques that are considered a cost accounting practice, including the methods and techniques used to accumulate the cost of specific activities. Additional subparagraphs are proposed to clarify what is meant by the selection and composition of cost pools and their allocation bases.

The proposed amendments to 9903.302–2 expand the existing coverage by specifying that, as used in part 9903 and the applicable contract clauses, changes in cost accounting practices include pool combinations, pool split-outs and transfers of existing ongoing functions. The existing cost accounting practice exceptions cited in 9903.302–2 (a) and (b) are restated and modified in new subparagraphs.

Within 9903.302–3, a new introductory paragraph is proposed to be added regarding the use of the illustrations that follow. Introductory paragraphs (a), (b) and (c) are proposed to be revised to clarify that the illustrations involve ''cost accounting practices'' that have changed. The illustration at 9903.302–3(c)(3) is proposed to be replaced by new illustrations depicting changes in cost accounting practices that are consistent with the revised definitions. The new illustration at 9903.302–3(c)(3) illustrates that the use of a different base for the allocation of indirect costs to final cost objectives is a change in cost accounting practice. Additional illustrations are added to 9903.302–3(c) and 9903.302–4 to depict various changes which do and do not result in changes in cost accounting practices when a contractor combines, eliminates or splits-out pools, transfers functions or when business combinations due to mergers and acquisitions occur.

A new subpart 9903.4, Contractor Cost Accounting Practice Changes and Noncompliances, is proposed. It details the methodology for determining required contract price or cost accumulation adjustments due to changes in a contractor's cost accounting practices and specifies the actions to be taken by the contractor and the cognizant Federal official (e.g., the contracting officer, administrative contracting officer (ACO) or other agency official authorized to act in that capacity), including the negotiation of cost impact settlements on behalf of the Government. The proposed subpart provides coverage on the applicability and purpose of the subpart, materiality considerations, definitions of terms related to the subpart, procedures for changes in compliant cost accounting practices, and procedures for noncompliance actions. An additional section is also included to illustrate the application of the proposed coverage. The proposed coverage is briefly described below.

Section 9903.405, Changes in Cost Accounting Practices, includes subsections on the following areas: contractor notification of changes in cost accounting practices; Government determinations, approvals and initiating the cost impact process; contractor cost impact submissions; and negotiation and resolution of the cost impact action.

Section 9903.405 provides a streamlined process which does not require submissions of cost impact estimates or contract price adjustments for every CAS-covered contract affected by a change in accounting practice. It provides flexibility to the cognizant Federal agency official in determining the level of detail required for a cost impact submission and materiality thresholds for required contract price and cost adjustments. To this end, it creates a three-step sequential process which includes (1) An initial evaluation to determine if the cost impact of the accounting change is obviously immaterial, (2) the use of a general dollar magnitude (GDM) settlement proposal, and if ultimately determined necessary, (3) the submission of a detailed cost impact proposal for contracts exceeding Government determined materiality thresholds. The procedure encourages settlement of material cost impacts based on the contractor's GDM settlement proposal to the maximum extent possible, without having to resort to a detailed cost impact proposal. It also provides for contract price adjustment on individual contracts only when the cost impact amount is material.

Section 9903.405 includes rules for the use of the offset process. It allows for the use of the offset process to reduce the number of contract price and cost adjustments required as a result of a change in cost accounting practice, while still providing for adjustments of individual contracts when the cost impact amount is material. The rules provide that offsets of increased costs against decreased costs shall only be made within the same contract type.

Section 9903.405 also explains when and what action needs to be taken to preclude increased costs paid by the Government as a result of a voluntary change in cost accounting practice. It clarifies how increased costs to the Government are measured on firm fixed-price contracts as a result of a change in accounting practice. It also makes clear that action must be taken to preclude increased costs from being paid when

the estimated aggregate higher allocation of costs on flexibly-priced contracts subject to adjustment exceeds the estimated aggregate lower allocation of costs on firm fixed-price contracts subject to adjustment as a result of a voluntary change in accounting practice.

Section 9903.406, Noncompliances, provides detailed rules and regulations for handling noncompliant actions. It outlines the procedures to be followed when the parties agree or disagree on whether a noncompliant condition exists. An example of an acceptable GDM Settlement Proposal format that the contracting parties may use to resolve a noncompliance is included. The proposed section contains separate coverage on estimating practice noncompliances and cost accumulation practice noncompliances to clarify the different actions, particularly to recover increased costs and/or applicable interest on increased costs paid, that need to be taken under these different noncompliant conditions. It also provides procedures to be followed when a noncompliant condition does not result in material increased costs paid by the Government.

C. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96–511, does not apply to this proposal, because this proposal imposes no paperwork burden on offerors, affected contractors and subcontractors, or members of the public which require the approval of OMB under 44 U.S.C. § 3501, *et seq.*

D. Executive Order 12866 and the Regulatory Flexibility Act

The economic impact of this proposal on contractors and subcontractors is expected to be minor. As a result, the Board has determined that this NPRM will not result in the promulgation of a ''major rule'' under the provisions of Executive Order 12866, and that a regulatory impact analysis will not be required. Furthermore, this proposal will not have a significant effect on a substantial number of small entities because small businesses are exempt from the application of the Cost Accounting Standards. Therefore, this proposed rule does not require a regulatory flexibility analysis under the Regulatory Flexibility Act of 1980.

E. Public Comments

This NPRM was developed after consideration of the public comments received in response to the Board's NPRM that was published in the **Federal Register** on September 18, 1996, 61 FR 49196, wherein public comments were invited. The comments received and the Board's actions taken in response thereto are summarized in the paragraphs that follow:

Cost Accounting Practice Definitions

Comment: Several contractor representatives advocated that the proposed amendments making explicit that pool combinations and split-outs are changes in cost accounting practices were not necessary because:

—Only a change in the selection of an allocation base ''method'' used to allocate pooled costs to cost objectives is a change in cost accounting practice.

—As long as cost pools are homogeneous, in compliance with 9904.418, before and after a pool is combined or split-out, then no change in cost accounting practice has occurred.

—9904.418 provides adequate protection if material differences in the amount of costs allocated to cost objectives result due to pool combinations or split-outs.

—One commenter stated: ''* * * Pool combinations split-outs do not necessarily result in a change to cost accounting practice. When pools are combined or a single pool is split into two or more pools, we do not agree that a change in cost accounting practice has necessarily occurred. If the combined pools consist of the same functions and the allocation bases are the same (e.g. direct labor dollars, * * *) then the composition of the cost pools has not changed. Only the amounts are different. The same is true for pool split outs. * * *''

—Regarding shifts in cost allocations to contracts, another commenter expressed the belief that the Board's concerns are eliminated by 9904.418–50(b)(2). ''* * * if the splitting out or merging of pools and bases results in material differences from that which existed prior to the split-out or merger, the pools cannot be changed without risking a 418 noncompliance (which protects the Government) or without causing a change in cost accounting practice (e.g., use of an allocation base of labor dollars instead of labor hours), in which case the Government interests are again protected.''

Response: For the reasons set forth below, the Board does not agree with the commenters' interpretations and conclusions.

CAS 418 Does Not Explicitly Provide the Protection Alluded to by the Commenters

Before concluding that the cited 9904.418 provisions provide adequate protection, one must accept the commenters' unstated premise that the contracting parties agree on how to determine whether combined or spilt-out pools continue to have the same beneficial or causal relationship to cost objectives or if material differences in the amounts of cost allocated to individual cost objectives have resulted after a pool combination or split-out. Such a premise, however, is not self-evident. For example, some contractors have taken the position that as long as the original pools have similar activities (purchasing and purchasing, inspection and inspection, etc.), then the resulting pool combination is still compliant with CAS 9904.418 and that no change in cost accounting practice has occurred, irrespective of disparate pool demographics and resulting shifts of indirect costs allocated to cost objectives.

The Board is not persuaded that most contractors, in individual cases, would agree with the commenters' inferences, i.e., that a comparison of the difference between the costs allocated to individual cost objectives utilizing the original pool configurations versus the new combined pool or split-out pools is clearly required under CAS 9904.418 or, if a material difference occurs, that a noncompliant condition requiring corrective action exists.

In order to be compliant with CAS 9904.418, both the original pool(s) and resulting pool combinations or split-outs, must be homogeneous. Essentially, the CAS 9904.418 criteria involves two concepts: One requires that activities included in a pool have the same or similar beneficial or causal relationship to cost objectives, and the other requires that ''pooled'' costs allocated to cost objectives not be materially different from the allocation that would result if the cost of activities included in that pool were allocated separately.

However, the CAS 9904.418 criteria is not explicit regarding comparisons of costs allocated to cost objectives based on different groupings of similar activities, such as through the use of existing pools (or pool) versus a new combined pool or split-out pools. The cited 9904.418–50(b) language does not specify that the contracting parties must determine if materially different cost allocations result due to pool combinations or split-outs, nor are such comparisons precluded. The commenters did not indicate how cost

allocation comparisons between the original pool(s) and the resultant combined pool or split-out pools could be accomplished under CAS 9904.418 in order to provide the Government with sufficient protection in cases where material differences in cost allocations to cost objectives result. Thus, the Board disagrees with the commenters' premise that CAS 9904.418 comparisons provide adequate protection in the event of material differences in cost allocations to cost objectives attributable to pool combinations or split-outs, particularly since some commenters and contractors have argued that combining pools with similar activities is compliant with CAS 9904.418, and not a practice change, irrespective of the impact it may have on cost allocations to cost objectives.

Adoption of the commenters' concept that the Government can achieve equity in the event significant cost shifts occur after a pool combination or spilt-out by simply pursuing a CAS 9904.418 noncompliance would most likely result in recurring controversies and potential disputes, particularly if a noncompliance determination were predicated on a material difference between cost allocations resulting under the old and new pool configurations.

Administrative Cost Implications of Noncompliances

If the Government determined that a merged or split-out pool was not in compliance with CAS 9904.418, the noncompliant cost accounting practice would have to be corrected and the CAS contract price or cost adjustment remedies for estimating and/or cost accumulation noncompliances would apply. To correct the noncompliance, the contractor would have to replace the newly established cost accounting practice with a compliant practice, by probably changing back to the original practice. It is not self-evident how the commenters' suggested alternative ''noncompliance approach'' would result in lower administrative costs and motivate contractors to implement economy and efficiency changes unless one were to conclude that CAS 9904.418 provides little, if any, protection for shifts in costs allocated to cost objectives due to pool mergers and or split-outs.

Cost Accounting Practice Definition Considerations

Compliance with CAS 9904.418 before and after a pool combination or split out does not in itself mean that there was no change in the cost accounting practices used to accumulate pooled costs and allocation base activities. When indirect cost pools are combined or split out, the costs of the same ongoing activities (functions) are grouped and accumulated differently. The intermediate cost objectives used as the cost accumulation points in the contractor's cost accounting system may change, e.g., intermediate cost objectives for similar functions may be combined or split-out. There is a change in the number of pools used to accumulate the indirect costs of specific activities for the allocation of cost to final cost objectives. Although the pools are compliant with CAS 9904.418, before and after the change, the methods and techniques used to accumulate costs in intermediate cost objectives, the selection and composition of the pool(s) and the composition of the allocation base(s) have changed. It is precisely these changes in the pattern of accumulating the costs of indirect functions and activities and the accumulation of base activities that were addressed in the proposed revisions to the definition of a ''cost accounting practice''.

Potential CAS 9904.401 Noncompliances

If the Government relied exclusively on CAS 9904.418, as suggested, contractors might erroneously assume that indirect costs can be estimated and accumulated differently. For example, a contractor might estimate indirect costs in contract cost proposals based on the use of two pools and, after award, accumulate actual costs based on the use of one combined pool. This would, however, violate the consistency and comparability objectives and requirements of 9904.401.

The CAS 9904.401 provision at 9904.401–50(a)(2) provides that ''* * * the cost accounting practices used in estimating costs in pricing a proposal and in accumulating and reporting costs on the resulting contract shall be consistent with respect to * * * (2) The indirect cost pools to which each element or function of cost is charged or proposed to be charged * * *'' Therefore it could be argued that if pool combinations and split-outs are not treated as compliant changes in cost accounting practices, a contractor could never combine or split-out a pool because that would result in a CAS 9904.401 noncompliance.

That line of reasoning is, however, not what the current CAS contract clause provisions stipulate for compliant changes. The Board's rules clearly permit contractors to combine or split-out pools as a voluntary change from one compliant practice to another compliant practice. However, to remedy any material shifts in costs allocated to cost objectives resulting from such compliant changes, the contractor is specifically required to agree to contract price and cost adjustments under the CAS contract clauses.

In Brief

Under the Board's existing rules, pool combinations and split-outs resulting in cost accounting practice changes are permitted as compliant changes to established cost accounting practices. However, the practice change is subject to the Board's notification and disclosure requirements, and the resulting cost impact of the practice change on CAS-covered contracts is subject to the applicable CAS contract price and cost adjustment provisions.

The commenters' recommendations avoid resolution of the primary issue, i.e., what constitutes a change in cost accounting practice? It only moves the issues concerning pool combinations and split-outs from disagreements over whether a change in cost accounting practice has occurred to disagreements over whether there is a CAS 9904.401 or CAS 9904.418 noncompliance. It does not resolve the underlying issue.

The argument that pool combinations and split-outs should not be considered changes in cost accounting practice that are subject to the Board's rules for contract price and cost adjustment, as suggested by the commenters, appears inconsistent with the resulting actions necessitated by such actions. For example:

—New forecasted indirect cost rate agreements and/or billing rates need to be established.

—The contractor's Disclosure Statement, if required, must be updated to reflect the selection and composition of the new combined or split-out pools and the composition of each new pool's allocation base.

Under the Board's proposed approach in this NPRM, if the original pools were compliant with CAS 9904.418 and the new combined pool or split-out pools is/are CAS 9904.418 compliant, then the resulting changes in the methods and techniques used to accumulate the costs of indirect activities and allocation base data, the selection and composition of the pool(s) and the composition of the allocation base(s), can be treated as a compliant change in cost accounting practice. The outcome of the proposed approach is more predictable than the commenters' suggested approach which could result in noncompliances. The administrative costs and financial risks to contractors associated with compliant changes should be less than the

administrative costs and financial risks associated with contractor corrective actions that would be required if a practice change is implemented and it is subsequently determined to be noncompliant.

Accordingly, the commenters' suggestions that the amendments proposed in the prior NPRM not be promulgated were not adopted.

Comment: Several commenters stated that the proposed language concerning ''cost accumulation'' was confusing and that cost accumulation was not a cost accounting practice but the result of the application of a contractor's cost accounting practices.

Response: The proposed coverage was intended to make it explicit that the term ''cost accounting practice'' includes the methods and techniques used to accumulate costs of specific activities in specific intermediate cost objectives and to accumulate the costs of specific activities, or groups of activities, in specific indirect cost pools for subsequent allocation to intermediate and/or final cost objectives. This concept, although questioned by several commenters, is consistent with 9904.401–50(a)(2) which specifically requires that:

''(a) * * * The standard allows grouping of homogeneous costs in order to cover those cases where it is not practicable to estimate contract costs by individual cost element or function. However, costs estimated for proposal purposes shall be presented in such a manner and in such detail that any significant cost can be compared with the actual cost accumulated and reported therefor. In any event the cost accounting practices used in estimating costs in pricing a proposal and in accumulating and reporting costs on the resulting contract shall be consistent with respect to ''* * * (2) The indirect cost pools to which each element or function of cost is charged or proposed to be charged * * *''

Since commenters opined that the proposed language may be interpreted differently, the Board has essentially retained the existing language at 9903.302–1(c) that cited ''* * * methods and techniques used to accumulate costs * * *'' in an attempt to mitigate the commenters' expressed concerns and to facilitate implementation of the amendments being proposed today. The Board wishes to emphasize, however, that the proposed coverage contained in this NPRM is not intended to alter the meaning of any Standard in parts 9904 or 9905 of the Board's regulations. Rather, the intent is to facilitate an understanding that the Board's definition of a cost accounting practice, in part 9903, includes the methods and techniques used to accumulate cost in specific intermediate cost objectives and the *selection* of the number of pools established to accumulate the costs of specific functions (or activities). Specifically, that the number of pools established to accumulate the costs of specific activities, or groups of activities, included therein, is a method or technique used to allocate indirect costs, i.e., a cost accounting practice. Accordingly, the phrase ''selection * * * of cost pools'' was added to the definition of a cost accounting practice (see 9903.302–1(c)(1)(iii)). Where deemed appropriate, the illustrations proposed in the prior NPRM for inclusion in section 9903.302–3 were revised to further clarify these cost accounting practices.

Comment: Several commenters opined that existing regulations provide the Government with adequate protection against significant cost shifts resulting from pool combinations and split-outs. One commenter stated: ''* * * The Truth in Negotiations Act requires full disclosure of contractor decisions and plans (regarding organizational changes) prior to contract award. The causal beneficial relationship and homogeneity requirements of the Standards require that major elements of indirect pools have the same or similar relationship to benefiting cost objectives. Novation agreements prevent improper cost increases to the Government * * *''

Response: The referenced laws and regulations serve different purposes.

The Truth in Negotiations Act (TINA) only applies to the specific data that the contractor identifies and certifies as being accurate, complete and current as of a specified date. A signed certification is normally obtained prior to contract award when contract negotiations are completed or agreement on contract price occurs. After contract award, TINA provides no protection for decisions or plans made to change the cost accounting practices used to accumulate the costs of contract performance. Also, TINA provides no protection for contracts priced using noncompliant practices. The Board's rules and Standards do. Applicable CAS contract clauses require that the same cost accounting practices used to develop contract cost proposal estimates be applied consistently when accumulating the costs of contract performance, after contract award. Changes in compliant practices are permitted but affected contract prices and costs are subject to adjustment for the cost impact of the change in practice. TINA and CAS are completely independent concepts that have entirely different applications and purposes.

As discussed in a prior comment, 9904.418, in and of itself, does not address all aspects relative to changes in cost accounting practices resulting from pool combinations or split-outs.

Novation agreements do not address a contractor's cost increases or decreases due to changes in cost accounting practices. Novation agreements are used only when a contract is transferred or assigned from the original performing entity to a subsequent performing entity (''successor-in-interest''). Novation agreements limit the cost to the Government (amount paid by the Government) by precluding increased contract costs for the novated contracts. The novation agreement enables the Government to disallow any higher level of costs incurred by the successor in interest.

Comment: One commenter suggested that the words ''at specified locations'' proposed for 9903.302–1(c) (2) and (3) be replaced with ''for a particular segment, home office, or business unit'' because contractors may not accumulate costs by location.

Response: The suggestion was adopted.

Comment: Several commenters suggested that certain language in proposed 9903.302–1(c) (1), (2) and (3) be deleted or conformed with the language in the Board's rules and applicable Standards.

Response: To the extent deemed appropriate, the Board has revised the proposed language for 9903.302–1(c) for improved conformity with the language contained in the Board's rules and applicable Standards.

Comment: In reading the prior NPRM preamble comments at 61 FR 49199, some commenters concluded that to move work from one segment to another is deemed a cost accounting practice change by the Board. One commenter stated the prior NPRM implies that a contractor cannot decide to move contract work to another segment without generating a cost accounting practice change.

Response: If there is a change in the place of performance for some part of the contract work, the costs estimated to be performed in-house by the proposing segment will not be accumulated in the proposing segment's cost accounting records under the same elements of cost as proposed, e.g., as direct material, labor and allocable overhead cost. Instead the allocable contract costs will still be accumulated by the same performing segment, but as a different cost element, e.g., intra-company transfer cost, in accordance with the segment's established cost accounting practices. Such intra-company

''purchases'' or ''orders'' that result in the accumulation of costs under different cost elements by the proposing segment do not constitute a change to that segment's established cost accounting practices.

However, the prior NPRM also stated that if the responsibility for performing a contract is transferred in its entirety from one segment to another segment, that ''neither segment's cost accounting practices may have changed * * * Such changes in the place of contract performance are subject to applicable procurement regulations * * *'' In such cases, the costs of contract performance estimated in accordance with the original segment's cost accounting practices would not be incurred, accumulated and reported by the original proposing segment. Instead, a different segment, i.e., the acquiring segment, would accumulate the costs of contract performance in accordance with its established cost accounting practices. The contract transfer does not constitute a change to either segments' established cost accounting practices. Such contract transfers in place of performance are not specifically addressed under the Board's regulations which presume that contracts and subcontracts will be performed by the segment or segments designated in the contractor's proposal. Resolution of contract transfers resulting in changes in the place of contract performance remain subject to applicable procurement regulations.

Comment: One commenter stated that the prior NPRM appears inconsistent. Specifically: ''* * * the NPRM states that a change in the composition of a cost pool or allocation base represents an accounting practice change. However, performing an additional contract within that cost pool and allocation base, or completing an existing contract does not represent an accounting practice change. Similarly, the transfer of an ongoing G&A function, such as Marketing, from a Home Office to a Business Segment, is treated in the NPRM as a change but transfers of employees are not * * *'' Another commenter stated that under the prior NPRM, composition of the pool would be defined as a volume change.

Response: There is no inconsistency.

The Board's underlying concept is that the indirect cost of performing a specific function (or activity) must be accumulated in the same intermediate cost objective and included in the same indirect cost pool when a contractor estimates and accumulates costs. An entire function cannot be transferred from one indirect cost pool to another indirect cost pool after award unless the contractor processes a compliant change in cost accounting practice. Otherwise, the transfer is not in compliance with the requirements of 9904.401 or 9905.501, as applicable.

An individual employee can change duties to support different functions and be transferred from function to function or from pool to pool. Such employee transfers are not a change in cost accounting practice as long as the costs of the ongoing functions or activities continue to be accumulated in the same intermediate cost objectives and the intermediate cost objectives remain in the same indirect cost pools.

Volume changes (e.g., adding contract work or completing work) are not a cost accounting practice change. There is no inconsistency because the addition of new work and completion of existing work is considered in the contractor's forecasts when direct and indirect cost levels are estimated to support the contractor's forecasted indirect cost rates that are used to estimate contract costs.

Comment: A commenter concluded that the Government may deem equipment transfers to be a change in cost accounting practice.

Response: Presumably, the commenter is referring to the physical transfer of equipment whose costs are depreciated and recovered as an indirect cost. A change in cost accounting practice would not result if the physical transfer of equipment occurs because the equipment will be used to support a different function or activity. The Board's assumption is that the original function and the different function did not move, i.e., the indirect costs of each function are included in the same indirect cost pool or pools before and after the transfer. Only the equipment and its depreciation charge moved because the equipment is now used to support the different function. Therefore, the described transfer of equipment is similar to the employee transfer discussed above and the ''employee transfer'' illustration that is proposed to be added as ''not a change in cost accounting practice'' (see 9903.302–4(h) in this NPRM).

Change to a Cost Accounting Practice—Exceptions

Comment: Regarding the proposed revisions for 9903.302–2(b)(1), one commenter recommended that the undefined term ''company-wide'' proposed in the prior NPRM be replaced with the term ''home office''.

Response: The commenter's recommendation was adopted. In addition, the last sentence was revised to clarify that the exception does not apply to transfers of ongoing functions between segments as well as to transfers of ongoing functions between pools within a segment.

Comment: Regarding the proposed addition of a new exception at 9903.302–2(b)(4), commenters expressed concern that the rationale for the proposed exception was not clear, that the proposed language was not clear and/or that certain technical aspects required expansion. Another opined that the cost impact of the change would be zero and that there was no benefit from this exception. A Federal agency commented that the described exception is a cost accounting practice change that should be disclosed to the Government and treated as an ''exemption'' from the cost impact and contract price and cost adjustment process.

Response: The unintended confusion and concerns generated by this proposed exception have been interpreted by the Board to mean that the anticipated costs of implementation associated with this proposed exception could far exceed the potential benefits envisioned by the Board. Accordingly, the Board is not proceeding with the previously proposed exception in this supplemental NPRM. Consequently, when a contractor makes the types of changes that were proposed in the prior NPRM as exceptions to the Board's definition of a ''change to a cost accounting practice,'' such changes shall not be treated as exceptions to the Board's rules. Instead, the determination of whether a change in cost accounting practice has or has not occurred shall continue to be made in accordance with the Board's promulgated definitions of the terms ''cost accounting practice'' and ''change to a cost accounting practice.''

Exemptions From Contract Price And Cost Adjustment Proposed in the Prior NPRM That Are Withdrawn

9903.302–2(c)(1)—Physical Changes To Improve Management Efficiency and Effectiveness

Comments: Contractors conceptually supported the proposed exemption for improved effectiveness and efficiencies but recommended significant language changes and questioned the level of detail needed to obtain the exemption. The concern was that the administrative cost of requesting the exemption would approximate the same levels of cost needed to prepare and support a cost impact proposal. Examples of recommendations were that:

—Detailed guidance be developed on what constitutes ''improved

management efficiency and effectiveness,'' to eliminate the potential requirement of a cost impact as measurable proof of such efficiency and effectiveness.

—The criteria should not be limited to just ''* * * changes in cost accumulation practices * * *'' It should apply to all applicable cases. The term ''physical realignment'' should be clarified.

Other commenters did not support the proposed exemption.

One respondent recommended ''* * * deletion of the (c)(1) exemption since it does not support consistency, the primary objective of the Cost Accounting Standards. It also does not support the objective of fairness since the contractor's interests are placed above the interests of the government with no legal recourse. Historically at this contractor location, the contract price and cost adjustment process has not hindered contractor accounting change decisions that result in more economical business operations . . . Further, the current exemption criterion is too broad, does not appear consistent with the prefatory response requiring significant physical and cost level changes, and promotes inconsistent treatment of organizational accounting changes. The tremendous resources expended to enhance the Cost Accounting Standards, especially in the cost impact area, will be neutralized by this one sentence exemption, if implemented. Contractor's will be allowed to submit nearly all future accounting changes under this exemption while the improved CAS cost impact regulations may rarely ever be used . . .''

A Federal agency representative recommended deletion of the exemption proposed in the prior NPRM and reinstatement of the desirable change criteria that was proposed in the ANPRM. Another Federal agency official recommended that the proposed exemption be revised to ''* * * state that in order for a change in cost accumulation practice to be exempt from a contract price and cost adjustment, it must result from restructuring activities and the contractor must notify the cognizant Federal agency official of the change prior to beginning the restructuring activities or by some other mutually agreeable date.''

Response: The contractor community indicated that the administrative costs associated with the submission of data and other efforts needed to support a request for the proposed exemption may exceed the administrative costs associated with the cost impact process. If the request for exemption were denied, the contractor would still be subject to potential contract price and cost adjustment and the CAS cost impact process. The contractor community advocated expansion of the proposed cost accumulation exemption criteria (which was designed to mitigate the cost impact process associated with pool combinations and split-outs) to include all cost accounting practice changes. Additionally, the contractor community advocated that the criteria for desirable changes also be expanded to include changes made to improve the economy and efficiency of the contractor's operations.

The Federal agency's recommendation that only a change in cost accounting practice resulting from restructuring activities be exempted, implies that a contractor's exemption request would not be approved unless the restructuring activities are determined to result in savings in accordance with that agency's procedures. The Board does not believe that CASB rules and agency procurement regulations should be so inextricably interwined.

In order to arrive at an equitable balance between the previously proposed ''exemption'' provision and the equitable adjustment provisions applicable to ''desirable changes,'' the Board, in this supplemental NPRM, proposes to replace the previously proposed exemption coverage with expanded ''desirable change'' coverage as described below, under the heading ''Desirable Changes.'' The Board believes such expanded ''desirable change criteria'' when finalized in the Board's regulations will result in greater use of that provision, and that it would not discourage contractor's from implementing economy and efficiency measures that result in cost accounting practice changes. The approach being proposed in this NPRM should also minimize the costs required to administer compliant changes made to a contractor's cost accounting practices.

Additional comments relative to this matter are requested under Section F.

9903.302–2(c)(2)—Changes in the Selection and Composition of Overhead and General and Administrative Expense Pools when Specified Criteria are Met

Comment: Several contractor and two Federal agency representatives recommended deletion of this previously proposed exemption. One commenter supported the Board's proposal. Another recommended that the proposed one percent corridor be expanded.

Response: The proposed exemption was intended to allow contractors to combine or split-out pools that included the same or similar types of activities with common beneficial or causal characteristics; provided, the resulting indirect cost allocations to final cost objectives would closely approximate the indirect cost allocations that would have resulted had the pool combination or split-out not been made. In such circumstances, contractors would provide notification of the change in cost accounting practice, demonstrate that the resulting indirect cost rates are expected to fall within a prescribed corridor, but they would not be required to incur the administrative costs associated with the cost impact process. The proposal was not supported by either the contractor community or by Federal representatives. The Board has, therefore, withdrawn this proposed exemption from the supplemental NPRM being issued today.

Additional comments relative to this matter are requested under Section F.

Illustrations—Changes in cost accounting practices

Comment: Commenters suggested certain editorial changes to the illustration proposed at 9903.302–3(c)(4) in the prior NPRM. One commenter stated that the illustration did not represent a change in cost accounting practice since the accounting method or technique had not changed.

Response: The proposed illustration is consistent with the Board's definitions of the terms ''cost accounting practice'' and ''change to a cost accounting practice.'' The illustration was revised to incorporate suggested editorial changes and to emphasize how the methods and techniques had changed with respect to cost accumulation, selection and composition of the pool, and composition of the allocation base.

Comment: In regard to the illustrations proposed at 9903.302–3(c)(5) and (6) in the prior NPRM, one commenter disagreed that the illustrations depicted changes to cost accounting practices and recommended that they be deleted. Others inquired regarding the application of the Board's proposed exemptions to the illustrated practice change.

Response: The purpose of the proposed illustrations was to provide examples of practice changes subject to the proposed exemptions from the contract price and cost adjustment. Since the proposed exemptions have

been withdrawn, the proposed illustrations have also been withdrawn.

Comment: A commenter recommended deletion of the illustration proposed at 9903.302–3(c)(9) in the prior NPRM because ''* * * the method or technique has not changed * * *'' Another indicated that the illustration represented a change in cost accounting practice because there has been a ''* * * a change in the allocation base * * *'' but that the illustration was confusing in that the change was referred to as ''* * * a change in the selection of the allocation base activity * * * perhaps if the word ''activity'' is deleted, users will not have to interpret what was intended.''

Response: The illustrated transfer of the entire inspection function from one pool to another pool is a change in cost accounting practice because several of the methods or techniques listed as examples in the definition of the term ''cost accounting practice'' have changed. The proposed illustration was revised to more precisely cite the methods or techniques that changed (see 9903.302–3(c)(7)).

Comment: The illustration proposed at 9903.302–3(c)(10) in the prior NPRM introduces the concept of contract practices versus contractor practices. Extending the voluntary change concepts to contract practices that change because of a merger or acquisition is inappropriate. One commenter did not agree that the depicted pool split-out was a change in cost accounting practice.

Response: The purpose of the proposed illustration is to make explicit that a cost accounting practice change made to an acquired segment's established cost accounting practices by an acquiring contractor after the effective date of a merger or acquisition is a change to that segment's established cost accounting practices with regard to the acquired CAS-covered contracts that will be completed by the acquired segment. The Board agrees with the commenter that the Board's rules governing changes to a cost accounting practice apply to the contractor's cost accounting practices established for the performing segment or business unit, and that separate practices are not to be established for individual contracts. However, the Board's rules are applied to individual contracts through the incorporation of an applicable CAS contract clause which requires the contractor to comply with applicable Standards and to consistently follow the contractor's established (or if required, disclosed) cost accounting practices when accumulating and reporting contract performance cost data. Thus, when the acquiring contractor elects to change the cost accounting practices previously used by the acquired segment to estimate and accumulate contract costs, a cost accounting practice change occurs for the acquired CAS-covered contracts affected by the practice change, and such covered contracts are subject to potential contract price and cost adjustment. The proposed illustration was modified to reflect that the contracting parties agreed that a change to a cost accounting practice had occurred (see 9903.302–3(c)(8)).

Comment: The use of the words ''identified'' in the illustration proposed to be added as 9903.302–4(i) in the prior NPRM is not clear.

Response: The illustration, promulgated in this proposed rule at 9903.302–4(h), was revised to clarify that the transfer of an employee from one intermediate cost objective to a different intermediate cost objective does not result in a change to a cost accounting practice when the costs of the ongoing functions or activities continue to be accumulated consistently in the same intermediate cost objectives and that the intermediate cost objectives remain in the same indirect cost pools, before and after the employee is transferred. The words ''identified'' were deleted where it appeared.

Comment: With respect to the illustration proposed to be added as 9903.302–4(j) in the prior NPRM, the increase in the base for the allocation of home office costs resulting from the creation of a new segment is not an ''initial adoption'' of a cost accounting practice.

Response: The initial allocation of home office costs to a newly created segment constitutes the initial adoption of a cost accounting practice for that entity. If the same established practices used for existing segments are applied (e.g., volume increase in base) or if a special or different allocation method or technique is established to reflect the beneficial or causal relationship of the home office costs to the new segment, a cost accounting practice is established for the first time, and, if required, must be disclosed. However, such first time adoptions are treated as an exception from the definition of a change to a cost accounting practice in order not to trigger the CAS contract price and cost adjustment provisions. The proposed illustration, promulgated in this rule at 9903.302–4(i), was revised to make explicit that the described ''increase in the base for the allocation of home office costs'' is a first time adoption of a cost accounting practice, i.e., an exception to the definition of a change to a cost accounting practice.

Contract Clauses

Comment: A commenter recommended deletion of the proposed words ''or will result'' in paragraph (a)(5), entitled ''Noncompliance,'' of the proposed contract clause because the commenter believed that the meaning and resulting application of the phrase was unclear. The commenter inquired: Does it apply to increased costs under the contracts that have been awarded by the date of noncompliance or is a projection based on future awards required?

Response: The intent of the phrase ''will result'' is to require consideration of the amounts remaining to be paid under existing CAS-covered contracts affected by a noncompliant cost accounting practice that was used to estimate contract costs. For example, assume that a noncompliant practice was used to estimate contract costs for a fixed-price contract which resulted in the negotiation of an overstated price. After award, at the time the noncompliance is being resolved, the affected fixed-price contract is partially complete with units of production remaining to be billed at the negotiated contract unit price. In such cases, increased costs paid occurred when the Government paid for the units that were completed and delivered. Increased costs paid by the Government would also result in the future as the contractor receives payment for the remaining contract items when they are completed and delivered. Resolution of estimating noncompliances, in the form of required contract price adjustments for affected cost-type and/or fixed-price contracts, need not wait until the Government actually pays the increased costs included in the negotiated contract price. The proposed provision was retained.

Comment: A commenter recommended that the ''access to records'' paragraph be revised by deleting the proposed coverage describing the type and form of records covered. The commenter expressed concern that the proposed language regarding providing copies of computer software may involve third party agreements.

Response: The previously proposed references to ''software'' have been deleted from the revised contract clause language being proposed today.

Comment: A Federal agency recommended that the contract clause at 9903.201–4(d), applicable to negotiated contracts awarded to a United Kingdom contractor, and 9903.201–4(e) Cost

Accounting Standards—Educational Institutions, be modified for consistency with the amendments proposed for the contract clauses at 9903.201–4(a), Full Coverage, and 9903.201–4(c), Modified Coverage.

Response: Clause (d), for United Kingdom contractors, is quite different from the other referenced provisions. In addition, it is both brief and simple. In the absence of any identified implementation problems, that clause does not appear to be in need of modification. The clause for educational institutions was promulgated on November 8, 1994. In response to one related ANPRM comment, the Board asked in the prior NPRM (61 FR 49206) for further comments on the desirability and support for making such revisions. Only this one comment was received. Accordingly, the Board believes that such revision is not currently warranted.

Desirable Changes

Comment: Several contractors urged the Board to retain the ANPRM provisions that included economy and efficiency changes as examples of desirable changes. A professional association recommended: ''* * * make it clear that organizational changes intended to produce cost savings are desirable and should be administered using equitable adjustment procedures.''

Response: The ANPRM criteria for desirable changes was deleted when the NPRM exemption for economy and efficiency changes was proposed. The Board concluded that performing contractors and Federal officials should not be able to choose which of the two types of coverage should be applied to changes in cost accounting practices that result from contractor actions taken to improve the economy and efficiency of operations. In practice, such provisions could result in endless debates and produce potential disputes between the contracting parties. Accordingly, the ANPRM desirable change criteria citing economies and efficiencies were not incorporated in the prior NPRM issued on September 18, 1996.

As discussed under the heading ''Exemptions From Contract Price And Cost Adjustment Proposed in the Prior NPRM are Withdrawn,'' a number of commenters expressed concern that the proposed exemptions, while appreciated for their fairness, would increase rather than decrease contract administrative costs. Some also believed that the exemptions should be expanded and that more detailed procedural provisions were needed. After considering the comments received, the Board concluded that the proposed ANPRM economy and efficiency criteria provide for an equitable resolution process that can be reasonably implemented, in a fairly predictable manner, with a minimum of administrative effort. Further, the ANPRM approach was generally supported by contractors and a commenting Federal official. Accordingly, the Board proposes to adopt the commenters' recommendations to reinstate the ANPRM ''economy and efficiency'' criteria for ''desirable'' changes (and to also delete the previously proposed ''exemptions'') in this supplemental NPRM. Additionally, the previously proposed permissive use of the ANPRM economy and efficiency criteria was replaced by mandatory language that states a change in cost accounting practice ''shall'' be deemed a desirable change if a listed criterion is met.

Specific comments relative to this proposed provision are requested under Section F.

Comment: Clarify that the proposed criteria are not conjunctive by adding the phrase ''one or more of'' after ''not limited to.''

Response: The proposed criteria are not conjunctive. The recommended phrase was added at 9903.201–6(b) to clarify that only one criterion needs to be met for a practice change to be deemed a desirable change.

Comment: Several commenters from the contractor community again recommended that the Board include as desirable changes, accounting changes required by law or regulation, as well as accounting changes required for conformity with changes in generally accepted accounting principles (GAAP) promulgated by the Financial Accounting Standards Board.

Response: The Board continues to disagree with the commenters. As stated in the prior NPRM, the original CASB concluded that all contractor proposed changes in cost accounting ''... for any reason ...'' should be considered for contract adjustment and that if major changes in cost accounting practice were required in order for contractors to comply with an express provision of law, the Board would appropriately modify its Standards (Preamble J, Changes compelled by law or regulation (43 FR 9775, March 10, 1978)). Accounting procedures required to conform with laws, regulations or GAAP are generally not mandated for Federal contract cost accounting purposes. While a contractor must comply with such requirements for tax reporting purposes or financial statement reporting purposes to stockholders, such requirements are not *per se* required cost accounting practices for Federal contracting purposes. Hence, any contractor desired change to an established cost accounting practice used to estimate, accumulate and report the costs of performing CAS-covered contracts and subcontracts remains subject to the Board's Standards, rules and regulations, including the CAS contract clause adjustment provisions governing changes in cost accounting practices. Accordingly, each contractor change in cost accounting practice made for any reason must be considered on a case-by-case basis in order to determine whether the change is or is not desirable.

Comment: Several commenters recommended deletion or revision of the proposed criteria at 9903.201–6(b)(1) which provides that if the Government determines that a change in cost accounting practice is ''necessary'' in order for the contractor to remain in compliance with an applicable Standard, the practice change shall be deemed to be a ''desirable'' change. The commenters believed such changes are ''required'' changes that are subject to equitable adjustments under the CAS contract clause provisions for required changes. Furthermore, contractors should not be required to request a second determination that a change ''required to remain in compliance'' be deemed a desirable change.

Response: As stated in the prior NPRM preamble comments (61 FR 49202), the CAS contract clause provisions that refer to a ''required'' change only pertain to a change in cost accounting practice that is made in order to comply with a new Standard, modification or interpretation thereto when it first becomes applicable to an existing covered contract through the award of a subsequent CAS-covered contract or subcontract. It does not apply to changes in cost accounting practices made subsequently by a contractor due to changed circumstances in order to remain in compliance with an existing Standard already applicable to an existing contract. By treating such subsequent changes as ''desirable'' changes, the contracting parties can negotiate equitable adjustments for covered contracts and/or subcontracts materially affected by subsequent changes that the cognizant Federal agency official has determined, on a case-by-case basis, were necessary in order for the contractor to remain in compliance with an applicable Standard.

When a determination is made that a practice change was ''necessary,'' it is expected that the cognizant Federal

agency will treat that determination as the equivalent of a desirable change determination. No further paperwork is envisioned by the Board in such cases. If not determined ''necessary'' and the practice change is not otherwise considered to be a desirable change, the compliant practice change would be a voluntary change that is subject to the ''no increased cost to the Government'' provisions of affected CAS-covered contracts and subcontracts.

To distinguish subsequent changes in cost accounting practices from first time ''required'' practice changes, the Board has retained the proposed criteria, including the proposed designation of ''necessary'' in the rule being proposed today. The proposed procedures at 9903.405–2(d) for requesting that a voluntary change be considered a desirable change were modified to also require the submission of data demonstrating that a change was ''necessary'' to remain in compliance with an applicable Standard.

Comment: Two Federal commenters objected to the criteria proposed at 9903.201–6(b)(2) in the prior NPRM. One stated that the provision is subject to misinterpretation, that contractors are responsible for initiating voluntary changes and that the Government only determines if a practice change is adequate and compliant. The other commenter also believes it is inappropriate for the Government to make recommendations to contractors to change an accounting practice.

Response: In response to the ANPRM, some contractors advocated that a change in cost accounting practice recommended by the cognizant Federal agency official and implemented by the contractor be considered a desirable change, since they apparently had experienced such conditions. A Federal agency recommended deletion of the proposed provision because in their view this provision would rarely be used and it would avoid contractor interpretations of discussions held with Federal officials as representing recommended changes. In the prior NPRM, a requirement for a written Government recommendation was added to preclude contractor actions or misinterpretations of conversational exchanges with Government representatives.

The Board has reconsidered this matter and agrees with the Federal commenters that the Government should not recommend specific cost accounting practices to be applied by contractors. Rather, authorized Government representatives should limit their oversight activities to determining whether a contractor's proposed or established cost accounting practices are in compliance with the Board's applicable Standards. Accordingly, the referenced provision has been deleted from this supplemental NPRM.

Cognizant Federal Agency Responsibilities

Comment: Representatives from two Federal agencies expressed a number of concerns regarding proposed subsection 9903.201–7 and one recommended deletion of proposed paragraph (d) therein. The primary concerns were that the proposed amendments may conflict or duplicate existing and/or future provisions in Federal Acquisition Regulation (FAR) subparts 30.6 and 42.3, and that the proposed responsibilities for obtaining funding may go beyond the control of the cognizant Federal agency official.

Response: The Board continues to recognize that responsibility for administering CAS-covered contracts rests with the various Federal agencies, including civilian agencies that are subject to CASB rules and regulations. The Board, in reviewing how the CAS cost impact process was conducted at a number of contractor locations, concluded that this process was generally not being accomplished in a timely or efficient manner. One contributing factor was that neither the Board's rules nor applicable agency regulations clearly set forth the complete process to be followed or actions to be taken by the contracting parties. This supplemental NPRM proposes a precise yet flexible approach for the submission of cost impact data due to compliant changes in cost accounting practices and noncompliances and for determining the resultant contract price or cost adjustments required under the Board's rules and regulations. The Board believes such specificity will facilitate the CAS administrative process, reduce administrative costs and improve timeliness.

However, the Board also recognizes that certain implementing administrative policies and procedures need to be established in applicable agency regulations. Accordingly, the Board has modified the previously proposed provisions to provide agencies with more flexibility in developing applicable implementing policies and procedures. Proposed paragraph (d) has been significantly modified in this supplemental NPRM. It was retitled to reflect its applicability to just the processing of contractor changes in cost accounting practices. The proposed language was revised to state that actions are to be taken in accordance with applicable agency regulations. A new paragraph (3) was added to clarify that other methods may be used to resolve negotiated cost impact settlements if the cognizant Federal agency official determines that funds needed to effect contract price modifications will not be made available in a timely manner.

The Board is of the opinion that modification of contract and subcontract prices, as prescribed in the regulations being proposed today, represents the preferred method to be used to resolve material cost impacts due to a change in cost accounting practice. Modification of contract prices enable the contracting parties to establish contract prices for covered contracts that correlate with the increased or decreased cost allocations to such contracts that result due to practice changes. This facilitates contract administration by permitting meaningful comparison of estimated and actual costs. The Board is also aware that often the necessary funding required to increase some contract prices may not be readily available. In the NPRM being issued today, revised coverage has been added to emphasize that the decision on how to best achieve an equitable solution, in the aggregate, remains a cognizant Federal agency official responsibility.

Cost Impact Process

Comment: A Federal agency expressed concern about the extent of detailed administrative responsibilities and requirements included in the prior NPRM. An industry representative presented a similar view by stating that some of the proposed material was overly prescriptive.

Response: In order to fully and clearly describe the cost impact process, inclusion of certain administrative responsibilities and requirements is unavoidable. However, the Board agrees that some of the prior NPRM material may have been overly instructional and prescriptive in nature. The Board has deleted such material.

Comment: Industry commenters questioned the fairness of having ''strict'' time requirements put on contractors for cost impact responsibilities, while the Government had ''suggested'' time periods for completion of their required actions. A Federal agency commenter, on the other hand, wanted more flexibility with regard to time requirements applied to the responsibilities of cognizant agency officials.

Response: In order to fairly respond to both industry and Government groups, all specific time frame requirements,

with the exception of the advance notification requirements for changes in cost accounting practices, have been deleted from the NPRM being issued today. Previously proposed time requirements were replaced with language that states that actions should be taken ''on or before the date specified by the cognizant Federal agency official or other mutually agreeable date''. However, the Board concluded that the length of time taken to complete the change in cost accounting practice and noncompliance cost impact and resolution process has been a problem in the past, and believes the problem will continue if not adequately addressed by procurement officials. The Board therefore urges Federal agencies to establish reasonable and specific time guidelines in their implementing regulations for the completion of the various steps to be specified in subpart 9903.4 when this rulemaking process is completed.

Comment: One industry commenter suggested that the term ''voluntary'' be eliminated from the definition of a desirable change because not all desirable changes are voluntary. A Government commenter suggested that the rule refer to changes that are not required changes as either voluntary changes ''not deemed desirable'' or as voluntary changes deemed ''desirable'', as applicable.

Response: The Board believes that through usage and practice the contracting parties familiar with the requirements of the CAS contract clause provisions governing compliant changes in cost accounting practices have assigned distinct meanings to the terms ''voluntary'' and ''desirable'' changes. The usage of and reference to these terms in most of the commenters' responses affirms the Board's belief. The Board therefore does not wish to disturb this commonly accepted and understood usage of these terms. The proposed definition of a voluntary change was revised for greater consistency with the common usage of the term by adding that it is a change ''that is not deemed desirable by the cognizant Federal agency official and for which the Government will pay no increased costs''. Similarly, the definition of a desirable change has been expanded to indicate that these are changes which become subject to ''equitable adjustments'' if covered contracts are affected by the change. Thereafter in the proposed subpart being issued today, practice changes are referred to as ''voluntary'' when no increased costs will be paid by the Government and as ''desirable'' when equitable adjustments will apply.

Comment: Several industry commenters objected to the proposed notification requirement for required changes (at 9903.405–2(b)(1) in the prior NPRM). The commenters contended that the proposed 60 day advance notification requirement was not always practical or even possible when a Request For Proposal provides a shorter time period for proposal submissions.

Response: Estimated costs proposed for a CAS-covered contract must be predicated on cost accounting practices that are compliant with the CAS that will apply to the potential contract, if awarded. The proposed advance notification requirement was intended to provide the Government with additional time to determine if the contractor's changed cost accounting practice to be used for contract cost estimating purposes was adequately disclosed and compliant with the potentially applicable CAS. However, the Board agrees with the commenters that the 60 day advance notification requirement may not always be practical. The proposed requirement was revised to require notification ''* * * as soon as it becomes known that a required change must be made, but no later than the date of submission of the price proposal in which the contractor must first use the changed practice to estimate costs for a potential CAS-covered contract.''

Comment: Industry commenters, in general, objected to the proposed provisions (at 9903.405–2(b)(2) (i) and (ii) in the prior NPRM) which precluded contractors from using a proposed new accounting practice for estimating costs for the first time (the effective date) until the earlier of 60 days after notification or the date a determination of adequacy and compliance is made by the cognizant Federal agency official. A Government agency expressed concern about applying different treatment for contracts awarded between the notification date and effective date based on the ''preclusion of use'' provision, than for other contracts awarded prior to the notification date for voluntary changes. They recommended that the Board delete the ''special equitable adjustment'' treatment included in the prior NPRM for these contracts. A group of ''concerned U.S. Taxpayers'' raised several questions with regard to the ''special equitable adjustment'' provisions which indicated that the procedure included in the prior NPRM for these ''special'' contracts may be difficult to apply.

Response: The Board, in researching this issue, learned that a lack of consistency exists as to the point in time when contractors actually begin to use a changed cost accounting practice to estimate costs in price proposals. Some used immediate implementation, while others waited until the cognizant Federal agency official made a determination of adequacy and compliance. The Board's purpose in proposing the ''special equitable adjustment treatment'' provision was to promote consistency in use of changed practices for estimating costs for price proposals.

After considering the many negative comments received about this provision, the Board has decided to withdraw the proposed requirement which would have precluded contractors from immediately using proposed new practices for estimating purposes. The Board is also eliminating the related ''special equitable adjustment'' provisions proposed for contracts awarded between the notification and effective dates (at 9903.405–2(f), 9903.405–5(d)(7) and 9903.407–1(h) in the prior NPRM). Due to this elimination, the effective date for voluntary changes being proposed in this supplemental NPRM is the date on which the contractor first begins using the new practice for estimating costs for potential CAS-covered contracts. In the event that the cognizant Federal agency official subsequently determines that the new practice is noncompliant with an applicable Cost Accounting Standard, the contractor's implementation of the noncompliant practice for estimating purposes would be handled in accordance with 9903.406–3.

The Board has also revised the previously proposed requirements for the notification date for voluntary changes based on the elimination of the ''preclusion of use'' and ''special equitable adjustment'' provisions. As revised, the requirement for notification is ''60 days before the applicability date'' or the date of submission of the first contract price proposal which reflects the use of the voluntary change (see 9903.405–2(b)(2) in this NPRM). The previously proposed provision of concern to some commenters regarding the establishment of a ''revised notification date'' (at 9903.405–3(a) in the prior NPRM) has also been eliminated since this related to the 60 day window period for the ''preclusion of use'' and ''special equitable adjustment'' provisions.

Comment: Several Government commenters requested that the Board include a provision requiring the Federal agency official to notify the contractor of the desirable change determination so that a voluntary

change could be treated as a ''desirable'' change for cost impact and contact price adjustment purposes.

Response: Since there is a proposed requirement for the contractor to submit a written request and provide written justification for desirable changes, the Board agrees that the cognizant Federal agency official's decision and response should also be in writing. The Board proposes to establish this requirement at 9905.405–3(b). When the contractor provides the required notification, a determination has not yet been made by the cognizant Federal agency official as to whether a voluntary change is or is not desirable. Accordingly, 9903.405–2(b)(2) was revised to clearly reflect that the notification requirement applies to a voluntary change. A similar requirement concerning the determination made on planned voluntary changes with retroactive applicability dates is also proposed at 9903.405–3(c).

Comment: In the interest of streamlining, both industry and Government commenters recommended that the general dollar magnitude (GDM) submissions and Cost Impact Settlement Proposal submissions (at 9903.405–4 (a) and (b) in the prior NPRM) be combined into one submission.

Response: The Board agrees with this recommendation. A combined submission format is being proposed at 9903.405–4(a)(4). The Board has decided to refer to the submission as a ''GDM Settlement Proposal'' in order to give recognition to the submission's two purposes: (1) To provide a general dollar magnitude estimate of the aggregate cost impact amounts by contract type; and (2) to provide the contractor an opportunity to propose specific adjustments to settle the cost impact of a change in cost accounting practice. Previously proposed paragraph (c) covering the submission of a detailed cost impact proposal has been moved to 9903.405–4(b).

Comment: One commenter suggested that a contractor's cost impact submissions be shown by two contract groups rather than by contract type. The suggested groups were ''firm fixed-price'' and ''other than firm fixed-price''.

Response: The Board believes that the suggested ''other than firm fixed-price'' grouping to be inappropriate because it would combine contracts that should not be combined, e.g., incentive contracts with non-incentive contracts. In order to reduce the number of contract types that must be listed in the GDM Settlement Proposal, the Board believes that in most situations, the contract types may be limited to the following groups: firm fixed-price (FFP); time and material (T&M); incentive type (FPI/CPIF); and all other cost reimbursement contracts. These contract ''type'' groupings are illustrated in the GDM Settlement Proposal being proposed today at 9903.405–4(a)(4).

Comment: One industry commenter recommended that a contractor initially only be required to submit a GDM estimate of the aggregate impact of changes in cost accounting practices so that a materiality determination can be made prior to requesting any individual contract data. A Government commenter supported the submission of some contract data, as proposed in the prior NPRM, by opining that ''a GDM alone does not furnish any information on the expected impact on specific large contracts, and the lack of data may cause delays and requirements for a detailed cost impact proposal''.

Response: The submission of some individual contract data with the GDM aggregate estimate serves three purposes. First, it provides reasonable assurance with regard to the accuracy of the aggregate estimate by contract type submitted in the GDM. Secondly, it provides additional and needed support to determine if a cost impact due to changes in cost accounting practices is material both in the aggregate and for individual contracts. Finally, it provides a contractor an opportunity to propose specific adjustments to settle the cost impact without resort to a detailed cost impact proposal. The Board included in the prior NPRM, and has more prominently displayed in this NPRM, a provision that states that if the cognizant Federal agency official determines that the impact of a change is obviously immaterial, the process will be considered completed (see 9903.405–3(d)). Absent an ''obviously immaterial'' condition, the Board continues to believe that individual contract data is needed to evaluate the accuracy of the GDM aggregate estimate and to determine the materiality of the impact both for the aggregate amounts and for individual contracts. The Board has therefore retained the proposed requirement for the submission of individual contract data along with the GDM aggregate estimate (as part of the GDM Settlement Proposal).

Comment: A Government commenter recommended that the previously proposed provision at ''* * * 9903.405–3(b) be expanded to specifically require the contractor to submit a GDM. Disputes have arisen over who is required to submit a GDM, the contractor or the Government''.

Response: In order to make clear that it is the contractor that is required to prepare and submit the GDM Settlement Proposal, the Board has included revised wording at 9903.405–3(e) in this NPRM.

Comment: One commentator suggested that the baseline for computing the cost impact due to changes in cost accounting practices be the ''before change'' cost data baseline as opposed to the ''after change'' cost data baseline as proposed at 9903.405–4(a)(3).

Response: The most important factors in the computation of the cost impact of a change in cost accounting practice are: (1) to use a consistent cost data baseline; and (2) to isolate the cost impact of cost allocation differences on covered contracts that are due solely to the application of the original and changed cost accounting practices. If this is done properly, there should not be a significant difference in the cost impact amount, regardless of which baseline is used. The Board continues to believe that the ''after change'' cost data baseline is preferable for the reason stated at 9903.405–4(a)(3). The Board has not mandated its use, however, as evidenced by the proposed use of the word ''should'' and the phrase ''in most cases'' included in this subparagraph. To provide added flexibility for determining the data to be used for cost impact computation purposes, additional language was inserted to reflect the Board's preference for the use of the latest forecasted data used for forward pricing purposes, while still permitting the use of other data that ''is considered preferable and agreed to by both the contractor and cognizant Federal agency official.''

Comment: One industry commenter suggested that the Board establish specific materiality thresholds for the aggregate, ''all other'' contract, and individual contract amounts for contract price adjustment purposes.

Response: The Board's decision not to specify materiality amounts for cost impact thresholds is consistent with the position the Board has taken in the past with regard to this issue. The Board leaves such materiality determination decisions to the cognizant Federal agency officials who must evaluate the specific circumstances on a case-by-case basis in making these determinations.

Comment: Several industry commenters argued that the use of the ''netting'' process described in the prior NPRM be expanded to required and desirable changes, and not be limited to ''no increased costs'' voluntary changes. One Government commenter recommended deleting the term ''netting'' because ''* * * it is confusing for the rule to discuss the two different terms, 'offset' and 'netting'. Since

'offsets' is the term currently used and most contractors and contracting officers are familiar with it, we see no reason to introduce a new term.''

Response: The concept of ''netting'' only has relevance for a voluntary change for which there will be no increased costs to the Government. The proposed use of the term ''netting'' was to be associated with the process used to determine if the Government would potentially pay increased costs, in the aggregate, after giving consideration to appropriate adjustments of all affected contracts, due to the cost impact of a voluntary change in cost accounting practice. Since increased cost to the Government is not a concern for required or desirable changes which result in equitable adjustments upward or downward based on the cost impact, ''netting'' simply does not apply to such practice changes. The Board agrees with the Government commenter that the introduction of the term has caused some additional confusion concerning this process. The term ''netting'' has therefore been eliminated from this NPRM.

The process for determining whether increased costs to the Government would result after all potential contract price adjustments are considered is still an essential action that must be accomplished for a voluntary change. The required process is specified at 9903.405–5(d) in this NPRM.

Comment: Regarding the ''preclusion of increased cost'' matrix previously proposed at 9903.405–5(d)(3) for voluntary changes, one industry commenter argued that it was not equitable that no upward adjustments be made when a higher amount of costs are to be allocated to both flexibly priced and firm fixed-price contracts, while downward adjustments to both flexibly priced and firm fixed-price contracts are made when a lower amount of costs were to be allocated to these contract types as a result of voluntary changes in cost accounting practices. Other commenters argued that downward adjustments to CAS-covered fixed-price contracts should be limited to corresponding upward adjustments to CAS-covered flexibly priced contracts, or otherwise a ''windfall'' accrues to the Government.

Response: The proposed matrix is intended to show that for voluntary changes, the Government will not pay increased costs in the aggregate by precluding any net upward price adjustments. The Board's proposed rule is predicated on the basic concept that the Government should not pay more than the Government would have paid had the voluntary change not been made. That is the important distinction between a voluntary change and a desirable or required change.

If the same scenarios that appear in the matrix were applied to required or desirable changes, there would be no limit on upward or downward adjustments, nor would there be a concern with regard to whether the cost allocation increases or decreases were coming from other CAS-covered work, other Government non-CAS-covered work, or commercial work. For required or desirable changes, CAS-covered contracts are subject to equitable adjustments under the changes clause of the contract. Therefore, in the scenario for required and desirable changes in which the costs to be allocated are higher for all contract types, the CAS-covered contracts are equitably adjusted upward to reflect the impact of the change (see 9903.405–5(d)(6)). The Government certainly could not claim an ''offset'' against the upward adjustment of the flexibly priced contracts by saying that a corresponding higher amount of costs to be allocated to firm fixed-price contracts represents ''decreased'' cost, thereby denying the contractor its equitable adjustments. The same is true of the opposite scenario of a lower amount of costs to be allocated to all contract types due to required and desirable changes. The contractor similarly has no ''offset'' claim here, and the Government is entitled to its downward equitable adjustments under the contract clause provisions for required and desirable changes.

The contract clause provision for changes in cost accounting practices which applies to ''any change'' is that ''the change must be applied prospectively'' and that ''if the contract price or cost of this contract is materially affected by such changes, such adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) of this clause'' (see (a)(2) of the contract clause at 9903.201–4(a)). Therefore, in accordance with this provision, contract prices are to be adjusted upward or downward to reflect any material cost impact due to compliant changes in cost accounting practices. The only exception results from the ''no increased cost'' provision for voluntary changes at (a)(4)(ii) of the contract clause. This precludes net upward contract price adjustments for voluntary changes. There is no similar preclusion of net downward contract price adjustments for voluntary changes.

The Government should be left no worse off as a result of a voluntary change than it is for a required or desirable change with regard to contract price adjustments. Therefore, net downward contract price adjustments can and should be made if the cost impact reflects a lower amount of costs in the aggregate to be allocated to CAS-covered contracts as a result of changes in cost accounting practices. Such net downward adjustments do not create a ''windfall'' to the Government. Nor do these downward contract price adjustments result in recovery by the Government of costs greater than the lesser allocation of costs in the aggregate on the relevant contracts subject to price adjustment (this would only occur if the Government made downward contract price adjustments greater than the aggregate lower cost allocation amounts reflected by the cost impact). The contract price adjustments merely adjust the affected contract values to make them consistent with the costs expected to be accumulated under the changed cost accounting practices to be used to accumulate costs on those contracts for the remainder of their contract performance period.

Due to the apparent continuing confusion regarding the use of the term ''increased costs'', the Board re-examined the proposed definitions contained in the prior NPRM. The Board concluded that it was not commonly understood that the definition of increased cost was dependent upon the type of contract involved and whether the contract price would or would not reflect the changes in cost allocations resulting from a change in cost accounting practice. The Board has therefore modified the proposed definitions to clarify that the term ''increased cost'' refers to ''increased cost to the Government'' and that the definition is from the point of view of the condition that would result if no contract price or cost adjustments were made to achieve equity.

Comment: Another commenter recommended substituting ''Increased Costs'' and ''Decreased Costs'' for ''Higher'' and ''Lower'' in the matrix to conform with the terms used throughout the NPRM with regard to cost impacts due to changes in cost accounting practices.

Response: Since ''Increased Costs'' has a certain defined connotation in the CAS Board's rules and regulations, use of this term disturbs the various scenarios and related conclusions presented in the column entitled ''Actions To Be Taken To Preclude Increased Costs''. However, in order to make clear what is meant by ''Higher'' and ''Lower'' in the matrix with regard to shifts of costs resulting from voluntary changes, descriptive footnotes have been added in the matrix (see

9903.405–5(d)(3)). The proposed language is consistent with the language used in the definitions of increased costs included in 9903.403.

Comment: One commenter suggested that the Board eliminate the term ''disallow'' in the matrix since we are dealing with costs that are otherwise allowable except for the ''no increased cost'' provision for voluntary changes.

Response: The Board proposes to replace the term with the phrase ''preclude payment of'' to be consistent with the wording in the contract clause provision for voluntary changes.

Comment: One commenter interpreted the prior NPRM as requiring that, for noncompliances, detailed cost impact proposals must be submitted, and stated that ''requiring a detailed cost impact proposal for all noncompliances is contrary to acquisition reform and streamlining Government regulations.''

Response: The Board did not intend that a detailed cost impact proposal be submitted for all noncompliances. The Board's prior proposal has been revised to clarify this point. In this NPRM, the proposed language at 9903.406–2(e) specifies that a cost impact submission may be in a format similar to the GDM Settlement Proposal shown at 9903.405–4(a)(4), the detailed cost impact proposal specified at 9903.405–4(b) or other mutually agreeable format which will accomplish the objectives of 9903.406–3 (c) and (d) for a cost estimating noncompliance or 9903.406–4 (c) and (d) for a cost accumulation noncompliance. Also, an example of a GDM Settlement Proposal format for a noncompliance action has been added to 9903.406–2(e). Elsewhere in proposed 9903.406, the previously proposed phrase ''cost impact proposal'' was replaced with the phrase ''cost impact submission'' in order to avoid the perception that a detailed cost impact proposal was being required for all noncompliances.

Comment: One commenter recommended using the phrase ''cost accounting noncompliance'' in lieu of ''cost accumulation noncompliance''.

Response: The Board proposed the terms ''estimating'' and ''accumulating'' to describe the two types of noncompliances that can occur. The two terms are consistent with the terminology used in 9904.401 which requires consistency in the cost accounting practices used to estimate and accumulate costs. The Board believes that use of the phrase ''cost accounting noncompliance'' would lead to confusion since cost accounting practices are used to both estimate and accumulate costs.

Comment: One commenter recommended that a provision be added that would allow a contractor to submit data demonstrating that the impact of a noncompliance is immaterial and therefore could be handled under 9903.406–5 as a Technical Noncompliance.

Response: The Board agrees with this recommendation and proposed language has been added at 9903.406–3(a) and 9903.406–4(a) to reflect this permitted action.

Comment: One commenter suggested that the Board add an illustration to show that a situation similar to the one described in the prior NPRM illustration proposed at 9903.407–1(e)(1) could be resolved by adjusting one contract rather than three contracts.

Response: The Board has added such an illustration at 9903.407–1(d)(2) in this NPRM.

Comment: One commenter advised that, in the proposed illustration at 9903.407–1(g)(2), the statement that increased cost on a CPFF contract was ''coming from a shift of costs from both Contract A and other non-government work'' implies that the need to preclude costs depends on how the costs are shifted and recommended its deletion.

Response: The Board did not intend to imply that, when changes in cost accounting practices result in shifts of costs to or from CAS-covered contracts, the resolution of the cost impact and resulting contract price adjustments would be affected or influenced by whether the cost shift was coming from or going to other CAS-covered work or non-CAS-covered work. In order to avoid any unintentional implications or inaccurate inferences, the cited reference to the source of the shift of costs onto the CPFF contract was deleted (see the revised illustration at 9903.407–1(f)(2) in this NPRM).

Comment: A commenter did not understand why the proposed resolution of the estimating noncompliance illustrated in the prior NPRM, at 9903.407–2(a)(2), did not result in net upward adjustments to the affected fixed-price contracts. Specifically, the commenter stated that ''we are unable to determine either the logic or the regulatory basis for the Government to keep the windfall profit''.

Response: The commenter's assertion appears to be that fixed-price contract prices should be adjusted upward to reflect the full amount by which the estimated costs contained in the contractor's cost proposals were understated due to the application of a noncompliant cost accounting practice. This contrasts with the proposed resolution shown in the referenced illustration which limited the upward adjustment on one fixed-price contract to the downward adjustment experienced on a different fixed-price contract, i.e., an approach that results in no increased cost, in the aggregate, to the Government when an estimating noncompliance is corrected. The proposed illustration was consistent with the regulatory provisions proposed in the prior NPRM at 9903.406–3(c)(2). The Board's rationale was based on the opinion that contractors are expected to consistently apply their established cost accounting practices, in compliance with applicable Cost Accounting Standards when estimating costs for potential CAS-covered contracts, and, if the contract is awarded, when accumulating and reporting the costs of contract performance. The Board's continuing objective is to encourage contractors to utilize compliant cost accounting practices in a consistent manner when submitting cost proposals that are intended to reflect the estimated costs of contract performance expected to be accumulated in the contractor's cost accounting records if the contract were awarded.

In questioning the Board's basis for the proposed solution, perhaps the commenter is advocating that the correction of a contractor's estimating noncompliance, as illustrated in the prior NPRM, should result in revised contract prices that are higher, in the aggregate, than the amounts agreed to by the contracting parties at the time of negotiation. If such a policy were established, a contractor that inadvertently or knowingly proposed a lower estimated cost by using a noncompliant cost accounting practice would have the potential ability to gain a competitive advantage or mislead the Government regarding the eventual cost to the Government while being assured that after contract award, by initiating action to correct the noncompliant practice, the contract price would be revised upward to fully cover the understated costs. The Board does not agree with the thrust of the commenter's inquiry.

Accordingly, the illustration proposed in the prior NPRM was retained in this NPRM. In addition, 9903.406–3(d) was revised to clarify that estimating noncompliances cannot result in net upward contract price adjustments. A schedule was also added to illustrate whether contract price adjustments are to be required for flexibly-priced and/or fixed-price contracts when an estimating noncompliance results in the negotiation of contract prices that are higher or lower than the prices that

would have resulted had a compliant practice been used.

Comment: One commenter advised that it would be useful if the Board would prescribe which of the two ''underpayment interest rates'' prescribed at 26 U.S.C. 6621 specifically applies to the CAS contract price adjustment interest provision required by 41 U.S.C. 422(h)(4) and included in the various CAS contract clauses.

Response: The Board agrees with the commenter that this issue has engendered some confusion among contractors and Government agencies. The Board's enabling statute, and the various CAS contract clauses, specify that the interest rate prescribed at 26 U.S.C. 6621 shall be used in making such calculations. At the time the Board's current enabling statute was enacted, this provision only contained one ''underpayment interest rate''. Subsequntly, the statute was amended to include two different ''underpayment interest rates''. Upon careful consideration of this issue, the Board has concluded that the lesser of the two ''underpayment rates'' should be used in making the appropriate interest adjustment calculation. The Board has reached this conclusion after considering the specialized nature of the more recently enacted ''underpayment rate for large corporations'' and what would appear to be its limited use in certain Internal Revenue Service tax enforcement actions. In addition the interest rate specified at 26 U.S.C. 6621(a)(2) was the rate in effect at the time that the Board's current enabling statute was enacted. To effect the requested clarification, a revision has been made at 9903.306.

Educational Institutions

Comment: Several commenters suggested that the Board exempt educational institutions from the requirements of proposed subpart 9903.4, Contractor Cost Accounting Practice Changes and Noncompliances. They believed that OMB Circular A–21, Cost Principles for Educational Institutions, as amended April 26, 1996, which now incorporates the Board's applicable Standards and Disclosure Statement, provides sufficient coverage and guidance for the reporting of changes to established cost accounting practices and for making required price or cost adjustments if a practice change or a noncompliance results in a material cost impact on Federally sponsored agreements, including any CAS-covered contracts.

Response: As proposed, subpart 9903.4 would have applied to all CAS-covered contractors, including educational institutions. However, a waiver provision authorizing cognizant agencies to waive, on a case-by-case basis, any CAS unique 9903.405 requirements for determining the cost impact of compliant changes in cost accounting practices under CAS-covered contracts awarded to educational institutions was also provided at 9903.401–2 in the prior NPRM. The waiver provision was intended to provide maximum flexibility when the cognizant Federal agency official must concurrently determine contract price and cost adjustments for CAS-covered awards and make similar adjustments for non CAS-covered contracts and Federal grants in accordance with applicable OMB Circular A–21 requirements. Under the proposed waiver authority, the cognizant Federal agency official can waive specific CAS adjustment methodologies so that one set of calculations can be applied, in a consistent manner, to the total universe of Federally sponsored agreements affected by a compliant change in cost accounting practice. However, actions specified in subpart 9903.4 requiring notification to the Government when a practice change is made and to equitably resolve the cost impact resulting from the use of a noncompliant cost accounting practice used to estimate, accumulate or report costs were not subject to the proposed waiver.

Although OMB Circular A–21 does not contain the specificity contained in subpart 9903.4 for determining the cost impact of a cost accounting practice change or a noncompliance on CAS-covered contracts, the Board is sympathetic with the commenters' expressed concerns. To promote the concept that the cognizant Federal agency official should administer all Federally sponsored agreements on a consistent basis with regard to cost accounting matters, the Board, in the NPRM being issued today, has expanded the proposed waiver authority to include all of the requirements of subpart 9903.4 except for the adequacy and compliance determinations required by 9903.405–3(a). As revised, the proposed provision requires the cognizant Federal agency official to administer the cost accounting aspects of CAS-covered contracts awarded to an educational institution in accordance with proposed subpart 9903.4 procedural requirements but where alternate procedures are deemed appropriate and necessary in order to achieve a uniform and consistent approach for all Federally sponsored agreements being performed by an educational institution, the cognizant official is authorized to waive subpart 9903.4 requirements on a case-by-case basis. A provision requiring the cognizant Federal agency official to determine the specific procedures to be applied for providing notification of a cost accounting practice change and resolving the cost impact due to a change in cost accounting practice or a noncompliance is also being proposed (see 9903.401–2).

F. Additional Public Comments

Interested persons are invited to participate by submitting data, views or arguments with respect to the proposed amendments contained in this NPRM. All comments must be in writing and submitted timely to the address indicated in the **ADDRESSES** section of this NPRM.

The Board is considering the establishment of certain new provisions that it believes would facilitate the overall process governing compliant changes in cost accounting practices and noncompliances. Therefore, the Board invites interested parties to specifically comment on the following amendments being proposed today:

—Proposed 9903.201–6(c)(2), Desirable changes, which proposes to establish that when cost savings are expected to result from management actions that will be taken to improve the economy and efficiency of operations, changes in cost accounting practices associated with such operational changes shall be deemed to be desirable and not detrimental to the Government. Such determinations would permit the equitable adjustment of existing CAS-covered contracts materially affected by such changes in cost accounting practices.

—Proposed 9903.401–2, Educational Institutions, which proposes to establish that the cognizant Federal agency official is required to administer the cost accounting aspects of CAS-covered contracts and other Federally sponsored agreements in a uniform and consistent manner. Where determined necessary, the proposed provisions would permit the cognizant Federal agency official to waive applicable subpart 9903.4 requirements to attain that objective.

—Proposed 9903.406–2(e) which includes a newly proposed General Dollar Magnitude Settlement Proposal format for determining and resolving the estimated cost impact of a noncompliant cost accounting practice.

—Proposed 9903.406–3(d) which includes a newly proposed schedule

for determining the contract price adjustments to be required when an estimating noncompliance occurs.

Exemption provisions under consideration.

In addition to requesting public comments on the proposed amendments being promulgated today, the Board requests interested parties to provide their views on the potential establishment of ''exemption'' coverage in the Board's rules and regulations that would exempt compliant changes in cost accounting practices from contract price and cost adjustment when specified criteria are met.

The Board, after considering the public comments received in response to the ''exemptions'' that were proposed in the prior NPRM, is proposing in this NPRM to establish expanded coverage for ''desirable change determinations'' inlieu of the previously proposed ''exemptions'' as discussed in section E above under the topic heading ''Exemptions From Contract Price And Cost Adjustment Proposed in the Prior NPRM are Withdrawn.'' However, the Board will consider this matter further if commenters responding to this NPRM indicate that there is a compelling need and strong support for the establishment of such exemptions, in addition to the proposed amendments being issued today in this NPRM.

To assist interested parties wishing to comment on this matter, the Board is providing below the draft ''exemption'' coverage that was prepared by the CASB staff as ''Option B'' and ''Option C'' for the Board's consideration. Specifically of interest to the Board are the potential commenters' views regarding the draft exemption criteria and procedural requirements. Commenters may wish to indicate under what specific circumstances, if any, they believe a particular draft exemption should be applied or modified. For example: Should the Option B exemption be limited to major nonrecurring organizational changes that materially alter a contractor's operations? Should it only apply to restructuring activities approved in advance under agency regulations? The submission of specific alternative criteria and/or procedural requirements that commenters believe could result in the establishment of workable regulatory exemption coverage are also welcome.

Option B—Draft Exemption for Improved Management Efficiency and Effectiveness

Commenters primarily opined that it was not clear how the exemption proposed in the prior NPRM at 9903.302–2(c)(1) would be administered or what evidence was needed to obtain the proposed exemption. To that end, the CASB staff drafted for the Board's consideration coverage along the following lines:

1. In section 9903.302–2, add a new paragraph ''(c)'' to read as follows:

(c) *Voluntary Cost accounting practice changes exempt from contract price and cost adjustment.* The types of voluntary changes in cost accounting practice described in (1) below shall not be subject to contract price or cost adjustment. However, the cost accounting practices resulting from such changes must comply with all applicable Cost Accounting Standards and notification of the change in cost accounting practice must be provided as required by 9903.405–2.

(1) Changes in the allocation of cost to cost objectives involving the transfer of functions or merger of cost pools that are made due to management actions which are undertaken for improved management efficiencies and effectiveness and which involve the physical realignment or reduction of facilities or personnel.

(2) To qualify for this exemption the contractor must, prior to making the change:

(i) Request the exemption.

(ii) Submit a comprehensive description of the planned change(s) intended to improve the segment's or business unit's economy and efficiency of operations and of the voluntary changes to the contractor's established cost accounting practices that will be made to implement the planned change(s).

(iii) Provide a summary schedule of the aggregate increase or decrease in the total amount of costs expected to be allocated to all existing CAS-covered fixed-price contracts and flexibly-priced contracts (by contract types; such as fixed-price incentive, cost-reimbursement, etc.) after the change(s) are made.

(iv) Demonstrate that an equal or lesser amount of costs, in the aggregate, will be allocated to any existing CAS-covered contracts that are flexibly priced, by contract type, after the planned changes are implemented.

(3) The required cost comparison calculation methodology is summarized below:

	Fixed-price contracts	Flexibly priced contracts, by contract type
1. Total amount of costs that would be allocated to existing CAS-covered contracts, in accordance with established cost accounting practices, at the estimated cost levels that would continue if the contemplated economy and efficiency changes were not made.		
2. Total amount of costs that would be allocated to existing CAS-covered contracts, in accordance with the new changed cost accounting practices, at the estimated new cost levels that would result if the planned economy and efficiency management changes were made.		
3. Difference (1. minus 2.).		

(4) When the requirements of 9903.302–2(c)(2)(iv) are met, the cognizant Federal agency official shall notify the contractor that the voluntary change(s) to established cost accounting practices resulting from the planned management changes will be exempt from the contract price and cost adjustment provisions of affected CAS-covered contracts.

(5) When the requirements of 9903.302–2(c)(2)(iv) are not met, the cognizant Federal agency official shall determine, in writing, if the voluntary change to the contractor's established cost accounting practices resulting from the planned management changes otherwise qualifies for the exemption, i.e., that the potential savings to be realized in cost proposals for anticipated future CAS-covered contracts and subcontracts when the planned economy and efficiency changes are implemented will substantially exceed any increased cost allocations to flexibly-priced contracts identified under (c)(3) above. If so determined, the cognizant Federal agency official shall notify the contractor that the voluntary change to the contractor's established cost accounting practices otherwise qualifies

for the requested exemption, i.e., the voluntary practice change will be exempt from the contract price and cost adjustment provisions contained in existing CAS-covered contracts affected by the changes.

(6) When the cognizant Federal agency official determines the voluntary change to the contractor's cost accounting practices resulting from the planned management changes does not qualify for the requested exemption, the cognizant Federal agency official shall inform the contractor of the determination and initiate the cost impact process in accordance with 9903.405–3. The contractor may request a desirable change determination in accordance with 9903.201–6 and subpart 9903.4 prior to the submission of a requested cost impact submission.

2. Modify paragraph 9903.201–6(c)(2) proposed in this NPRM by deleting the economy and efficiency criteria proposed at 9903.201–6(c)(2)(i) or by replacing that proposed mandatory provision with a permissive provision that reads as follows:

Section 9903.201–6 Desirable changes.

* * * * *

(''x'') The cognizant Federal agency official should determine that a change in cost accounting practice is beneficial and not detrimental if cost savings, in the aggregate, will occur under existing and/or future CAS-covered contracts and subcontracts, e.g., cost accounting practice changes attributable to:

(i) An organizational change that combines, separates or centralizes operations, and the contractor or subcontractor demonstrates that more efficient and economical operations will result.

* * * * *

Option C—Draft Exemption for Changes in the Selection and Composition of Overhead and General and Administrative Expense Pools.

The contractor community did not appear to object to an equitable process to determine and resolve material differences in the amount of costs allocated to CAS-covered contracts that may occur due to a pool combination or split-out. Rather, they expressed concerns regarding the rigid process that was proposed in the prior NPRM. Accordingly, the CASB staff prepared for the Board's consideration the following draft exemption provision that would provide the cognizant Federal agency official with a flexible process for determining if a requested exemption for a practice change attributable to a pool combination or split should be granted.

1. In section 9903.302–2, add a new paragraph ''(d)'' to read as follows:

(d) *Voluntary cost accounting practice changes exempt from contract price and cost adjustment.* The types of voluntary changes in cost accounting practice described in (1) below shall not be subject to contract price or cost adjustment. However, the cost accounting practices resulting from such changes must comply with all applicable Cost Accounting Standards and notification of the change in cost accounting practice must be provided as required by 9903.405–2.

(1) Changes in the selection and/or composition of an overhead or general and administrative expense pool resulting from the consolidation of existing pools or the expansion of an existing pool into two or more pools that meet all of the following conditions:

(i) The elements of cost and the functions included in the original and resultant merged or split-out pools remain the same. After the change, the costs of the ongoing functions are accumulated in intermediate cost objectives that are now included in the resultant merged pool or split-out pools.

(ii) The selected allocation base remains the same for the affected pools. After the change, only the composition of the allocation base will change since the merged or split-out allocation base(s) are now accumulated in a new configuration for each selected pool in the post-change pool structure.

(iii) The merged or split-out pools involve the allocation of similar pooled overhead or G&A costs to similar final cost objectives and the underlying levels of pooled costs and allocation base measures retain their proportional relationships with respect to the existing CAS-covered contracts. This test is met if the cognizant Federal agency official determines that, after the change, the resultant pools are homogeneous (see 9904.418–50(b)) and the amount of indirect costs allocated to individual CAS-covered contracts affected by the change is not materially different from the amounts that would have been allocated to such final cost objectives if the pool combination(s) or split-out(s) had not occurred.

(2) To qualify for this exemption the contractor must, prior to making the change:

(i) Request the exemption.

(ii) Submit a comprehensive description of the planned pool combinations or split-outs, including details concerning the estimated amount of costs to be accumulated in the original and resultant pool or pools, the respective allocation base totals, and their respective indirect cost rates.

(iii) Provide a summary schedule of the aggregate increase or decrease in the total amount of costs expected to be allocated to all existing CAS-covered fixed-price contracts and flexibly-priced contracts (by contract types; such as fixed-price incentive, cost-reimbursement, etc.) after the change(s) are made.

(3) In making the determination required under 9903.302–2(d)(1)(iii) above, the cognizant Federal agency official may determine that a material difference in the amount of indirect costs allocated to CAS-covered contracts will not result if the rates (or rate) used to allocate pooled indirect costs to final cost objectives fall within a corridor that is plus or minus a stated percentage (to be determined by the cognizant Federal official on a case by case basis) of the rate (or rates) that would have resulted if the combination or expansion had not occurred. The comparison shall be based on the level of ongoing pooled costs and allocation base activity that is expected to occur after the change is made. For example, assuming a one percent corridor was determined to be an appropriate range and under the original cost accounting practices followed for a single pool the overhead recovery rate is expected to be 200%, then the resultant split-out rates must fall within the corridor of 198% to 202%. In the case of a combination of pools and their respective allocation bases, the corridors around the two forecasted rates that would result if there were no combination must converge or overlap to be considered similar, e.g., if the continued use of two pools would result in rates of 101% and 99%, their respective ''one percent'' corridors of 100% to 102% and 98% to 100% would overlap.

(4) The cognizant Federal agency official shall determine, in writing, if the voluntary change to the contractor's established cost accounting practices resulting form the planned pool combination or split-out qualifies for the exemption. The cognizant Federal official shall inform the contractor of the determinations made. If the voluntary change is determined to be exempt, no further action is required. If not determined to be exempt, the cognizant Federal official will initiate the cost impact process in accordance with 9903.405–3. The contractor may request a desirable change determination in accordance with 9903.201–6 and subpart 9903.4 prior to the submission of a requested cost impact submission.

List of Subjects in 48 CFR Part 9903

Cost accounting standards, Government procurement.

Richard C. Loeb,

Executive Secretary, Cost Accounting Standards Board.

For the reasons set forth in this preamble, chapter 99 of title 48 of the Code of Federal Regulations is proposed to be amended as set forth below:

1. The authority citation for part 9903 continues to read as follows:

Authority: Pub. L. 100–679, 102 Stat 4056, 41 U.S.C. 422.

PART 9903—CONTRACT COVERAGE

Subpart 9903.2—CAS Program Requirements

2. Section 9903.201–4 is proposed to be amended by revising paragraphs (a)(1) and (c), and the contract clauses set forth in paragraphs (a) and (c), to read as follows:

9903.201–4 Contract clauses.

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

(2) * * *

COST ACCOUNTING STANDARDS—FULL COVERAGE

(June 1997)

(a) The provisions of part 9903 of 48 CFR chapter 99, including the definitions and requirements contained therein, are incorporated herein by reference and the Contractor, in connection with this contract, shall—

(1) Disclosure. Disclose in writing the Contractor's cost accounting practices by submission of a Disclosure Statement as required by 9903.202. The practices disclosed for this contract shall be the same practices currently disclosed and applied to all other contracts and subcontracts being performed by the Contractor and which contain a Cost Accounting Standards (CAS) contract clause. If the Contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets, and commercial or financial information which is privileged and confidential, the Disclosure Statement shall be protected and shall not be released outside of the Government.

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

(3) Compliance with Standards. Comply with all CAS contained in part 9904, including any modifications and interpretations thereto, in effect on the date of award of this contract or, if the Contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the Contractor's signed Certificate Of Current Cost Or Pricing Data. The Contractor shall also comply with any CAS, including any modifications or interpretations thereto, which become applicable because of a subsequent award of a CAS-covered contract or subcontract to the Contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract.

(4) Compliant changes in cost accounting practices. As required by subpart 9903.4, provide timely notification of changes in disclosed or established cost accounting practices, provide data concerning the cost impact of such changes and:

(i) Required change. Agree to an equitable adjustment of the price of this contract as provided under this provision if the contract cost is affected by a change to a disclosed or established cost accounting practice which, pursuant to subparagraph (a)(3) of this clause, the Contractor or a subcontractor is required to make.

(ii) Voluntary change. Agree to an adjustment in the price or cost of this contract as provided under this provision if contract cost is affected by a voluntary change made by the contractor or a subcontractor; provided that no agreement may be made under this provision that will result in the payment of any increased costs by the United States in the aggregate for all of the contractor's or a subcontractor's CAS-covered contracts and subcontracts affected by the change.

(iii) Desirable change. Agree to an equitable adjustment of the price of this contract as provided in this provision if contract cost is affected by a change in cost accounting practice made by the contractor or a subcontractor that the cognizant Federal agency official finds to be a desirable change.

(5) Noncompliance. As required by subpart 9903.4, initiate action to correct any noncompliance, provide data concerning the cost impact of the noncompliance and agree to an adjustment of the contract price or cost if the Contractor or a subcontractor fails to comply with an applicable Cost Accounting Standard, including any modifications or interpretations thereto, or to follow any cost accounting practice consistently and such failure results or will result in any increased costs paid by the United States. Also, agree to the recovery of any increased costs paid by the United States, together with interest thereon computed at the annual rate established under section 6621 of the Internal Revenue Code of 1986 (26 U.S.C. 6621) for such period, from the time the payment by the United States was made to the time the adjustment is effected. In no case shall the Government recover costs greater than the increased cost to the Government, in the aggregate, on the relevant contracts subject to price or cost adjustment, unless the contractor made a change in its cost accounting practices of which it was aware or should have been aware at the time of price negotiations and which it failed to disclose to the Government.

(b) Disputes. If the cognizant Federal agency official and the Contractor disagree as to whether the Contractor or a subcontractor has complied with an applicable CAS in part 9904, including any modifications or interpretations thereto, an applicable provision or requirement in part 9903 or as to any resulting price or cost adjustment demanded by the United States, such failure to agree will constitute a dispute under the Contract Disputes Act (41 U.S.C. 601).

(c) Access to records. The Contractor shall permit any authorized representatives of the Government to examine and make copies of any documents, papers, or records, regardless of type and regardless of whether such items are in written form, in the form of computer data or in any other form, relating to compliance with the requirements of this clause.

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

(End of clause)

* * * * *

(c) *Cost Accounting Standards—Modified Coverage.* (1) The contracting officer shall insert the following clause, Cost Accounting Standards—Modified Coverage, in negotiated contracts when the contract amount is over $500,000, but less than $25 million, and the offeror certifies it is eligible for and elects to use modified CAS coverage (see 9903.201–2), unless the clause prescribed in paragraphs (d) or (e) of this subsection is used.

(2) The following clause requires the contractor to comply with 9904.401, 9904.402, 9904.405 and 9904.406, to disclose (if it meets certain requirements) actual cost accounting

practices, and to follow disclosed and established cost accounting practices consistently.

COST ACCOUNTING STANDARDS—MODIFIED COVERAGE (JUNE 1997)

(a) The provisions of part 9903 of 48 CFR chapter 99, including the definitions and requirements contained therein, are incorporated herein by reference and the Contractor, in connection with this contract, shall—

(1) Disclosure. Disclose in writing the Contractor's cost accounting practices by submission of a Disclosure Statement, if it is a business unit of a company required to submit a Disclosure Statement, pursuant to 9903.202. The practices disclosed for this contract shall be the same practices currently disclosed and applied to all other contracts and subcontracts being performed by the Contractor and which contain a Cost Accounting Standards (CAS) contract clause. If the Contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets and commercial or financial information which is privileged and confidential, the Disclosure Statement shall be protected and shall not be released outside of the Government.

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

(3) Compliance with Standards. Comply with the requirements of 9904.401, Consistency in Estimating, Accumulating and Reporting Costs; 9904.402, Consistency in Allocating Costs Incurred for the Same Purpose; 9904.405, Accounting For Unallowable Costs; and 9904.406, Cost Accounting Period; including any modifications or interpretations thereto, in effect on the date of award of this contract, or, if the Contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the Contractor's signed Certificate Of Current Cost Or Pricing Data. The Contractor shall also comply with any modifications or interpretations to such CAS which become applicable because of a subsequent award of a CAS-covered contract or subcontract to the Contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract.

(4) Compliant changes in cost accounting practices. As required by subpart 9903.4, provide timely notification of changes in disclosed or established cost accounting practices, provide data concerning the cost impact of such changes and:

(i) Required change. Agree to an equitable adjustment of the price of this contract as provided under this provision if the contract cost is affected by a change to a disclosed or established cost accounting practice which, pursuant to subparagraph (a)(3) of this clause, the Contractor or a subcontractor is required to make.

(ii) Voluntary change. Agree to an adjustment in the price or cost of this contract as provided under this provision if contract cost is affected by a voluntary change made by the contractor or a subcontractor; provided that no agreement may be made under this provision that will result in the payment of any increased costs by the United States in the aggregate for all of the contractor's or a subcontractor's CAS-covered contracts and subcontracts affected by the change.

(iii) Desirable change. Agree to an equitable adjustment of the price of this contract as provided in this provision if contract cost is affected by a change in cost accounting practice made by the contractor or a subcontractor that the cognizant Federal agency official finds to be a desirable change.

(5) Noncompliance. As required by subpart 9903.4, initiate action to correct any noncompliance, provide data concerning the cost impact of the noncompliance and agree to an adjustment of the contract price or cost if the Contractor or a subcontractor fails to comply with an applicable Cost Accounting Standard, including any modifications or interpretations thereto, or to follow any cost accounting practice consistently and such failure results or will result in any increased costs paid by the United States. Also, agree to the recovery of any increased costs paid by the United States, together with interest thereon computed at the annual rate established under section 6621 of the Internal Revenue Code of 1986 (26 U.S.C. 6621) for such period, from the time the payment by the United States was made to the time the adjustment is effected. In no case shall the Government recover costs greater than the increased cost to the Government, in the aggregate, on the relevant contracts subject to price or cost adjustment, unless the contractor made a change in its cost accounting practices of which it was aware or should have been aware at the time of price negotiations and which it failed to disclose to the Government.

(b) Disputes. If the cognizant Federal agency official and the Contractor disagree as to whether the Contractor or a subcontractor has complied with an applicable CAS in part 9904, including any modifications or interpretations thereto, an applicable provision or requirement in part 9903 or as to any resulting price or cost adjustment demanded by the United States, such failure to agree will constitute a dispute under the Contract Disputes Act (41 U.S.C. 601).

(c) Access to records. The Contractor shall permit any authorized representatives of the Government to examine and make copies of any documents, papers, or records, regardless of type and regardless of whether such items are in written form, in the form of computer data or in any other form, relating to compliance with the requirements of this clause.

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

(End of clause)

3. Section 9903.201–6 is proposed to be revised to read as follows:

9903.201–6 Desirable changes.

(a) Prior to making any equitable adjustment under the provisions of paragraph (a)(4)(iii) of the contract clauses set forth in 9903.201–4(a), 9903.201–4(c) or 9903.201–4(e), the cognizant Federal agency official shall make a finding that the change is desirable, as defined at 9903.403, i.e., desirable and not detrimental to the interests of the Government.

(b) The determination as to whether or not a change in cost accounting practice is desirable should be made on a case-by-case basis in accordance with, but not limited to, one or more of the criteria specified in paragraph (c) of this subsection.

(c) A change in cost accounting practice shall be deemed to be desirable and not detrimental if the cognizant Federal agency official determines that:

(1) For a Cost Accounting Standard which the contractor has complied with, the change is necessary in order for the contractor to remain in compliance with that Standard.

(2) Cost savings, in the aggregate, will occur under existing and/or future CAS-covered contracts and subcontracts, e.g., cost accounting practice changes attributable to:

(i) An organizational change that combines, separates or centralizes operations, and the contractor or subcontractor demonstrates that more efficient and economical operations will result.

(ii) The development of a new and significantly improved cost accounting system that will be implemented at a specific date in the future. The purpose of the new cost accounting system is to improve the contractor's or subcontractor's financial management

capabilities and there is a reasonable expectation that more efficient and economical operations will result and benefits will accrue to the Government.

(3) Circumstances, other than those listed in paragraphs (c) (1) and (2) of this section, included as justification in the contractor's written request for a desirable change determination clearly demonstrate that the change is otherwise desirable and not detrimental to the interests of the Government.

(d) The cognizant Federal agency official's finding should not be made solely because of the financial impact of the proposed change on a contractor's or subcontractor's current CAS-covered contracts. A change may be determined to be desirable and not detrimental to the Government's interest even though costs of existing contracts may increase, provided there is a reasonable expectation that benefits will accrue to the Government in future awards.

4. Section 9903.201–7 is proposed to be revised to read as follows:

9903.201–7 Cognizant Federal agency responsibilities.

(a) The requirements of 48 CFR chapter 99, shall, to the maximum extent practicable, be administered by the cognizant Federal agency responsible for a particular contractor organization or location, usually the Federal agency responsible for negotiating indirect cost rates on behalf of the Government. The cognizant Federal agency should take the lead role in administering the requirements of chapter 99 and coordinating CAS administrative actions with all affected Federal agencies. When multiple CAS-covered contracts and/or subcontracts or more than one Federal agency are involved, the cognizant Federal agency official and affected agencies shall coordinate their activities in accordance with applicable agency regulations. Coordinated administrative actions will provide greater assurances that individual contractors follow their cost accounting practices consistently under all their CAS-covered contracts and that aggregate contract price and cost adjustments required under CAS-covered contracts for changes in cost accounting practices or CAS noncompliance issues are determined and resolved, equitably, in a uniform overall manner.

(b) Federal agencies shall prescribe regulations and establish internal policies and procedures governing how agencies will administer the requirements of CAS-covered contracts, with particular emphasis on inter-agency coordination activities. Procedures to be followed when an agency is and is not the cognizant Federal agency should be clearly delineated. Agencies are urged to coordinate on the development of such regulations.

(c) Internal agency policies and procedures shall provide for the designation of the agency office(s) or officials responsible for administering CAS under the agency's CAS-covered contracts and subcontracts at each contractor and subcontractor business unit and the delegation of necessary contracting authority to agency individuals authorized to negotiate cost impact settlements under CAS-covered contracts, e.g., Contracting Officers, Administrative Contracting Officers (ACO's) or other agency officials authorized to perform in that capacity.

(d) *Processing changes in cost accounting practices.*

(1) The cognizant Federal agency official shall, in accordance with applicable agency regulations:

(i) Make all required determinations for all CAS-covered contracts and subcontracts affected by a change in cost accounting practice, including cost impact materiality determinations, in the aggregate.

(ii) Coordinate with affected agencies on the potential modification of CAS-covered awards, prior to actual negotiations.

(iii) Negotiate the cost impact settlement, in the aggregate, for all CAS-covered contracts and subcontracts materially affected by the change in cost accounting practice.

(iv) Inform the affected agencies of the negotiation results, by distribution of the negotiation memorandum.

(v) When contract and/or subcontract price adjustments are negotiated:

(A) Request affected agencies to prepare implementing contract modifications and to obtain implementing subcontract modifications from the next higher-tier contractor, as appropriate. The modifications shall be predicated on the negotiated cost impact settlement reflected in the negotiation memorandum and are to be forwarded for signature by the contractor through the cognizant Federal agency official.

(B) Concurrently, obtain contractor signatures for all contracts and subcontracts to be modified and distribute the executed modifications to the awarding agencies.

(2) Awarding agencies shall, in accordance with applicable agency regulations:

(i) Coordinate with and support the cognizant Federal agency official.

(ii) Prepare and/or obtain contract modifications needed to implement negotiated cost impact settlements, as requested by the cognizant Federal agency official.

(iii) When the cognizant Federal agency official has properly determined a cost impact settlement on behalf of the Government, make every effort to provide funds required for increased contract price modifications to affected Contracting Officers for obligation so that the cognizant Federal agency official can concurrently execute all the requested contract modification(s) needed to settle the cost impact action in a timely manner.

(3) If the cognizant Federal agency official makes a written determination that funding needed to execute required modifications is not expected to be available, an equitable solution by use of any other suitable technique which resolves the negotiated cost impact settlement may be used (see 9903.405–5(c)(3)).

Subpart 9903.3—CAS Rules and Regulations

5. Section 9903.301 is proposed to be amended by adding two definitions in alphabetical order to read as follows:

9903.301 Definitions.

(a) * * *

* * * * *

Function, as used in this part, means an activity or group of activities that is identifiable in scope and has a purpose or end to be accomplished. Examples of functions include activities such as accounting, marketing, research, product support, drafting, assembly, inspection, field services.

* * * * *

Intermediate cost objective means a cost objective that is not a final cost objective. Intermediate cost objectives are used to accumulate the costs of specific functions or groups of functions that are generally included in specific indirect cost pools and then allocated as pooled cost to other intermediate and/or to final cost objectives. Intermediate cost objectives may also be used to accumulate direct costs that are included in a cost pool and allocated to final cost objectives as a direct charge.

* * * * *

6. Section 9903.302–1 is proposed to be amended by revising paragraph (c) to read as follows:

9903.302–1 Cost accounting practice.

* * * * *

(c) *Allocation of cost to cost objectives,* as used in this part, refers to the cost accounting methods or techniques used to assign an item of cost or a group of items of cost to intermediate and final cost objectives.

The allocation of cost to cost objectives includes both the direct and indirect allocation of costs.

(1) Examples of cost accounting practices involving the allocation of cost to cost objectives are the methods and techniques used to:

(i) Accumulate cost in the contractor's cost accounting system,

(ii) Determine whether a cost is to be directly or indirectly allocated to intermediate or final cost objectives,

(iii) Determine the selection and composition of cost pools, and

(iv) Determine the selection and composition of the appropriate allocation bases.

(2) The selection of cost pools involves the determination to establish one or more cost pools for the accumulation of specific costs to be allocated to other intermediate and/or to final cost objectives for a particular segment, home office, or business unit. The composition of cost pools involves the determinations to accumulate, by elements of cost, the costs of the specific functions or groups of functions to be included within each established cost pool.

(3) The selection of an allocation base involves the determination on what type of allocation measurement activity (e.g., labor hours, square footage, labor dollars, total cost input) will be used as the basis for the allocation of the total costs accumulated in each selected pool to intermediate and/or final cost objectives for a particular segment, home office, or business unit. The composition of an allocation base involves the determination to accumulate and measure the selected allocation base data associated with each selected pool that was established. The composition of an allocation base includes the specific functional groupings within the base. The composition of a home office allocation base includes the grouping of segments within the applicable base. Examples of allocation bases include direct engineering labor hours for a specific direct engineering function performed at a specified location, total cost input of a particular segment, total payroll costs for specific segments reporting to the same group or home office.

7. Section 9903.302–2 is proposed to be revised to read as follows:

9903.302–2 Change to a cost accounting practice.

(a) *Change to a cost accounting practice,* as used in this part, including the contract clauses prescribed at 9903.201–4, means any alteration in a cost accounting practice, as defined in 9903.302–1, whether or not such practices are covered by a Disclosure Statement, including the following changes in cost accumulation:

(1) *Pool combinations.* The merging of existing indirect cost pools.

(2) *Pool split-outs.* The expansion or breakdown of an existing indirect cost pool into two or more pools.

(3) *Functional transfers.* The transfer of an existing ongoing function in its entirety from an existing indirect cost pool to a different pool or pools.

(b) *Exceptions.* (1) The initial adoption of a cost accounting practice for the first time a cost is incurred, or a function is created, is not a change in cost accounting practice. This exception shall be applied at the segment or home office level, depending upon the nature of the cost or the function involved. At the segment level, different segments can establish different cost accounting practices for the same type of cost when the cost is incurred for the first time or a function is created by each segment. This exception does not apply to transfers of ongoing functions, e.g., from one pool or segment to another pool, segment or home office.

(2) The partial or total elimination of a cost or the cost of a function is not a change in cost accounting practice.

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

(c) Mergers and Acquisitions. (1) Each CAS-covered contract requires that the performing contractor consistently follow its established or disclosed cost accounting practices over the contract's entire period of performance.

(2) When a business unit or a segment performing a CAS-covered contract is acquired by a different contractor through a merger or acquisition, the acquired business unit or segment shall accumulate and report costs incurred from the effective date of acquisition or merger through completion of the acquired contract consistently in accordance with the cost accounting practices established by the acquired business unit or segment. Compliant or noncompliant changes made to such established and/or disclosed cost accounting practices after the effective date of the merger or acquisition by the acquiring contractor shall be processed as changes in cost accounting practice in accordance with the requirements of part 9903.

(3) This paragraph (c) applies equally to CAS-covered subcontracts acquired by a contractor or subcontractor.

8. Section 9903.302–3 is proposed to be amended by adding a new introductory paragraph, revising the introductory text to paragraphs (a), (b) and (c), revising the illustration at (c)(3) and by adding new illustrations (c)(4) through (c)(9) to read as follows:

9903.302–3 Illustrations of changes which meet the definition of "change to a cost accounting practice."

The following illustrations are not intended to cover all possible changes in cost accounting practices nor are the illustrations to be used as limitations for determining if an accounting change has occurred. Further, each illustration is not intended to be all-inclusive. Accordingly, the lack of a mentioned change in cost accounting practice does not mean that there is not a change in cost accounting practice. The decision as to whether a change in cost accounting practice has or has not occurred, requires a thorough analysis of the circumstances of each individual situation based on the definitions and exceptions specified in 9903.302–1 and 9903.302–2.

(a) The cost accounting practice used for the measurement of cost has been changed.

* * * * *

(b) The cost accounting practice used for the assignment of cost to cost accounting periods has been changed.

* * * * *

(c) The cost accounting practice used for the allocation of cost to cost objectives has been changed.

Description	Accounting treatment
* * * * *	
(3) The contractor changes to a different allocation base	(3)(i) Before change: The contractor used a direct manufacturing labor hours base to allocate costs accumulated in the manufacturing overhead pool to final cost objectives. (ii) After change: The contractor uses a direct manufacturing labor dollars base to allocate costs accumulated in the manufacturing overhead pool to final cost objectives. (iii) The described change from a direct labor hours base to a direct labor dollars base represents a change in the selection of the allocation base measurement activity.
(4) A Segment combines two similar ongoing functions (i) The ongoing direct and indirect assembly operations at Plants A and B are merged.	(4)(i) Before change: The Segment established separate assembly overhead pools to accumulate the indirect costs applicable to Plant A's and Plant B's respective assembly functions. Pooled costs were allocated to individual final cost objectives based on Plant A's and Plant B's respective assembly direct labor dollars allocation bases. (ii) After change: The indirect costs of the two ongoing assembly functions are combined and accumulated in one indirect assembly cost pool. Pooled costs are allocated to individual final cost objectives based on a total assembly direct labor dollars allocation base applicable to the two plant locations. (iii) The methods and techniques used to accumulate cost changed because the indirect cost pools used to accumulate the cost of specific activities have changed from two pools to one pool. The selection of pools used to allocate the segment's indirect costs to final cost objectives changed from two pools to one. The composition of the pools changed because the specific activities originally included in the two indirect cost pools are now included in one pool. The composition of the allocation base changed because the selected allocation base measurement activity originally accumulated separately for each selected pool is now accumulated in one combined base for one pool.
(5) Assume the same circumstances as in (c)(4) of this illustration, except that Plants A and B are separate Segments A and B that are combined as Segment C.	(5)(i) Before change: Segments A and B each established an assembly overhead pool to accumulate the indirect costs applicable to their respective assembly functions. Pooled costs were allocated to final cost objectives based on Segment A's and B's respective assembly direct labor dollars. (ii) After change: Segment C establishes a single assembly overhead pool to identify and accumulate the costs of Segment A's and Segment B's ongoing indirect assembly functions. Pooled costs are allocated to final cost objectives based on Segment C's total assembly direct labor dollars generated by the two ongoing but separate assembly operations (iii) For the same reasons cited in (c)(4)(iii) of this illustration, a cost accounting practice change has occurred.
(6) The contractor changes how the ongoing indirect costs of the manufacturing and assembly operations are accumulated and allocated to final cost objectives by a segment.	(6)(i) Before change: The indirect costs applicable to the manufacturing and assembly functions were accumulated in a plant-wide indirect cost pool and allocated to final cost objectives by use of a direct labor dollars base comprised of manufacturing and assembly direct labor dollars. During each cost accounting period, a single plant-wide indirect cost rate was used to allocate the accumulated indirect costs to individual final cost objectives (ii) After change: The ongoing indirect manufacturing and assembly costs are split-out and accumulated separately in a manufacturing pool and assembly pool. The pooled costs are allocated to final cost objectives by use of a manufacturing direct labor dollars base and an assembly direct labor dollars base, respectively. Two indirect cost rates are now used to allocate the ongoing indirect costs to individual final cost objectives (iii) The decision to accumulate the ongoing costs of the manufacturing and assembly functions separately, in two pools instead of one, represents changes in the methods and techniques used to accumulate indirect costs and in the selection and composition of the pool (see explanations in illustration (c)(4)(iii)). The decision to allocate the accumulated pool costs to final cost objectives by use of separate allocation bases for the manufacturing and assembly functions instead of one plant-wide allocation base represents a change in the composition of the base.

Description	Accounting treatment
(7) The contractor transfers the incoming materials inspection function (i) Incoming materials are inspected in the same manner before and after the change.	(7)(i) Before change: The cost of performing the incoming inspection function was accumulated in an intermediate cost objective that was included in the Segment's manufacturing overhead expense pool. Accumulated pool costs were allocated to final cost objectives based on manufacturing direct labor dollars. (ii) After change: The accumulated cost of the incoming inspection function is included in the Segment's materials handling overhead pool. These pooled costs are allocated to final cost objectives based on direct material costs. (iii) The decision to include the accumulated cost of the ongoing inspection function in a different cost pool represents a change in the methods and techniques used to accumulate indirect cost because the costs accumulated in the intermediate cost objective for the incoming inspection function are included for accumulation in a different indirect cost pool and a change in the composition of the two pools because the incoming inspection function is now included in a different pool. The decision to allocate incoming inspection costs to final cost objectives by use of a material cost base rather than a labor dollars base represents a change in the selection of the allocation base measurement activity for the incoming inspection function.
(8) A contractor establishes a new product line by acquiring another company. Both entities are performing CAS-covered contracts. (i) The acquired company will be treated as a new segment. The acquired segment will complete the CAS-covered contracts that were novated from the prior company to the contractor. It will not perform any work associated with the contractor's existing lines of business.	(8) As of the effective date of acquisition, the contractor requires the new segment to accumulate and report the continuing costs of the acquired ongoing functions differently, e.g., the acquired company's single overhead pool is split into two new pools. The contracting parties agree that the pool split-out resulted in changes to the acquired segment's previously established cost accounting practices (i) The cost accounting practice changes are subject to the contract price and cost adjustment provisions of the acquired CAS-covered contracts (ii) The initial adoption exception provided by 9903.302–2(b)(1) would not apply because this is not a first time incurrence of cost or creation of a function, with regard to the ongoing acquired CAS-covered contracts
(9) A contractor expands the existing product line of Segment A by acquiring another company. Both entities are performing CAS-covered contracts. (i) Segment A will operate and manage the acquired company's ongoing operations. (ii) Segment A will complete the acquired CAS-covered contracts that were novated from the prior company to the contractor.	(9)(i) As of the effective date of acquisition, Segment A merges the continuing functions of the acquired company with Segment A's similar functions and merges the indirect costs of the acquired company's ongoing functions into Segment A's indirect cost pools, in accordance with Segment A's established cost accounting practices. The acquired company's allocation base is similarly merged into Segment A's allocation base. (ii) The cost accounting practices that will be used to accumulate and report costs of Segment A's existing and acquired contracts will be different than the practices that were previously used to estimate, accumulate and report contract costs. (iii) The methods and techniques used to accumulate costs have changed. The acquired contractor's intermediate cost objectives used to accumulate the costs of its ongoing indirect functions and activities have been eliminated, because the ongoing costs are now accumulated in Segment A's intermediate cost objectives. Indirect cost accumulation changed because the costs of the ongoing activities previously accumulated in two pools are now accumulated in one pool. Accumulation of the allocation base activity changed since the base activity previously accumulated in two bases is now accumulated in one combined base. (iv) The pool and base combinations made by the acquiring contractor represent changes in the selection and composition of the pools and the composition of bases for the existing Segment and acquired company. (v) The cost accounting practice changes are subject to the contract price and cost adjustment provisions of the existing and acquired CAS-covered contracts.

9. Section 9903.302–4 is proposed to be amended by adding an introductory paragraph, and illustrations (h) through (j) to read as follows:

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

The following illustrations are not intended to cover all possible changes that are not changes in cost accounting practice nor are the illustrations to be used as limitations for determining that an accounting change has not occurred. The decision as to whether a change in cost accounting practice has or has not occurred, requires a thorough analysis of the circumstances of each individual situation based on the definitions and exceptions specified in 9903.302–1 and 9903.302–2.

Description	Accounting treatment
* * * * * * *	
(h) The contractor transfers an inspection department employee from Plant A to Plant B.	(h)(1) Before the transfer, the employee's salary was accumulated as inspection labor and was included in Plant A's overhead pool. (2) After the transfer, the employee's salary is similarly accumulated in an intermediate cost objective that is included in Plant B's overhead pool. The salaries of all employees performing the inspection function at Plants A and B continue to be accumulated in their respective intermediate cost objectives which continue to be included in their respective pools. (3) Since the cost of the inspection functions at Plants A and B continue to be accumulated within the same intermediate cost objectives and the selection and composition of the pools has not changed, before and after the employee transfer, no change in cost accounting practice has occurred.
(i) A contractor with a corporate home office creates a new segment for the purpose of entering a new line of business. The new segment will not perform any work associated with the contractor's existing CAS-covered contracts.	(i)(1) After change: The costs of the contractor's home office continue to be accumulated and allocated to segments in accordance with the contractor's established cost accounting practices. The new segment is added to the applicable home office allocation base or bases used to allocate home office costs to segments. (2) The addition of the new segment to the applicable home office allocation base represents an initial adoption of a cost accounting practice for the segment when it was created (see exception at 9903.302–2(b)(1)). Since the selection and composition of the home office pool and applicable allocation bases were not otherwise changed, the described increase in the base for the allocation of home office costs represents an initial adoption of a cost accounting practice that is not subject to the contract price or cost adjustment process.
(j) Assume the same circumstances as in (i) of this illustration, except that:. (1) The contractor acquired a new segment that is performing CAS-covered contracts from another company. (2) The acquired segment will continue to estimate, accumulate and report costs in accordance with the original company's compliant and previously disclosed cost accounting practices for that segment. A new Disclosure Statement is filed to that effect. Also disclosed is the contractor's home office cost allocation to the segment.	(j)(1) For the reasons stated in (i) of this illustration, the described home office change is not a cost accounting practice change. (2) At the segment level, the first time incurrence of the acquiring contractor's home office cost allocation is an initial adoption of a cost accounting practice (see exception at 9903.302(b)(1). Since the contractor adopted the acquired segment's previously established cost accounting practices, no change in established cost accounting practices occurred for the acquired CAS-covered contracts.

10. Section 9903.306 is proposed to be revised to read as follows:

9903.306 Applicable interest rate.

The interest rate applicable to any contract price adjustment shall be the annual rate of interest established under section 6621(a)(2) of Title 26 (26 U.S.C. 6621(a)(2)) for such period. Such interest shall accrue from the time payments of the increased costs were made to the contractor or subcontractor to the time the United States receives full compensation for the price adjustment.

11. A new subpart 9903.4 is proposed to be added to read as follows:

Subpart 9903.4—Contractor Cost Accounting Practice Changes and Noncompliances

Sec.

9903.401 Applicability of subpart.
9903.401–1 CAS-covered contracts and subcontracts.
9903.401–2 Educational institutions.
9903.402 Purpose.
9903.402–1 Changes in cost accounting practice.
9903.402–2 Failure to comply (noncompliances) with an applicable cost accounting standard or to follow any cost accounting practice consistently.
9903.403 Definitions.
9903.404 Materiality determination for making adjustment.
9903.405 Changes in cost accounting practice.
9903.405–1 General.
9903.405–2 Notification of changes in cost accounting practices.
9903.405–3 Determinations, approvals and initiating the cost impact process.
9903.405–4 Contractor cost impact submissions.
9903.405–5 Negotiation and resolution of the cost impact.
9903.406 Noncompliances.
9903.406–1 General types of noncompliances.
9903–406–2 Noncompliance determinations and initiating the cost impact process.
9903–406–3 Cost estimating noncompliance.
9903–406–4 Cost accumulation noncompliance.
9903–406–5 Technical noncompliances.
9903.407 Illustrations.
9903.407–1 Changes in cost accounting practice—illustrations.
9903.407–2 Noncompliance illustrations.

Subpart 9903.4—Contractor Cost Accounting Practice Changes and Noncompliances

9903.401 Applicability of subpart.

9903.401–1 CAS-covered contracts and subcontracts.

(a) This subpart 9903.4 applies uniformly to all CAS-covered contracts and subcontracts affected by a compliant change in cost accounting practice and/or a noncompliant cost accounting practice. By accepting the first CAS-covered contract or subcontract that incorporates part 9903, which includes this subpart 9903.4, the contractor agrees to process cost accounting practice changes and noncompliance actions occurring after the award of that contract or subcontract in accordance with this subpart for all existing CAS-covered contracts and subcontracts affected by the change or noncompliance.

(b) To aid in meeting the requirements set forth in this subpart 9903.4 for processing cost accounting practice changes and noncompliance actions, the contractor shall maintain a system for identifying all existing CAS-covered

contracts and subcontracts, and their periods of performance.

9903.401–2 Educational institutions.

(a) This subpart 9903.4 applies to all CAS-covered contracts and subcontracts awarded to educational institutions. Such CAS-covered contracts and subcontracts incorporate part 9903 by reference and contain specific terms and conditions that require the educational institution to disclose its cost accounting practices (if specified criteria are met), provide notification if a change to a cost accounting practice is made and to agree to contract price or cost adjustments for material cost impacts attributable to compliant changes in cost accounting practices and/or to noncompliant practices. This subpart 9903.4 establishes procedures for providing such notifications, the submission of requested cost impact data, and determining the required adjustments.

(b) On April 26, 1996, the Office of Management and Budget (OMB) incorporated in OMB Circular A–21, Cost Principles for Educational Institutions (61 FR 20880, May 8, 1996), the Disclosure Statement (Form CASB DS–2) and the CAS applicable to educational institutions that were promulgated by the Board at 48 CFR chapter 99 (59 FR 55746, November 8, 1994). As amended, Circular A–21 also contains certain requirements and guidance regarding the notification to be provided when an educational institution changes a cost accounting practice and the cost adjustments that may be required or other actions to be taken by the cognizant Federal agency when Federally sponsored agreements (contracts, grants and cooperative agreements) are affected by compliant practice changes or noncompliant practices.

(c) The amended CASB and OMB requirements were intended to be compatible and are to be administered by the cognizant Federal agency official in a uniform and cost effective manner. To the maximum extent feasible, the cognizant Federal agency official should apply a single set of procedures when obtaining notifications, cost impact data and when determining the adjustments that may be required for individual CAS-covered contracts and other Federally sponsored agreements subject to amended OMB Circular A–21 that are affected by the same practice change or noncompliance. The procedures applied to all Federally sponsored agreements, including CAS-covered contacts and subcontracts, should be consistent with this subpart 9903.4 requirements and objectives. The cognizant Federal agency official may use applicable portions of this subpart 9903.4 as guidance and, if mutually agreed to by the educational institution, the contracting parties may elect to apply the 9903.4 provisions as deemed appropriate in the circumstances.

(d) *Waiver authority.* When an educational institution changes a compliant cost accounting practice or fails to comply with an applicable Cost Accounting Standard that affects CAS-covered contracts and other Federally sponsored agreements, the cognizant Federal agency official may waive or modify, on a case-by-case basis, applicable requirements of this subpart 9903.4 for affected CAS-covered contracts and subcontracts as deemed necessary in order to establish appropriate alternative procedures or methods for obtaining notifications of practice changes, the submission of cost impact data or determining contract price or cost adjustments in a uniform manner for all Federally sponsored agreements. The basis for the waiver and the alternate procedures utilized shall be documented in a written determination. This waiver authority does not apply to the adequacy and compliance determinations required by 9903.405–3(a).

(e) A written determination to apply the provisions of this subpart 9903.4, OMB Circular A–21, or other appropriate procedural guidance to educational institutions shall be made by the cognizant Federal agency official. Educational institutions should contact their cognizant Federal agency for specific instructions within 60 days after receipt of a CAS-covered contract that is subject to this subpart.

9903.402 Purpose.

9903.402–1 Changes in cost accounting practice.

The contract clauses prescribed in 9903.201–4, Contract clauses, set forth the requirements for changes in cost accounting practices that a contractor may be required to make in order to comply with a standard, modification or interpretation thereof that becomes applicable to existing covered contracts for the first time due to the subsequent award of a covered contract or may otherwise decide to make, e.g., a voluntary change from an established or disclosed compliant cost accounting practice to another compliant cost accounting practice. Section 9903.405 establishes the specific actions to be taken by the contracting parties for such compliant cost accounting practice changes. Section 9903.405 also establishes procedures for adjusting contract amounts that are materially affected by compliant changes in cost accounting practices, while not requiring adjustment of all contracts that are affected by such changes.

9903.402–2 Failure to comply (noncompliances) with an applicable cost accounting standard or to follow any cost accounting practice consistently.

The contract clauses prescribed in 9903.201–4, Contract clauses, require the contractor or subcontractor to agree to an adjustment of the contract price or cost if the contractor or subcontractor fails to comply with an applicable Cost Accounting Standard, modification or interpretation thereto, or to follow any cost accounting practice consistently, and such failure results or will result in any increased cost paid, in the aggregate, by the United States, under CAS-covered contracts and subcontracts. Section 9903.406 establishes the actions to be taken by the contracting parties in order to resolve the noncompliant condition and/or effect recovery of any increased costs paid as a result of the noncompliance.

9903.403 Definitions.

This section 9903.403 defines terms as used in this part 9903, including the contract clauses prescribed at 9903.201–4. Where the defined terms refer to a ''contractor'' or ''contract'' the definition is intended to apply equally, as applicable, to a ''subcontractor'' or ''subcontract.''

Applicability date means—

(1) For required cost accounting practice changes, the date on which a contractor is first required to accumulate and report costs in accordance with an applicable Standard, modification or interpretation thereto; or

(2) For voluntary cost accounting practice changes, the date on which a contractor begins to use a new cost accounting practice for cost accumulation and reporting purposes.

Contracts subject to adjustment means CAS-covered contracts and subcontracts, including definitized contract options, that:

(1) Have contract performance beyond the applicability date of a change in cost accounting practice, and have their current contract prices based on a previous cost accounting practice; or

(2) Are affected by the application of a noncompliant practice that was used to estimate or accumulate costs.

Cost impact means the increase or decrease in estimated or actual costs allocable to a CAS-covered contract or subcontract due to a compliant change in cost accounting practices, a

noncompliance with a Cost Accounting Standard, or a failure to follow cost accounting practices consistently.

Desirable change means a voluntary change to a contractor's established or disclosed cost accounting practices that the cognizant Federal agency official finds is desirable and not detrimental to the Government pursuant to 9903.201–6 and is therefore subject to the equitable contract price adjustment provisions of CAS-covered contracts affected by the change.

Detailed cost impact proposal means a proposal that shows the cost impact of a change in cost accounting practice for contracts subject to adjustment that have an estimate-to-complete which exceeds a threshold amount specified by the cognizant Federal agency official.

Effective date means:

(1) For compliance with Standards, modifications and interpretations thereto, the date on which a contractor is first required to estimate proposed contract costs in accordance with an applicable standard, modification or interpretation, as specified by the CAS Board; or

(2) For voluntary cost accounting practice changes, the date on which a contractor begins using a new cost accounting practice for cost estimating purposes.

General dollar magnitude estimate means an estimate of the aggregate cost impact, by contract type, of a change in cost accounting practice, or a noncompliant practice on contracts subject to adjustment.

Increased costs to the Government due to a change in compliant cost accounting practices means:

(1) For flexibly priced CAS-covered contracts, when a greater amount of cost will be allocated to the contract than would have been allocated to it had the contractor not changed its cost accounting practices and no actions are taken to preclude the payment of the increased costs; or

(2) For firm fixed-price CAS-covered contracts, when the costs to be allocated to the contract are less than the amount of costs that would have been allocated to it had the contractor not changed its cost accounting practice(s) and the contract price is not adjusted downward to reflect the contractor's lesser allocation of cost to the contract.

Increased costs to the Government due to a cost accumulation noncompliance means increased costs resulting from a contractor's failure to comply with applicable Cost Accounting Standards, modifications or interpretations thereto, or to follow its disclosed or established cost accounting practices consistently when accumulating costs under CAS-covered contracts, and such failure results in a higher amount of costs allocated to these CAS-covered contracts than would have been allocated to the contracts had the contractor complied with applicable Standards, modifications or interpretations thereto, or followed its cost accounting practices consistently.

Increased costs to the Government due to a cost estimating noncompliance means increased costs resulting from a contractor's failure to comply with applicable standards, modifications or interpretations thereto, or to follow its disclosed or established cost accounting practices consistently when estimating proposal costs for a contemplated CAS-covered contract, and such failure results in a higher contract price than would have been negotiated had the contractor complied with applicable standards, modifications or interpretations thereto, or followed its cost accounting practices consistently.

Increased costs paid means the amount the Government actually pays, in the aggregate, for increased costs resulting from compliant cost accounting practice changes or noncompliant cost accounting practices used to estimate or accumulate costs.

Notification date means the date on which the contractor formally notifies the cognizant Federal agency official of a planned change in cost accounting practices.

Offset process means the combining of cost increases to one or more affected contracts of a given type with cost decreases to one or more affected contracts of the same type, for the purpose of mitigating action that needs to be taken due to changes in cost accounting practices.

Required change means a change in cost accounting practice that a CAS-covered contractor is required to make in order to comply with applicable standards, modifications or interpretations thereto, that subsequently become applicable to an existing contract due to the receipt of another CAS-covered contract or subcontract.

Technical noncompliance means a noncompliant cost accounting practice that does not currently result in material increased costs to the Government.

Voluntary change means a change in cost accounting practice from one compliant practice to another that a contractor with CAS-covered contracts elects to make that has not been deemed desirable by the cognizant Federal agency official and for which the Government will pay no increased costs.

9903.404 Materiality determination for making adjustment.

Contract price adjustments or actions to preclude or recover the payment of increased costs resulting from compliant changes in cost accounting practice, or failure to comply with an applicable Cost Accounting Standard, modification or interpretation thereto, or to follow any cost accounting practice consistently, shall only be required if the amounts are material. In determining materiality, the cognizant Federal agency official shall use the criteria specified in 9903.305. The cognizant Federal agency official should forego submission of a General Dollar Magnitude (GDM) Settlement Proposal or a detailed cost impact proposal (refer to 9903.405–4), and not adjust contracts, if the cognizant Federal agency official determines that the amount involved is immaterial.

9903.405 Changes in cost accounting practice.

9903.405–1 General.

A CAS-covered contractor shall make changes to its established or disclosed cost accounting practices when required in order to comply with applicable Cost Accounting Standards, including any modification and interpretations promulgated thereto. A contractor may change its established cost accounting practices voluntarily, provided the cognizant Federal agency official is notified of the change and the new practice complies with applicable Cost Accounting Standards. CAS-covered contracts and subcontracts affected by changes in cost accounting practices that are either required to comply with Cost Accounting Standards, modifications or interpretations thereto, or are made voluntarily for which the cognizant Federal agency official has made a finding that the change is desirable in accordance with 9903.201–6 are subject to equitable contract price adjustments. For all other voluntary accounting changes, disclosed in accordance with 9903.405–2, the cognizant Federal agency official shall take action to preclude the payment of increased costs by the United States as a result of the change, as prescribed in 9903.405–5(d). With the exception of such action to preclude the payment of increased costs for voluntary changes, the administrative procedures for handling potential contract price or cost adjustments will be consistent for all compliant accounting changes, as set forth in subsections 9903.405–2 through 9903.405–5. Implementation of any change in cost accounting practice without submission of the notification

required under 9903.405–2 shall be considered a failure to follow a cost accounting practice consistently, and shall be processed as a noncompliance condition in accordance with 9903.406.

9903.405–2 Notification of changes in cost accounting practices.

(a) The contractor shall submit to the cognizant Federal agency official a description of any planned change in cost accounting practices. The date of submission is hereafter referred to as the notification date.

(b) The contractor shall notify the cognizant Federal agency official in accordance with the following:

(1) Required changes shall be disclosed as soon as it becomes known that a required change must be made, but no later than the date of submission of the price proposal in which the contractor must first use the required change to estimate costs for a potential CAS-covered contract.

(2) Voluntary changes (including those ultimately deemed desirable) shall be disclosed as soon as the contractor decides to change an established or disclosed cost accounting practice. Notification shall be provided no later than 60 days before the applicability date or on the date of submission of the price proposal in which the contractor first uses the changed practice to estimate costs for a potential CAS-covered contract.

(c) If a contractor proposes to make the applicability date of a voluntary change (including those ultimately deemed desirable) retroactive to the beginning of the current fiscal year in which the notification is made, the contractor must submit rationale for such action and obtain the cognizant Federal agency official's approval. The rationale must state the reasons for making a retroactive change.

(d) When requesting that a voluntary change be deemed desirable, the contractor shall provide rationale and data demonstrating that the accounting change is desirable and not detrimental to the Government's interests or that the change in cost accounting practice was necessary to remain in compliance with an applicable Cost Accounting Standard (see 9903.201–6).

(e) *Data submission requirements:* The contractor shall submit a complete description of any change in cost accounting practice, including the relevant Disclosure Statement page revisions and amendments required to disclose the new practice (see 9903.202–3); any additional information which will help the cognizant Federal agency official make a determination of adequacy and compliance; and if applicable, data demonstrating that the change is:

(1) Obviously immaterial because the change in practice will not result in a greater or lesser allocation of cost to individual CAS-covered contracts affected by the change, i.e., after the change, the amounts of cost allocated to individual covered contracts will approximate the amounts that would have been allocated if the change were not made,

(2) Desirable and not detrimental to the interests of the Government, and/or

(3) One that warrants retroactive implementation.

9903.405–3 Determinations, approvals and initiating the cost impact process.

(a) *Adequacy and compliance determination.* Upon receipt of the contractor's notification, the cognizant Federal agency official, with the assistance of the auditor, shall review the planned cost accounting practice change concurrently for adequacy and compliance. If the cognizant Federal agency official identifies any area of inadequacy, a revised description of the new accounting practice shall be requested. Problems of adequacy should be resolved between the parties as soon as possible after the initial notification of the accounting change. If the cognizant Federal agency official determines that the disclosed practice is noncompliant with any Cost Accounting Standards, modifications or interpretations thereto, and the contractor implements the practice, the accounting change will be handled as a noncompliance under the provisions of 9903.406. Once the cognizant Federal agency official has determined that the accounting change is both adequate and compliant, the cognizant Federal agency official shall immediately notify the contractor.

(b) *Desirable change determinations.* When the contractor's notification includes a request that a planned voluntary change be deemed desirable and not detrimental, the cognizant Federal agency official should, in accordance with 9903.201–6, make a decision with regard to this finding promptly after the change is determined to be adequate and compliant. The cognizant Federal agency official shall notify the contractor in writing regarding the decision of desirability, and concurrently request the contractor to submit a GDM Settlement Proposal.

(c) *Approval of retroactive application date.* When a contractor notification pertains to a planned voluntary change with a retroactive applicability date, the cognizant Federal agency official should review the contractor's submitted rationale and promptly determine if the requested retroactive application date should be approved or rejected. The cognizant Federal agency official shall notify the contractor in writing regarding the decision made.

(d) *Obviously immaterial changes.* If the cognizant Federal agency official determines that the cost impact of a change in cost accounting practice is obviously immaterial based on data submitted by the contractor pursuant to 9903.405–2(e)(1), or otherwise decides that the cost impact is immaterial, the decision will be documented, the contractor will be so notified, and the cost impact process will be concluded.

(e) *Request for GDM settlement proposal.* After a determination of adequacy and compliance has been made, the cognizant Federal agency official will request a GDM Settlement Proposal, as described in 9904.405–4(a). The request should specify a date for submission of the GDM Settlement Proposal. The contractor shall submit the GDM Settlement Proposal on or before the date specified or other mutually agreeable date. The cognizant Federal agency official will use the contractor's GDM Settlement Proposal to resolve the cost impact of a change in cost accounting practice on existing CAS-covered contracts and subcontracts, without requiring a detailed cost impact proposal, provided the official determines that the GDM Settlement Proposal is adequately supported and contains sufficient data.

9903.405–4 Contractor cost impact submissions.

(a) *General Dollar Magnitude (GDM) settlement proposal.* (1) The purpose of the GDM Settlement Proposal is to provide information to the cognizant Federal agency official on the estimated overall impact of a change in cost accounting practice on affected CAS-covered contracts and subcontracts that were awarded based on the previous accounting practice. It provides the contractor an opportunity to propose specific adjustments to settle the cost impact of changes in cost accounting practices. It also provides a sufficient number of individual contract and/or subcontract cost impact estimates to support the general dollar magnitude aggregate estimate by contract type and to assist the cognizant Federal agency official in determining whether any individual contract or subcontract price adjustments will be required. The GDM Settlement Proposal is used to determine if the change in cost accounting practice has resulted in material increased or decreased costs to existing contracts, and to attempt to

resolve the cost impact of the change in cost accounting practice without requiring a detailed cost impact settlement proposal as described in paragraph (b) of this subsection.

(2) The contractor, in the GDM Settlement Proposal, shall show a reasonable estimate of the aggregate impact of the change on CAS-covered contracts and subcontracts subject to adjustment, by contract type, from the applicability date of the change to completion of the contracts subject to adjustment. The individual contracts selected by the contractor for inclusion in the GDM Settlement Proposal shall be those contracts with the largest dollar impact. The contractor should submit specific adjustments to settle the cost impact of the cost accounting practice change(s). The proposed adjustment amounts shall be determined in accordance with the requirements of this subpart and may include proposed revisions to the profit, fee or incentive provisions of affected contracts.

(3) In computing the cost impact, the contractor shall use a consistent cost data baseline for the before and after change amounts. The cost impact data should generally be based on the latest forecasted direct and indirect cost data used for forward pricing purposes unless other data is considered preferable and agreed to by both the contractor and cognizant Federal agency official. In most cases, the after change cost data baseline should be used because this is the same cost data baseline that will be used to determine the revised forward pricing rates and current contract estimates-to-complete based on the new cost accounting practice.

(4) Any format which reasonably shows the aggregate impact by contract type and provides sufficient contract data to settle the cost impact is acceptable. In most situations, the grouping of the CAS covered contracts by contracts type within the GDM Settlement Proposal may be limited to the following contract types: firm fixed price (FFP); time and material (T&M); incentive-type (FPI/CPIF); and other cost reimbursement contracts (CPFF, CPAF, CR, etc). One acceptable GDM Settlement Proposal format is illustrated as follows:

SUMMARY—GDM SETTLEMENT PROPOSAL OF TOTAL COST IMPACT ON ALL COVERED CONTRACTS AWARDED PRIOR TO APPLICABILITY DATE

Required Changes, Voluntary Changes (1) , Desirable Changes (1)				
	Estimate to Complete (2)		Difference cost impact	Proposed adjustment amounts
	Old practice (3) (A)	New practice (4) (B)	(A–B)	(5)
AGGREGATE				
FFP				
T&M				
FPI/CPIF				
OTHER				
COST TYPE				
TOTAL				
CONTRACTS (6)				
FFP				
1.				
2.				
''ALL OTHER''				
TOTAL				
T&M				
1.				
2.				
''ALL OTHER''				
TOTAL				
FPI/CPIF				
1.				
2.				
''ALL OTHER''				
TOTAL				
OTHER COST TYPE				
1.				
2				
''ALL OTHER''				
TOTAL				

Instructions:

1. Indicate whether the cognizant Federal agency official has made a finding that the change is desirable, and, if not, attach an explanation detailing the proposed action(s) that will be taken to preclude the payment of aggregate increased costs, if any, pursuant to 9903.405–5(d).

2. The estimates to complete must be based on the same contract scope of effort, to be performed from the applicability date of the change until contract completion.

3. Enter the total estimated cost to complete all of the CAS-covered contract backlog based on the existing cost accounting practice. This estimate should be based on the CAS-covered contracts' allocable share of the total direct and indirect costs forecasted for all cost accounting periods during which the backlog of CAS-covered contracts estimated under the old practice will be performed.

4. Enter the total estimated cost to complete the CAS-covered contract backlog based on the new cost accounting practice. This estimate should also be based on the backlog contracts' allocable share of the total direct and indirect costs forecasted for all cost accounting periods during which the backlog of CAS-covered contracts estimated under the old practice will be performed. However, that forecasted data must first be recast to reflect application of the new cost accounting practice, e.g., determine the effect on indirect cost pools and allocation bases, recalculate rate(s) and apply the new rate(s) to the recast allocation base(s), as appropriate.

5. The amounts in this column indicate the contractor's proposal to settle the cost impact. Enter the proposed adjustment amounts in the aggregate by contract type and for individual contracts listed, as well as for the ''All Other'' contract category. Proposed revisions to profit, fee, or incentive provisions may also be included. (Attach explanatory schedule.)

6. List each contract needed to resolve ''material'' amounts identified in the GDM estimate and, based on the individual contract cost impact computations, enter the indicated data and proposed adjustment amount.

(5) The illustrated GDM Settlement Proposal format is an example of one method and does not preclude the use of any other format or method that displays a reasonable estimate of the cost impact by contract type and provides sufficient contract data to settle the cost impact. The GDM Settlement Proposal shall be adequately supported. If a GDM Settlement Proposal is not adequately supported, or cannot be adequately supported by the contractor, the cognizant Federal agency official shall request a detailed cost impact proposal in accordance with paragraph (b) of this subsection.

(6) The cognizant Federal agency official should attempt to use the contractor's GDM Settlement Proposal to resolve the cost impact process to the maximum extent possible. If additional individual contract data is determined necessary to resolve the cost impact, the cognizant Federal agency official should request the contractor to submit a revised GDM Settlement Proposal that includes the specific additional data needed, e.g., contracts with a dollar impact exceeding a specific dollar amount. The contractor should then submit the revised GDM Settlement Proposal on or before the date specified by the cognizant Federal agency official or other mutually agreeable date.

(7) If the impact is immaterial in both the aggregate by contract type and for the individual contracts included in the GDM Settlement Proposal, the cost impact process may be concluded without any adjustments. If the cognizant Federal agency official determines that the cost impact either in the aggregate by contract type or on individual contracts is material, the procedures in 9903.405–5, Negotiation and Resolution of the Cost Impact, should be followed. The requirement for adjustments should be based on separate materiality thresholds for: individual contracts; the ''all other contracts'' amounts; and the aggregate by contract type. The threshold for individual contract price adjustments may be based on cost impact dollar thresholds, a percentage of the contract price, or a combination of the two criteria, e.g., contracts with cost impacts exceeding a certain dollar amount provided that the impact exceeds a certain percentage of the contract price. The ''all other contract'' amount is the difference between the aggregate amount by contract type and the net sum total of the impact of the submitted individual contracts by contract type. The materiality thresholds, as used in this paragraph, are the amounts below which no adjustments are required.

(8) Upon receipt, the cognizant Federal agency official should promptly evaluate the contractor's GDM Settlement Proposal and, if the cost impact is determined to be material, proceed to either negotiate and resolve the cost impact, request additional data or request a detailed cost impact proposal in a timely manner.

(b) *Detailed cost impact proposal.* (1) A detailed cost impact proposal is required when the GDM Settlement Proposal cannot be adequately supported or does not contain sufficient data to resolve a cost impact due to a change in cost accounting practices. It will be used by the cognizant Federal agency official in lieu of the GDM Settlement Proposal to determine the magnitude of the impact of the change on existing CAS-covered contracts and subcontracts subject to adjustment and to determine which, if any, should be adjusted for the impact of the change. The determination by the cognizant Federal agency official of the need for a detailed cost impact proposal is final and binding, and not subject to the Disputes clause of the contracts affected by the practice changes.

(2) The detailed cost impact proposal need not include every contract and subcontract subject to adjustment as a result of the change in cost accounting practices. It typically will include all contracts and subcontracts having an estimate-to-complete, based on the old accounting practice, exceeding a specified amount established by the cognizant Federal agency official. The specified individual contract impact amount should be high enough so that the detailed cost impact proposal does not contain an excessive number of contracts and subcontracts. However, it should contain a sufficient number so that it includes a reasonably high percentage of both the backlog of these contracts and the aggregate impact amount by contract type. The established individual contract estimate-to-complete amount should be specified in a formal written request by the cognizant Federal agency official for the data. The request should also specify that the proposal include an aggregate amount, and be grouped, by contract type.

(3) The contractor shall submit the detailed cost impact proposal on or before the date specified by the cognizant Federal agency official or other mutually agreeable date.

(4) After analysis of the cost impact proposal, with the assistance of the auditor, the cognizant Federal agency official shall promptly negotiate and resolve the cost impact.

9903.405–5 Negotiation and resolution of the cost impact.

(a) *General.* (1) The cognizant Federal agency official shall negotiate any required contract price or cost adjustments due to changes in cost accounting practices or noncompliances on behalf of all Government agencies. Negotiation of price and cost adjustments may be based on a GDM Settlement Proposal or a detailed cost impact proposal.

(2) The Cost Accounting Standards Board's rules, regulations and Standards do not in any way restrict the capacity of the contracting parties to select the method by which the cost impact attributable to a change in cost accounting practice is resolved. A cost impact may be resolved by modifying a single contract, several but not all contracts, or all contracts subject to adjustment, or any other suitable technique which resolves the cost impact in a way that approximates the amounts that would have resulted if individual contracts had been adjusted.

(b) *Offset process.* The offset process of combining cost increases with cost decreases may be used to reduce the number of individual contract price or cost adjustments required as a result of a change in cost accounting practice. In applying this process, the following rules of offset apply:

(1) Use of the offset process shall not result in aggregate cost to the Government which is materially different from that which would result if individual contract prices had actually been adjusted to reflect the aggregate impact of the practice change.

(2) The offset process shall only be applied to contracts that are of the same contract type, e.g., FFP, T&M, incentive (FPI/CPIF) or other cost reimbursement contracts.

(3) The offset process should not be used to materially reduce the amount of the price adjustment to any one contract that exceeds the individual contract cost impact materiality threshold established

for individual contract price adjustments. It also should not be used to reduce the adjustment for these contracts to an amount below the established threshold. The offset process is used to determine the action required for contract adjustment purposes for the ''all other contract'' category.

(4) Within a segment, the effect of several changes may be combined in the offset consideration if the changes all take place at the same time. Such offsets may be used:

(i) Within the same contract to determine if the aggregate impact on the individual contract exceeds the materiality threshold;

(ii) On an overall basis to determine the aggregate ''all other contract'' amounts by contract type for all changes; or

(iii) If any action is required to preclude increased costs for concurrent voluntary changes.

(5) Offsets affecting incentive contracts may be applied, provided that the incentive provisions of these contracts are retained or not materially altered.

(6) To minimize action required to resolve cost impacts, cost increases at one segment of a company may be offset by decreases at another segment within the same contract types if the change causes costs to flow between segments either directly or via a higher organizational level such as a home office, or is made simultaneously at the direction of a higher organizational level such as a home office. For such changes, the cost impact settlement proposal should generally be submitted at the home office level so that the cognizant Federal agency official may determine the appropriate course of action.

(c) *Contract price and Cost adjustments.* (1) Once the GDM Settlement Proposal or detailed cost impact proposal has been analyzed, the cognizant Federal agency official shall determine, with the auditor's assistance, whether contract price or cost adjustments are warranted. Any adjustments should be limited to amounts that are material.

(2) If the accounting change produces a material cost increase or decrease in the aggregate by contract type, it may be necessary to adjust the prices of one or more contracts of each contract type affected by the change. The required adjustments to contract prices (including fixed-price contracts) may increase or decrease contract prices depending on whether estimated contract costs increase or decrease. For voluntary changes, the sum of the adjustments of all contract prices shall not result in net increased costs paid, in the aggregate, by the Government or net upward adjustments to contracts. Even if a change produces a zero aggregate impact on the costs of all affected contracts, it still may be necessary to adjust the prices of one or more contracts of each contract type. Such adjustments may be necessary to:

(i) Maintain consistency between the negotiated contract costs and the costs to be allocated to the contract using the new practice;

(ii) Preclude increased cost payments under affected flexibly priced contracts;

(iii) Preclude an enlargement of profit on affected firm-fixed price contracts beyond the level negotiated; or

(iv) Avoid distortions of incentive provisions and relationships between target costs, ceiling costs and actual costs on incentive type contracts.

(3) Whether the cognizant Federal agency official decides to resolve the cost impact by adjusting the price of one or more contracts of each contract type, or selects some other method for settlement in accordance with paragraph (a)(2) of this subsection, the negotiated net adjustment for each contract type should approximate the amounts that would result if the individual contract prices were adjusted to reflect the cost impact of the change in cost accounting practice.

(4) In determining whether contract price or cost adjustments are or are not required, the cognizant Federal agency official should analyze the contractor's cost impact submission to determine if the proposed adjustment amounts exceed the materiality thresholds established in accordance 9903.405–4(a)(7), and adjust individual contract prices accordingly.

(5) The cognizant Federal agency official, with the assistance of the auditor, should evaluate the aggregate amount by contract type, as well as the ''all other contracts'' amount, to determine if these amounts exceed the aggregate or ''all other contracts'' materiality thresholds established. If these amounts exceed the threshold, adjustments may be made by either adjusting contract prices or use of an alternate technique which accomplishes the same approximate result as if all individual contracts were adjusted. If these amounts do not exceed the established aggregate or ''all other contracts'' threshold, no adjustments are required, unless individual contracts exceed the established individual contract cost impact threshold or adjustments are otherwise considered necessary to achieve equity.

(6) Whenever contract price adjustments are anticipated, the cognizant Federal agency official should coordinate the Government cost impact resolution plan with affected Procurement Contracting Officers, Contracting Officers or other authorized officials performing in that capacity within each affected Federal agency.

(7) At the discretion of the cognizant Federal agency official, contract fee or profit may be adjusted when resolving the cost impact through contract price adjustments. Whether fee or profit is or is not considered, in addition to the cost impact, in making contract price adjustments, is a matter to be determined by the cognizant Federal agency official based on the circumstances surrounding the particular change in accounting practices, terms of the contract, and requirements of law.

(d) *Action to preclude increased costs paid for voluntary changes.* (1) In the absence of a finding pursuant to 9903.201–6 that a voluntary change is desirable, no agreement may be made with regard to a voluntary change in cost accounting practice that will result in the payment of increased costs by the United States. For these changes, the cognizant Federal agency official shall, in addition to the procedures specified in 9903.405–2 through 9903.405–5(c) which apply to all compliant accounting changes, take action to ensure that increased costs are not paid as a result of a change.

(2) To decide if action is required to preclude the payment of increased costs, the cognizant Federal agency official shall determine, with the assistance of the auditor, to what extent the United States would pay a higher level of costs, in the aggregate, once all potential contract price adjustments are considered. This occurs when the estimated aggregate higher allocation of costs to contracts subject to adjustment exceeds the estimated aggregate lower allocation of costs to other contracts subject to adjustment.

(3) The cognizant Federal agency official may preclude the payment of increased costs resulting form voluntary changes by limiting any upward contract price adjustments to affected contracts to the amount of any downward contract price adjustments to other affected contracts, i.e., no net upward contract price adjustments. The Government may also preclude increased costs by not paying the estimated amount of increased costs to be allocated to affected flexibly-priced contracts that exceeds the estimated reduction of costs to be allocated to affected firm fixed-price contracts. The following illustrates the actions required so that increased costs are not paid by the Government.

VOLUNTARY CHANGE IN COST ACCOUNTING PRACTICE

Cost shift by contract type		Actions to be taken to preclude the payment of increased costs
Flexibly-priced	Firm fixed-price	
Higher (1)	Higher (1)	No upward price adjustments. Preclude payment of the higher level of costs on flexibly-priced contracts.
Lower (2)	Higher (1)	Limit FFP upward price adjustments to amount of flexibly-priced downward price adjustments.
Lower (2)	Lower (2)	Adjust FFP and flexibly-priced contract prices downward by the amount of the net downward price adjustment.
Higher (1)	Lower (2)	Limit upward adjustments on flexibly-priced to amount of downward adjustments on FFP. Preclude payment of any excess increased costs on flexibly-priced.

Note:
(1) ''Higher'' indicates that a greater amount of cost will be allocated to the contracts than would have been allocated to them had the contractor not changed its cost accounting practices. This represents increased costs to flexibly priced contracts.
(2) ''Lower'' indicates that the costs to be allocated to the contracts are less than the amount that would have been allocated had the contractor not changed its cost accounting practices. This represents increased costs to firm fixed-price contracts.

(4) For individual CAS-covered firm fixed-price contracts, increased costs are precluded by adjusting the contract price downward by the amount of the estimated lower allocation of costs to the contracts as a result of a voluntary change in cost accounting practice.

(5) As stated in 9903.404, action to preclude or recover increased costs due to changes in cost accounting practices are required only if the amounts are material. If materiality dictates that action needs to be taken to preclude increased costs paid, in the aggregate, adjustments of contract prices or any other suitable technique which precludes payment of the increased costs may be used.

(6) For required or desirable changes, the sum of all adjustments to prices of affected contracts may result in an aggregate increase or decrease in CAS-covered contract prices because such changes are subject to equitable adjustments.

(e) Failure to agree. If the parties fail to agree on the price or cost adjustments, the cognizant Federal agency official may make unilateral adjustments, subject to appeal as provided in the Disputes clause of the affected contracts.

9903.406 Noncompliances.

9903.406–1 General types of noncompliances.

(a) A contractor's cost accounting practices may be in noncompliance with applicable Cost Accounting Standards, modifications or interpretations thereto, as a result of using a noncompliant cost accounting practice to estimate and negotiate costs on CAS-covered contracts, i.e., a cost estimating noncompliance; or by using a noncompliant cost accounting practice to accumulate and report costs on CAS-covered contracts, i.e., a cost accumulation noncompliance.

(b) Noncompliant cost accounting practices that result in material increased costs to the Government require correction and may result in contract price and/or cost adjustments as specified in 9903.406–3 and 9903.406–4. Noncompliant cost accounting practices that do not result in material increased cost to the Government should be considered a technical noncompliance and handled in accordance with 9903.406–5.

9903.406–2 Noncompliance determinations and initiating the cost impact process.

(a) When a Government representative finds a potential noncompliance, the representative should, after sufficient discussion with the contractor to ensure all relevant facts are known, immediately issue a report to the cognizant Federal agency official describing the cost accounting practice and the basis for the opinion of noncompliance. The representative's opinion on whether correction of the potential noncompliant practice would or would not have a material cost impact on existing or future CAS-covered contract costs, if known, should also be expressed in the report.

(b) The cognizant Federal agency official should make an initial finding of compliance or noncompliance and advise the cognizant auditor and contractor in a timely manner after the receipt of the audit report of potential noncompliance.

(c) If the cognizant Federal agency official makes a determination of compliance, no further action is necessary other than to notify the contractor and the cognizant auditor of the determination.

(d) If an initial finding of noncompliance is made, the cognizant Federal agency official should immediately notify the contractor in writing of the exact nature of the noncompliance. The contractor will either agree to the noncompliance determination, or disagree and submit reasons why the existing practices are considered to be compliant. The contractor shall respond by a date specified by the cognizant Federal agency official or other mutually agreeable date.

(e) If the contractor agrees with the initial finding of noncompliance, the contractor shall correct the noncompliance and submit a noncompliance cost impact submission as requested by the cognizant Federal agency official. The contractor's cost impact submission shall show the impact of the noncompliance on the affected CAS-covered contracts. It may be in a format that is similar to the GDM Settlement Proposal shown at 9903.405–4(a)(4), the detailed cost impact proposal specified at 9903.405–4(b) or other mutually agreeable format which will accomplish the objectives of 9903.406–3 (c) and (d) for a cost estimating noncompliance or of 9903.406–4 (c) and (d) for a cost accumulation noncompliance. The cognizant Federal agency official shall normally request a GDM Settlement Proposal and attempt to resolve the noncompliance without requiring a detailed cost impact proposal. The following illustration is one acceptable GDM Settlement Proposal format for a noncompliant action. This format is only one example of a noncompliance cost impact submission and does not preclude the use of any other mutually agreeable cost impact submission format. If a GDM Settlement Proposal is not adequately supported, or cannot be adequately supported by the contractor, the cognizant Federal agency official shall request a detailed cost impact proposal for the CAS-covered contracts materially affected by the noncompliance.

SUMMARY—GDM SETTLEMENT PROPOSAL OF TOTAL COST IMPACT ON ALL COVERED CONTRACTS AFFECTED BY A COST ESTIMATING NONCOMPLIANCE

	Contract cost amount		Difference cost impact	Proposed adjustment amounts
	Noncompliant practice (1) (A)	Compliant practice (2) (B)	(A–B)	(3)
AGGREGATE				
FFP				
T&M				
FPI/CPIF				
OTHER				
COST TYPE				
CONTRACT (4)				
FFP				
1.				
2.				
''ALL OTHER''				
TOTAL				
T&M				
1.				
2.				
''ALL OTHER''				
TOTAL				
FPI/CPIF				
1.				
2.				
''ALL OTHER''				
TOTAL				
ALL OTHER COST				
1.				
2.				
''ALL OTHER''				
TOTAL				

Instructions:

1. Insert the estimated cost amounts that resulted from the application of the noncompliant cost accounting practice and were included in the cost proposal(s) used to negotiate the contract price of affected contracts. If the proposed cost and negotiated contract cost were materially different, insert the negotiated contract cost amount that resulted from the application of the noncompliant cost accounting practice(s). Include the estimated cost amounts both in the aggregate and for individual contracts listed.
2. Insert the estimated cost amounts (reconstructed based on the same estimated cost levels to which the noncompliant practice was applied) to reflect the estimated costs that would have been proposed (or negotiated, if the estimated costs based on the noncompliant practice in 1 above are based on negotiated costs) if a compliant practice had been used.
3. Show amounts proposed for adjustment in order to settle the cost estimating noncompliance. The proposed adjustment amounts should include both adjusted costs and appropriate adjustments for profit, fee, or the contracts' incentive provisions.
4. List all contracts that were materially overstated or understated as a result of using the cost estimating noncompliant practice based on the use of a materiality threshold, i.e. all contracts that have contract prices overstated or understated by an amount in excess of a specified threshold.
5. Submit a separate schedule that shows the amount of aggregate increased cost actually paid by the United States due to the contract prices that were established based on the noncompliant practice; and, the contractor's proposed amounts, including applicable interest, to be paid or otherwise credited to the United States in settlement of the increased cost payments received by the contractor.

(f) If the contractor disagrees with the initial noncompliance finding, the contractor shall provide the cognizant Federal agency official with reasons why it disagrees with the initial finding. The cognizant Federal agency official shall evaluate the reasons why the contractor considers the existing practice to be compliant and again make a determination of compliance or noncompliance, and notify the contractor and auditor in writing. If the cognizant Federal agency official makes a determination of compliance, no further action is necessary other than to notify the contractor and auditor.

(g) Once the cognizant Federal agency official reaches a final position that a noncompliance exists, the official shall issue a final determination to inform the contractor of the Government's position and that failure to agree will constitute a dispute under the Disputes clause of the contract. A final determination of noncompliance should also include a request for corrective action and a noncompliance cost impact submission showing the impact of the noncompliance on CAS-covered contracts and subcontracts. If the contractor agrees with the noncompliance determination, the procedures in paragraph (e) of this subsection shall be followed.

(h) If the cognizant Federal agency official issues an initial determination of noncompliance on a revised accounting practice, and ultimately determines that the practice is compliant, the revised cost accounting practice should be handled in accordance with the procedures established in 9903.405.

9903.406–3 Cost estimating noncompliance.

(a) After a final determination of a cost estimating noncompliance is issued by the cognizant Federal agency official, the contractor shall correct the practice by changing to a compliant cost accounting practice. If the contractor believes the cost impact of the noncompliance is not material (i.e., a technical noncompliance, see 9903.406–5), the contractor shall submit data demonstrating the immateriality. If the cognizant Federal agency official agrees that the noncompliance does not result in a material impact on CAS-covered contracts, the procedures in 9903.406–5

shall be followed. Otherwise, paragraphs (b) through (g) of this subsection shall be followed.

(b) If the noncompliance occurs because the cost accounting practice used for estimating purposes is different than the disclosed and established cost accounting practice used for cost accumulation purposes, and the cognizant Federal agency official has found the cost accumulation practice to be compliant, the contractor shall first correct the noncompliance by replacing the noncompliant practice used to estimate costs with the compliant cost accounting practice used to accumulate and report actual contract costs. Where a previously submitted contract cost proposal based on the noncompliant cost estimating practice has not yet been negotiated, the contractor shall also take action to ensure that any subsequent contract cost negotiations of such proposals will be based on cost estimates that reflect the corrected and compliant cost accounting practice.

(c) Once the cognizant Federal agency official determines that the contractor's cost accounting practices used to estimate and accumulate costs will henceforth be consistent and compliant, the cognizant Federal agency official shall request the contractor to submit a noncompliance cost impact submission (see 9903.406–2(e)), for CAS-covered contracts that were negotiated based on the noncompliant practice. The cost impact submission will show the estimated contract cost amounts that were predicated upon the application of the noncompliant cost accounting practice, by contract type, and the estimated contract cost amounts that would have resulted had the compliant practice been used. The cognizant Federal agency official may establish contract thresholds so that any contracts with an immaterial cost impact may be omitted from the cost impact submission. The cost impact submission shall be in sufficient detail for the cognizant Federal agency official to determine whether:

(1) Any individual contracts are significantly overstated or understated as a result of the estimating noncompliance;

(2) The affected CAS-covered contract prices, by contract type, are, in the aggregate materially overstated; and

(3) Any net increased costs were paid under CAS-covered contracts as a result of the noncompliant practice, and if so, the period of overpayment.

(d) The cognizant Federal agency official should use the materiality guidelines established in 9903.305 and 9903.404 to determine whether any individual contract price adjustments, or adjustments for the net overstatement or understatement of contract amounts by contract type, due to use of the noncompliant practice are warranted. Adjustments should be limited to amounts that are material. In no case shall the Government recover costs greater than the increased costs, in the aggregate, on the relevant contracts. While individual contract prices may be increased as well as decreased to resolve an estimating noncompliance, the aggregate value of all contracts affected by the estimating noncompliance shall not be increased. The following schedule illustrates how to determine the contract price adjustments to be required.

REQUIRING CONTRACT PRICE ADJUSTMENTS FOR AN ESTIMATING NONCOMPLIANCE

Change in contract cost estimate by contract type if a compliant practice had been used		Actions to be taken
Flexibly-priced	Firm fixed-priced	
Higher (1)	Higher (1)	No contract price adjustments are required since there are no increased costs to the Government and upward price adjustments, in the aggregate, are not permitted.
Lower (2)	Higher (1)	Adjust flexibly priced contract prices down to recover increased cost to Government. Limit FFP upward price adjustments to amount of flexibly-priced downward price adjustments.
Lower (2)	Lower (2)	Adjust FFP and flexibly-priced contract prices downward by the amount of the increased cost to the Government.
Higher (1)	Lower (2)	Adjust FFP prices downward to recover the increased cost to the Government. Limit upward adjustments on flexibly-priced to amount of downward adjustments on FFP.

Notes:
(1) ''Higher'' indicates the estimated costs submitted in the contract cost proposal would have been higher, if the contractor had used a compliant cost accounting practice to estimate the proposed contract costs.
(2) ''Lower'' indicates that the estimated costs submitted in the contract cost proposal would have been lower, if the contractor had used a compliant practice to estimate the proposed contract costs. This represents increased costs to the Government.

(e) If any aggregate increased costs were paid as a result of the overstatement of contract prices due to the noncompliant practice, the cognizant Federal agency official should take action to recover any material increased costs paid. The cognizant Federal agency official should also recover interest on these increased cost payments at the annual rate established under section 6621(a)(2) of the Internal Revenue Code of 1986 (26 U.S.C. 6621(a)(2)) for such period, from the time payment by the United States was made to the time the increased cost payment is recovered.

(f) Negotiation and resolution of the cost impact should be accomplished in accordance with 9903.405–5(a).

(g) If the same noncompliant cost accounting practice was used to estimate and accumulate contract costs, the cognizant Federal agency official with the auditor's assistance, will evaluate the revised cost accounting practices for compliance with applicable Cost Accounting Standards, modifications or interpretations thereto. Corrective action and resolution of the noncompliant practice involves two distinct actions, one to resolve the cost estimating noncompliance in accordance with this subsection 9903.406–3 and one to resolve the cost accumulation noncompliance in accordance with 9903.406–4.

§ 9903.406–4 Cost accumulation noncompliance.

(a) After a final determination of a cost accumulation noncompliance is issued by the cognizant Federal agency official, the contractor shall correct the practice by changing to a compliant cost accounting practice. If the contractor

believes the cost impact of the noncompliance is not material (i.e., a technical noncompliance, see 9903.406–5), the contractor shall submit data demonstrating the immateriality. If the cognizant Federal agency official agrees the noncompliance does not result in a material impact on Government contracts, the procedures in 9903.406–5 shall be followed. Otherwise, paragraphs (b) through (f) of this subsection shall be followed.

(b) If the noncompliance results from a failure to comply with an applicable Cost Accounting Standard, modification or interpretation thereto, or failure to follow a disclosed or established practice consistently for cost accumulation purposes, the procedures established in this subsection should be used to resolve the impact due to the cost accumulation noncompliance. If the noncompliance results from a failure to comply with an applicable Cost Accounting Standard, modification or interpretation thereto, and requires a change in a disclosed or established cost accounting practice that was used for estimating and cost accumulation, two distinct actions are required, one to resolve the cost estimating noncompliance in accordance with 9903.406–3 and one to resolve the cost accumulation noncompliance in accordance with this 9903.406–4.

(c) Once the corrective action has been implemented, and the cognizant Federal agency official has determined that the accounting change, if any, meets the test of adequacy and compliance, the cognizant Federal agency official will request the contractor to submit a noncompliance cost impact submission (see 9903.406–2(e)). The submission shall identify the cost impact on CAS-covered contracts and any increased costs paid as a result of the cost accumulation noncompliance. Although overpayments due to cost accumulation noncompliances are generally recovered when the actual costs are adjusted to reflect a compliant practice (except for closed contracts), the cost impact submission must show the total overpayments made by the United States during the period of noncompliance, so that the proper interest amount can be calculated and recovered as required by paragraph (e) of this subsection.

(d) The level of detail to be submitted with a cost impact submission for a cost accumulation noncompliance will vary with the circumstances. Normally, the cost impact submission will identify the aggregate costs by contract type that were accumulated under the noncompliant cost accounting practice and the costs that would have been accumulated if the compliant cost accounting practice had been applied from the time the noncompliant practice was first applied until the date the noncompliant practice was replaced with a compliant practice. The cost impact submission for a cost accumulation noncompliance is primarily used by the cognizant Federal agency official to determine if, and to what extent, increased costs were paid in the aggregate on covered contracts during the period of noncompliance. The level of detail required to adequately support this determination should be based on discussions between the contractor and the cognizant Federal agency official, with assistance from the auditor, and included in the cognizant Federal agency's official request for the cost impact submission.

(e) Interest applicable to the increased costs paid to the contractor as a result of the noncompliance shall be computed at the annual rate established under section 6621(a)(2) of the Internal Revenue Code of 1986 (26 U.S.C. 6621(a)(2)) for such period, from the time the payments by the United States were made to the time the increased cost payments are recovered. If the increased costs were incurred and paid evenly over the fiscal years during which the noncompliance occurred, the midpoint of the period in which the noncompliance began may be considered the baseline for the computation of interest. An alternate equitable method should be used if the increased costs were not incurred and paid evenly over the fiscal years during which the noncompliance occurred.

(f) Negotiation and resolution of the cost impact should be accomplished in accordance with 9903.405–5(a).

§ 9903.406–5 Technical noncompliances.

(a) If a noncompliance cost impact is not material in the aggregate, the cognizant Federal agency official shall notify the contractor in writing that:

(1) The practice is noncompliant via a final determination of noncompliance;

(2) The contractor is not excused from the obligation to comply with the applicable Standard or rules and regulations involved; and,

(3) Corrective action should be taken.

(b) If the noncompliant practice is not corrected, the cognizant Federal agency official will inform the contractor that a technical noncompliance exists and that if the noncompliant practice subsequently results in materially increased costs to the Government, action will be taken to recover the increased costs plus applicable interest.

(c) The contractor shall notify the cognizant Federal agency official within 60 days of when the technical noncompliance becomes material.

§ 9903.407 Illustrations.

The following illustrations are not meant to cover all possible situations, but rather to provide some guidelines in applying the procedures specified in 9903.405 and 9903.406. The illustrations are meant to be considered only as examples. In actual cases, the individual circumstances need to be reviewed and considered to ensure equity for both parties.

§ 9903.407–1 Change in cost accounting practice—Illustrations.

(a) *Notification.* (1) The contractor provides notification of a change in cost accounting practices in April with a proposed retroactive applicability date of the beginning of the current year. In accordance with 9903.405–2(c), the contractor states that the reason for the beginning of the current year applicability date is to facilitate indirect cost allocations by use of one set of indirect cost rates for all work performed in the current year. The cognizant Federal agency official approves of the proposed applicability date (see 9903.405–3(c)). After determination of adequacy and compliance, the cognizant Federal agency official requests a GDM Settlement Proposal for contracts negotiated based on the previous accounting practice, including those negotiated after the applicability date of the change.

(2) The contractor provides notification of a voluntary change in cost accounting practices in June with a planned retroactive applicability date of the beginning of the current year. The cognizant Federal agency official finds that the rationale for the retroactive applicability date does not justify retroactive implementation (see 9903.405–3(c)). The contractor is informed that for cost accumulation purposes the new practice can be applied no earlier than 60 days after the contractor's notification of the accounting change, and that a retroactive applicability date will result in a noncompliance with disclosed practices and disallowance of any resulting increased costs. The contractor notifies the cognizant Federal agency official that, to avoid a noncompliance condition, it will change the applicability date to the beginning of its next cost accounting period.

(b) *GDM Settlement Proposal.* (1) In accordance with 9903.405–3(e), the cognizant Federal agency official

requests a GDM Settlement Proposal by contract type, which would include the impact on a sufficient number of contracts of each contract type to negotiate the impact of a change in cost accounting practice. The contractor supports the GDM Settlement Proposal by using a contract cost profile which shows the percentage of the three year forward pricing rate base data which consists of existing CAS-covered contracts subject to adjustment, and the percentage of the CAS-covered contracts subject to adjustment for each contract type. No contracts other than some of the individual contracts submitted with the GDM Settlement Proposal extend out beyond the three year period. The cognizant Federal agency official, with the assistance of the auditor and using the GDM Settlement Proposal individual contract data, determines that the general dollar magnitude estimate developed by the contractor reasonably approximates the aggregate impact, by contract type, of the accounting change on contracts subject to adjustment, i.e., contracts negotiated based on the previous practice. Pursuant to 9903.405–4(a)(6), the Government and contractor resolve the impact without a detailed cost impact proposal.

(2) The contractor reports a change in accounting practice which changes a direct cost element to an indirect expense. The cognizant Federal agency official, with the assistance of the auditor, determines that the GDM Settlement Proposal data submitted by the contractor does not adequately support the aggregate cost impact, by contract type, of the change in accounting practice. Therefore, in accordance with 9903.405–4(b)(1) and (2), the cognizant Federal agency official requests a detailed cost impact proposal to include a sufficient number of contracts, by contract type, to resolve the cost impact.

(3) The contractor submits a GDM Settlement Proposal which includes several contracts of each contract type showing the cost impact of the change in accounting practice. The impact is developed by computing the difference in the estimate-to-complete on these contracts using the old and new accounting practices. The cost impact settlement proposal includes all contracts that have a cost impact in excess of $1,000,000. The cognizant Federal agency official determines that the cost impact on each submitted contract was accurately computed. In accordance with 9903.405–4(a)(6), the cognizant Federal agency official decides that, based on the circumstances, contracts having an impact in excess of $500,000 are significant enough to require adjustment. The cognizant Federal agency official requests the contractor to submit a revised GDM Settlement Proposal that includes contracts having an impact in excess of $500,000 so that the cost impact can be resolved without a detailed cost impact proposal. The cost impact is ultimately negotiated based on the contractor's revised GDM Settlement Proposal.

(4) The same situation described in paragraph (c)(1) of this subsection occurs except that the aggregate impact by contract type in the GDM Settlement Proposal cannot be reconciled with the aggregate net impact of the individual contracts by contract type submitted with the proposal. In accordance with 9903.405–4(a)(5), the cognizant Federal agency official requests a detailed cost impact proposal to include a sufficient number of contracts by contract type to resolve the cost impact.

(5) After reviewing the GDM Settlement Proposal for a change in a cost allocation practice, the cognizant Federal agency official decides in accordance with 9903.405–4(a)(7) that, due to materiality, no additional data is needed and no contract price or cost adjustments are warranted.

(c) Detailed cost impact proposal. (1) In accordance with 9903.405–4(b)(2), the cognizant Federal agency official submits a written request for a detailed cost impact proposal to include all contracts with an estimate-to-complete based on the old practice in excess of $5,000,000 summarized by contract type. After evaluation of the detailed cost impact proposal, the cognizant Federal agency official determines whether contract price and/or cost adjustments are required in accordance with 9903.405–5(c).

(2) [Reserved]

(d) Offset process. (1) In analyzing the contractor's cost impact proposal, the cognizant Federal agency official determines that one firm fixed-price contract is the only contract that exceeds the threshold established for contract price adjustment purposes. The impact on that contract is a reduced allocation of $1,000,000, requiring a downward adjustment to the contract price. When the cognizant Federal agency official applies the offset process to all other firm fixed-price contracts subject to adjustment by combining the increases and decreases, the result is a higher allocation in the aggregate amount of $400,000 on all other firm fixed-price contracts. Although no individual contracts making up this aggregate amount exceed the established threshold, the cognizant Federal agency official decides, in accordance with 9903.405–5(c)(5), that to achieve equity, an upward adjustment in the amount of $400,000 is warranted. Rather than offset this amount against the one contract exceeding the individual contract cost impact threshold, the cognizant Federal agency official, in accordance with 9903.405–5(b)(3), selects two high dollar firm fixed-price contracts for upward adjustment, in addition to the $1,000,000 dollar downward adjustment to the contract exceeding the threshold.

(2) The same situation exists as described in paragraph (d)(1) of this subsection except that the cost impact on the one individual firm fixed-price contract has a cost impact showing a reduced allocation of $10,000,000 which significantly exceeds the individual contract threshold established. The cognizant Federal agency official decides to offset the $400,000 impact on the ''all other'' contracts against the impact on the contract exceeding the threshold and makes a downward adjustment of $9,600,000 thereby reducing the number of contracts requiring adjustment, while still following the guidelines of 9903.405–5(b)(3).

(3) The contractor makes simultaneous accounting practice changes at three of its business units at the direction of the next higher tier home office. The cognizant Federal agency official at the home office segment decides to handle this change as a voluntary change which cannot result in increased costs paid by the United States. Business Unit A has a cost impact on contracts subject to adjustment which results in a higher level of costs on flexibly-priced contracts of $1,000,000 in excess of the lower level of costs on firm fixed-price contracts. The impact on flexibly-priced contracts at Business Unit B and Business Unit C is a combined lesser allocation of costs of $1,200,000 in excess of the higher level of costs on firm-fixed price contracts, resulting in net decreased costs on Government flexibly-priced contracts at the three business units. To demonstrate that the accounting change did not result in aggregate increased costs to the Government, the contractor submits a consolidated GDM Settlement Proposal for the three business units at the home office level. As a result of considering the aggregate impact at the three business units at the home office level, the cognizant Federal agency official, in accordance with 9903.405–5(b)(6), takes no action to preclude the increased costs on flexibly-priced contracts at Business Unit A. Individual contracts at each business unit that had cost impacts

exceeding established thresholds were adjusted upward or downward, as appropriate, for the amount of the cost impact in accordance with 9903.405–5(c)(2).

(4) After determining the individual contracts subject to adjustment where the cost impact exceeded the established threshold for a change in an actuarial cost method for computing pension costs, the contractor computes an aggregate impact for ''all other contracts'' amounting to $1,000,000 of lesser allocation of costs for flexibly-priced contracts and $1,200,000 of lesser allocation of costs on firm-fixed price contracts. The cognizant Federal agency official considers these amounts significant enough to warrant an adjustment. Since the impact on the flexibly-priced contracts represents decreased costs to the Government and the impact on the firm fixed-price contract represents increased costs to the Government, the contractor asks the cognizant Federal agency official to offset the increases and decreases and make a downward adjustment on the fixed-price contracts for only $200,000. The cognizant Federal agency official determines that by doing this, the cost to the Government of a lesser pension cost paid of $1,200,000 would be materially different than if the individual contracts making up these aggregate amounts had been individually adjusted downward resulting in a lesser cost paid of $2,200,000. To achieve the desired result, the cognizant Federal agency official, in accordance with 9903.405–5(b)(1) and (2), selects a number of high dollar contracts and adjusts flexibly-priced contracts downward by $1,000,000 and firm fixed-price contracts downward by $1,200,000. In accordance with 9903.405–5(a)(2), an alternative technique, in lieu of adjusting contact prices, which achieves the same result of lesser cost paid of $2,200,000 could also have been used for the aggregate ''all other contract'' cost impact adjustment.

(e) Contract price and cost adjustments. (1) After considering the materiality criteria in 9903.305, the cognizant Federal agency official decides that only contracts that have an impact that exceeds both $500,000 and .5% of the contract value will be subject to adjustment based on the impact of the accounting change. Of the individual contracts submitted with the GDM Settlement Proposal, only nine contracts exceed this threshold. The aggregate impact of all other contracts by contract type is considered insignificant. In accordance with 9903.405–5(c)(4), the cognizant Federal agency official resolves the cost impact by adjusting only those contracts that exceed the individual contract cost impact threshold, and making no other adjustments, without the need for a detailed cost impact proposal.

(2) The same situation described in paragraph (e)(1) of this subsection occurs except that the aggregate amount for all other contracts not exceeding the established individual contract cost impact threshold is considered significant enough by the Government to warrant adjustment. The Government had established $500,000 as the ''all other contract'' threshold. The cognizant Federal agency official selects two of the largest contracts that do not exceed the threshold, for each contract type, for adjustment in the amount of the aggregate ''all other contract'' impact. In order to avoid additional contract price adjustment action, the contractor, in accordance with 9903.405–5(a)(2), proposes an alternative adjustment technique to resolve the aggregate ''all other contract'' impact amount. The cognizant Federal agency official determines that the proposed alternative adjustment technique accomplishes the same approximate result as adjusting the two selected contracts. The cognizant Federal agency official, in accordance with 9903.405–5(c)(3), agrees to use the alternative technique, in addition to adjusting the individual contracts that exceed the threshold, to resolve the impact of the change in cost accounting practice.

(f) *Increased cost.* (1) In analyzing the contractor's cost impact proposal, the cognizant Federal agency official determines that only two firm fixed-price contracts exceed the threshold for contract price adjustment purposes. All other amounts related to the cost impact are considered immaterial. The change is a voluntary change, i.e., the no increased cost limitation applies. The impact on the two contracts are a lower allocation of costs in the amount of $1,000,000 for contract A and a higher allocation of costs of $2,000,000 for contract B. In order to preclude increased costs paid by the United States as a result of the change, the cognizant Federal agency official, in accordance with 9903.405–5(d)(3), adjusts Contract A downward by $1,000,000, and limits the upward adjustment on Contract B to $1,000,000. This action adjusts the contracts to reflect the impact of the change to the maximum extent possible, while precluding a higher level of costs being paid by the United States.

(2) The same situation described in paragraph (f)(1) of this subsection occurs except that contract B is a CPFF contract. In accordance with 9903.405–5(d)(3), the cognizant Federal agency official adjusts the firm fixed-price contract downward by $1,000,000, and the estimated contract cost ceiling on the CPFF contract upward by $1,000,000. In accordance with 9903.405–5(d)(1), action must be taken to preclude the additional $1,000,000 of increased cost on the CPFF contract. An appropriate adjustment technique is used to preclude the payment of the increased costs in accordance with 9903.405–5(d)(3).

(3) After analyzing the contractor's GDM Settlement Proposal for a voluntary change, the cognizant Federal agency official determines that five contracts exceed the threshold established for contract price adjustment purposes. The impact on all other contracts, both individually and in the aggregate, is considered insignificant. The five contracts requiring adjustment are 3 firm fixed-price contracts and 2 CPFF contracts. The total impact on the 3 firm fixed-price contracts is a lower allocation of costs amounting to $3,000,000. The total impact on the 2 CPFF contracts is a higher allocation of costs of $2,000,000. The cognizant Federal agency official adjusts the contracts upward and downward for the amount of the impacts. In accordance with 9903.405–5(d) (1) and (2), no further action is needed to preclude increased costs paid, since the impact to the Government after contract price adjustments are made is a lesser cost paid in the amount of $1,000,000.

(g) *GDM Settlement Proposal based on contractor cost model and profile.* (1) The contractor has developed a cost model and profile which is used for the GDM Settlement Proposal. The cost model and profile data are updated whenever circumstances change and dictate revision to the data.

(2) For a voluntary accounting change, the contractor's cost model and profile is based on same three year forecast of direct and indirect cost data that supports the contractor's forward pricing rates used to estimate indirect costs in price proposals. The profile shows that 80% of the forecasted allocation base amounts in year 1 are comprised of existing covered contracts subject to adjustment, 50% of the amounts in year 2 are comprised of existing covered contracts subject to adjustment, and 20% of the amounts in year 3 are comprised of existing covered contracts subject to adjustment. Of the amounts applicable to CAS-covered contracts subject to adjustment, the contractor's cost model and profile

shows the following breakdown by contract type:

	In percent		
	Year 1	Year 2	Year 3
Direct labor base:			
CPFF	30	25	20
CPIF/FPI ..	20	21	22
FFP	50	54	58
Total cost input base:			
CPFF	25	22	21
CPIF/FPI ..	15	16	17
FFP	60	62	62

(3) The voluntary accounting change, which the cognizant Federal agency official has determined to be adequate and compliant, results in a transfer of a $5 million activity from the G&A pool to the overhead pool. The cognizant Federal agency official has determined that only individual contracts that have a cost impact in excess of $100,000 will be considered for adjustment, provided that the impact exceeds .5% of the contract value. The cognizant Federal agency official has also determined that $500,000 will be the adjustment threshold for the ''all other contracts'' amounts by contract type. To support the GDM Settlement Proposal, the contractor includes three (3) contracts having the largest estimate-to-complete, by contract type. Based on the cost model and profile the contractor computes the following general dollar magnitude impact by contract type:

	Year 1	Year 2	Year 3	Aggregate impact *
CPFF	$242	$77	$(4)	$315
CPIF/FPI	225	110	43	378
FFP	(310)	(189)	(18)	(517)

* Dollars in thousands.
( ) Denotes lesser allocation of costs.

(4) The aggregate impact amounts show a higher allocation of $693,000 on flexibly-priced contracts and a lesser allocation of $517,000 on firm fixed-price contracts. Only one contract of each contract type submitted with the GDM Settlement Proposal exceeds the threshold established. K1 is a CPFF contract with an impact of a higher allocation of $200,000. K2 is a CPIF contract having an impact of a higher allocation of $300,000. And K3 is an FFP contract having an impact of a lesser allocation of $400,000. After deducting the impact of the three contracts exceeding the threshold, the ''all other contracts'' amounts are a higher allocation of $115,000 for CPFF contracts, a higher allocation of $78,000 for incentive type contracts, and a lesser allocation of $117,000 for FFP contracts.

(5) Since the ''all other contracts'' amounts are less than the threshold for each contract type, the cognizant Federal agency official requires no adjustments for these amounts. The cognizant Federal agency official adjusts the FFP contract downward by $400,000 to preclude the increased costs on this contract. Because this is a voluntary change with no increased costs to be paid by the Government, the upward adjustments to the flexibly-priced contracts must be limited to $400,000. The cognizant Federal official decides to adjust the target cost on the CPIF contract upward by $300,000, with an appropriate upward adjustment of the target fee, in order to avoid distortions of contract incentive provisions based on the estimated higher allocation of costs (see 9903.405–5(b)(5)). The cognizant Federal agency official then limits the upward adjustment to the CPFF contract to $100,000. Additional action must then be taken to preclude the additional $100,000 of costs on the CPFF contract in accordance with 9903.405–5(d)(3).

9903.407–2 Noncompliance illustrations.

(a) *Estimating noncompliance.* (1) The cognizant Federal agency official determines that a cost accounting practice that the contractor has used for estimating and negotiating costs on CAS-covered contracts is noncompliant with an applicable Cost Accounting Standard. The practice is also different than the compliant, disclosed and established practice used for cost accumulation purposes. Therefore, the impact of the noncompliance only affects negotiated contract amounts under which the contractor used the noncompliant practice to estimate contract costs and any outstanding cost proposals not yet negotiated. The cognizant Federal agency official directs the contractor to change its estimating practices so that costs will be estimated, accumulated and reported consistently based on the contractor's established cost accounting practices and not use as a basis for the negotiation of contract prices any previously submitted contract cost estimates which were predicated on the noncompliant cost accounting practice. The cognizant Federal agency official then proceeds to request a cost impact submission for the impact of the noncompliant practice on covered contracts, as well as the amount of the increased costs paid as a result of the noncompliance. In accordance with 9903.406–3(d), the cognizant Federal agency official determines that the impact on contracts less than $10,000,000 would be immaterial, and limits the cost impact submission to contracts of $10,000,000 or more in amount. The contractor's cost impact submission shows that the contract amounts are overstated (in the aggregate) by a significant amount due to use of the noncompliant practice. The contracts are adjusted downward in the aggregate to reflect use of the compliant practice. Of the total amount of the overstatement in contract prices, the cognizant Federal agency official determines that 50 percent had been paid as of the date of the adjustment of the contract values. The cognizant Federal agency official, with the assistance of the auditor, computes and recovers interest applicable to the increased costs paid, for the period from date of payment to date of recovery of the increased costs paid.

(2) The cognizant Federal agency official determines that the cost accounting practice used by the contractor to estimate costs is noncompliant and different than the contractor's compliant, disclosed and established cost accounting practice. An analysis of the noncompliance cost impact submission developed by the contractor shows that, except for two large fixed-price contracts, the effect on negotiated contract values is immaterial. The cognizant Federal agency official determines that the impact on the two large fixed-price contracts is material enough to warrant an adjustment to reflect the application of the compliant disclosed practice. Since the amount of the understatement of the one contract

exceeds the amount of the overstatement of the other contract, the cognizant Federal agency official, in accordance with 9903.406–3(c)(2), limits the upward adjustment of the understated contract to the amount of the downward adjustment of the overstated contract. The cognizant Federal agency official further determines that the noncompliant practice did not result in increased cost paid by the United States. Therefore, no action was required to recover increased cost paid and applicable interest.

(b) *Cost accumulation noncompliance.* (1) The cognizant Federal agency official makes a final determination that the contractor is using an accounting practice for cost accumulation purposes that is noncompliant with an applicable Cost Accounting Standard. The cognizant Federal agency official further determines that the cost accounting practices used for cost estimating purposes are compliant. The noncompliant practice relates to the accumulation of actual indirect expenses. The contractor implements the same compliant practice used to estimate costs for cost accumulation and reporting purposes. The change to the compliant method for cost accumulation and reporting purposes results in automatic adjustment of actual costs and recovery of all increased cost paid due to the noncompliance. The contractor submits a noncompliance cost impact submission showing the amount of the increased cost paid during the period of noncompliance by using a method that does not require submission of individual contract data. The cognizant Federal agency official, with the assistance of the auditor, determines that the cost impact submission reasonably reflects the extent of the increased costs paid. It is also determined that the increased costs were paid evenly over the period of the noncompliance and the interest on the increased costs paid is computed using the midpoint of the noncompliance as a baseline. Since the increased costs have already been recovered through the adjustment of actual costs, the Government takes action only to recover the applicable interest by requesting a payment for the amount of the interest from the contractor.

(2) The cognizant Federal agency official determines that the contractor has accumulated costs based on a cost accounting practice that is not compliant with 9904.402 and is not consistent with its disclosed and established practice for its CAS-covered contracts. Since the noncompliance involves accounting for direct costs as indirect costs on some but not all of its CAS-covered contracts, the cognizant Federal agency official determines that individual contract data is required in order to compute the extent of increased costs paid, if any, as a result of the noncompliance. In accordance with 9903.406–4(d), the cognizant Federal agency official, with the assistance of the auditor, determines and discusses with the contractor the level of detail needed to compute the impact on costs paid as a result of the noncompliance. The cognizant Federal agency official submits a written request to the contractor for a noncompliance cost impact submission that specifies the level of detail required. After analyzing the cost impact submission, the cognizant Federal agency official determines that the amount of the increased costs paid is immaterial and does not warrant action to recover the increased costs, plus applicable interest. The cognizant Federal agency official takes action in accordance with 9903.406–5, Technical Noncompliance.

(3) The cognizant Federal agency official determines that the contractor is using a practice for cost accumulation purposes that is noncompliant with an applicable Cost Accounting Standard. The cognizant Federal agency official further determines that the noncompliant practice was also used for estimating purposes. In order to determine the extent of increased costs, if any, due to both overstated contract prices and billings of costs accumulated on CAS-covered contracts, the official, in accordance with 9903.406–4(b), requests two separate cost impact proposals to cover increased costs. The cost impact submission for the overstated contract prices will be in accordance with the cost impact proposal described in 9903.406–3, and the cost impact proposal for the overbilled accumulated costs will be as described in 9903.406–4.

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