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 third round of comments on proposed amendments to the regulatory provisions contained in chapter 99 of title 48. The CASB's objective in issuing this document is to utilize the proposed amendments as a basis for holding an open public meeting, conducting a benchmarking survey, and soliciting public comments.

The proposed amendments, when issued as a final rule, would revise the current definitions, exceptions and illustrations governing changes in cost accounting practices; exempt certain changes in compliant cost accounting practices from the CASB's contract price and cost adjustment requirements, and establish new coverage for ''desirable changes.'' A new subpart 9903.4, Contractor Cost Accounting Practice Changes and Noncompliances, is also proposed. The new subpart would establish contractor notification requirements for circumstances when contractors make changes to their compliant cost accounting practices. The new subpart would also delineate the process for determining and resolving the cost impact of a compliant change in cost accounting practice or a noncompliant practice on existing covered contract and subcontract prices and/or costs.

Educational Institutions: For covered contracts and subcontracts awarded to an educational institution, the proposed subpart also provides that certain subpart requirements may be waived, on a case-by-case basis, if the cognizant Federal agency official concurrently establishes with the educational institution an ''advance agreement'' that details the specific procedures to be followed for the notification and resolution of compliant changes to established cost accounting practices and/or the correction of noncompliant practices when the educational institution is performing covered contracts, covered subcontracts and other Federally sponsored agreements.

DATES: Comments must be submitted in writing, by letter, and should be received by October 19, 1999.

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 9013, Washington, DC 20503. Attn: CASB Docket No. 93–01N(3). 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 Corel WordPerfect 8 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: In response to the second of comments requested on this topic in the Supplemental Notice of Proposed Rulemaking, promulgated on July 14, 1997 (hereinafter referred to as ''SNPRM–I''), a number of commenters expressed their concerns regarding the purpose and scope of the Board's proposed amendments. In consideration of those concerns, the Board has decided to request a third round of public comments via this Supplemental Notice of Proposed Rulemaking (hereinafter referred to as ''SNPRM–II'') To ensure the views and concerns of interesteed parties are fully surfaced, the Board will also conduct an open public meeting and initiate a ''benchmarking'' survey.

Open Public Meeting

In addition to the submission of public comments, the Board will schedule an open public meeting to discuss this proposed rule. The date, time and location details of that meeting will be the subject of a separate **Federal Register** notice.

Benchmarking Survey

In response to the Board's prior proposal, some commenters generally recommended that the Board field test and/or further study the impact its proposal will have on contractors and the Government and then to reconsider the need for the proposed amendments. For a more detailed discussion of the commenters' concerns, see ''Cost Benefit Issues'' contained in Section B below. To better understand such concerns, the Board will invite a small number of major defense contractors to participate in a coordinated ''benchmarking'' survey. The objective of the survey will be to specifically identify the additional number of contract price and cost adjustment cases that would result if the Board's current proposal were applied to actual contractor changes that occurred in a recently completed cost accounting period. Participation by contractors will be on a voluntary basis. Collection and identification of the survey data is expected to be coordinated with the contractor's cognizant Federal audit organization prior to its submission. These ''benchmarking'' surveys will be formally initiated by the Board through coordination with interested industry associations. For those contractors that wish to participate in the survey but are not included in the resultant contractor groupings established through coordination with the industry associations, the survey questionnaire may be obtained by faxing a request to the CASB staff at 202–395–5105. In such cases, the survey data should be submitted by the due date specified below. Timely submitted contractor surveys will be examined, on a sampling basis, by the cognizant Federal audit organization after they are received by the CASB.

A. Regulatory Process

The CASB's rules, regulations and Cost Accounting Standards (CAS) 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 Standard, 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 Notice is a continuation of the third step 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 an 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 NPRM also 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. On July 14, 1997, the CASB published the SNPRM–I in the **Federal Register** (62 FR 37654), to solicit additional comments concerning certain proposed revisions to the previously proposed NPRM coverage and to solicit comments to determine to what extent, if any, there may be support for the establishment of new provisions that would exempt certain voluntary changes in a contractor's cost accounting practices from the Board's contract price and cost adjustment requirements.

Public Comments

Of the sixty-nine sets of public comments received in response to the SNPRM–I, fifty-nine were provided in a timely manner. The public comments were received from contractors, educational institutions, professional associations, Federal agencies, accounting organizations, and other individuals. A number of commenters supported the establishment of new provisions that would exempt from the Board's contract price and cost adjustment requirements those voluntary changes in compliant cost accounting practices that directly result from changes made by a contractor to improve the economy and efficiency of its operations. Some commenters supported the proposed amendments contained in the SNPRM–I. Some did not. Others offered suggestions on how the proposed coverage might be clarified or otherwise improved. The responses received in a timely manner are addressed in Section E, Public Comments.

Certain other inquiries and concerns, of a more general nature, that were expressed by several commenters with respect to the Board's overall objectives and rationale for the proposed amendments are addressed immediately below.

Board Objectives and Rationale

A number of contractors and professional associations questioned the purpose of the Board's proposed amendments and asked if other more simplified approaches would not better serve the Government and contractors. Some commenters felt that the Board had never supplied a clear rationale for the proposed definition of the term ''cost accounting practice.'' One commenter stated that because ''cost accounting practice'' is not so much an accounting concept as it is a key to the administration of CAS, a statement of purpose or rationale would help to understand the CAS Board's goal.

The Board's objectives are discussed below.

Continuing Board Objective: To support the Government's procurement process for negotiated cost-based contracts.

The Board's continuing objective is to promote an acquisition environment wherein Government contracting officials can, with a high degree of confidence, rely upon the estimated and actual cost information provided by contractors relative to (1) the costs contained in and/or submitted in support of proposed contract prices, (2) the overall costs of operations and/or (3) the costs of prior contract performance. Because the Board's CAS and Interpretations often limit or narrow the range of alternative cost accounting practices that might otherwise be used by a contractor, or by competing contractors, in calculating submitted cost information, Government procurement officials can with a greater degree of reliance make meaningful analyses and comparisons when contractor submitted cost information is derived through a contractor's consistent application of CAS compliant cost accounting practices.

Pursuant to its enabling statue, the Board promulgates CAS and Interpretations that are designed to achieve uniformity and consistency in the cost accounting practices used by contractors to estimate, accumulate and report costs. The concepts of ''uniformity'' and ''consistency'' are set forth in the Board's ''Statement of Objectives, Policies and Concepts'' (57 FR 31036, 7/13/92). The Board's rules also require the larger CAS-covered contractors to formally disclose to the Government their established cost accounting practices, via submission of a disclosure statement. Disclosure reduces the potential for Government misunderstandings concerning contractor cost information submissions. Consequently, the submission of estimated or actual cost information developed by contractors based on the consistent application of CAS compliant cost accounting practices enables the Government to make more meaningful cost comparisons between competing contractors, facilitates the negotiation of fair and reasonable contract prices, and permits the Government to make more reliable comparisons of a particular contractor's estimated and actual contract costs.

Immediate Board Objective: To bridge the gap between contractor cost accounting matters and the Government's procurement process for negotiating and administering negotiated cost-based contracts, particularly when contractors fail to apply their established cost accounting practices in a consistent manner, fail to comply with applicable CAS or make compliant changes to their established cost accounting practices.

Statutory Requirement. Under its enabling statute, the Board is required to promulgate regulations that require contractors and subcontractors to ''* * * agree to a contract price adjustment * * * for any increased costs paid to such contractor or subcontractor by reason of a change in the contractor's or subcontractor's cost accounting practices or by reason of a failure by the contractor or subcontractor to comply with applicable cost accounting standards.'' Accordingly, the Board's implementing regulations include provisions that are designed to establish what constitutes a ''change to a cost accounting practice'' and ''increased cost'' to the Government. The Board's regulations also provide for contract price and cost adjustments if a contractor changes its established cost accounting practice or applied a noncompliant practice. The Board's current proposal is designed to facilitate the implementation of the Board's statutory requirements.

Cost Accounting Practice Definition: Consistent with the Board's statutory requirements, the purpose of the Board's proposed amendments to the definitions of the terms ''cost accounting practice'' and ''change to a cost accounting practice'' is to direct the contracting parties to focus on the cost accounting

practices actually used by contractors to accumulate cost in cost pools for subsequent allocation to intermediate and final cost objectives when determining if a voluntary change in cost accounting practice has occurred. Specifically, the proposed amendments make clear that changes in the selection and/or composition of cost pools are changes in the methods and techniques used to allocate cost to cost objectives, i.e., a change to a cost accounting practice.

Based on the commenters' stated perceptions, some contractors apparently believe that the term ''cost accounting practice'' as defined in the Board's existing rules is merely a contractual term of art that is used to identify a finite or limited number of circumstances which trigger contract price or cost adjustments under the terms and conditions of CAS-covered contracts. In their view, a change in cost accounting practice only occurs if the change is specifically cited or illustrated in the Board's rules. That line of reasoning would inappropriately preclude from consideration the complete spectrum of cost accounting practices actually used by each contractor to accumulate costs in cost pools for subsequent allocation to intermediate and final cost objectives. The commenters' inferences are that the Board has the ability to promulgate a rule that describes or illustrates every conceivable circumstance that the Board considers to be a change to a cost accounting practice for each contractor performing CAS-covered contracts. That, however, is not feasible or desirable. Instead, the Board's objective is to maintain cost accounting practice definitions that can be related to each contractor's established cost accounting practices.

The Board's proposed definitions are, therefore, from a broader perspective. The Board's objective is to permit the application of the Board's rules to all contractors and subcontractors, regardless of their specific individual cost accounting practices applied to accumulate costs. The Board's expectations are that the contracting parties will be able to determine, on a case-by-case basis, whether a change in a particular contractor's established cost accounting practice has occurred based on the revised language contained in the Board's proposed definitions. Under the definition being proposed today, if a contractor makes changes that alter the flow of pooled costs to intermediate and final cost objectives, for ongoing functions, such changes would generally be considered a change in cost accounting practice. Thus, it is the substance of the actual change made that is to be evaluated by the contracting parties. A cost accounting practice change may occur even if it is not specifically depicted in the Board's rules.

The accompanying illustrations are a secondary source of guidance regarding the application of the primary policy reflected in the definitional language. A determination that a change in practice has occurred should normally result whenever there is a change in how pooled costs are accumulated for allocation to intermediate and final cost objectives. The determination is, therefore, not limited to only those circumstances that replicate the conditions associated with the changes in cost accounting practices illustrated in the Board's amended rule or by any previously proposed coverage (proposed definitional language or illustrations) associated with this rulemaking that is not eventually incorporated in the final rule.

Contract Price and Cost Adjustments. In proposing a new subpart 9903.4, the Board's objective is to establish a definitive cost impact process that fully considers and reflects how contractor submitted cost information is used by the Government (i) to negotiate contract prices at the time of award, (ii) to convert cost ceilings or target costs into final contract prices for flexibly priced contracts after award, and (iii) to pay contract costs under the terms and conditions of the different types of negotiated cost based contracts (FFP, CPFF, etc.) that are utilized by the Government to obtain products, supplies and services, research, etc.

Contractor cost estimates submitted to support proposed contract prices for the performance of specific tasks generally reflect the amount of direct and indirect costs that contractors expect they will actually accumulate in accordance with their established cost accounting practices after receipt of a contract award, if they were selected to perform the specific tasks. The Government's negotiators rely upon such cost estimates when they establish the negotiated contract price at the time of contract negotiations, prior to contract award. If a contractor changes a compliant cost accounting practice after contract award, the amount of costs accumulated for existing CAS-covered contracts may increase or decrease in comparison to the amounts that would have been accumulated had no practice change been made. Such post award changes made by a contractor could result in the payment of increased costs by the Government. If a contractor applied a noncompliant cost accounting practice, the amount of estimated costs based on the noncompliant practice may result in overstated or understated negotiated contract prices and/or the amount of actual costs accumulated for resultant CAS-covered contracts may be higher or lower than the amounts that would have resulted if a compliant practice had been used to accumulate costs. In such circumstances, contract price or cost adjustments may be required to preclude the payment of increased cost, to correct overstated contract prices and to deobligate overstated funding obligations that resulted from an estimating noncompliance, or to address individual contract cost overrun or underrun conditions that may result. Adjustments may also be required so that Government cost comparisons between estimated and actual costs of contract performance contained in contract cost status reports result in valid comparisons.

By proposing a definitive cost impact process, the Board is taking action to establish how the contracting parties are henceforth to:

- Estimate the amounts by which the amount of costs accumulated under existing CAS-covered contracts will increase or decrease after a compliant cost accounting practice change is made.
- Convert the estimated changes in cost accumulation (increases or decreases) for individual contracts to equitable contract price adjustments for ''required'' and ''desirable'' practice changes.
- Determine if ''voluntary'' cost accounting practice changes made unilaterally by a contractor after contract award will result in the payment of increased costs, in the aggregate, by the Government and to prescribe the actions to be taken to preclude the payment of the aggregate increased costs. At the time of contract award, a contractor agrees to consistently apply its established cost accounting practices when accumulating and reporting the costs of contract performance. A voluntary change in cost accounting practice negates that agreement and triggers the CAS contract clause price and cost adjustment provisions which preclude the Government from paying aggregate increased costs (as defined by the Board) that may result from a voluntary change in cost accounting practice. When a contractor makes a voluntary change to its established cost accounting practices, the amount of contract costs accumulated by the contractor for individual contracts may increase or decrease as compared to the amounts

that would have been accumulated for the individual contracts had the practice change not occurred. The cost impact process being proposed prescribes how to determine if the Government would pay ''increased costs,'' in the aggregate, as the result of a voluntary change in practice for the different types of contracts that may be involved (FFP or flexibly priced contracts). The increased cost determination is predicated upon an analysis of the changes in individual contract cost accumulations that are expected to result after the practice change and a determination on whether or not contract price adjustments or other actions are required to preclude the payment of aggregate increased costs, e.g., require adjustment of the Government's contractual obligations to pay the negotiated cost-based contract prices (FFP or cost ceilings for flexibly priced contracts) which were determined at the time of award based on proposed contract costs that were estimated in conformity with the contractor's then established cost accounting practices and the contractor's agreement to consistently apply such established practices when accumulating and reporting the actual costs of contract performance.

- Convert the estimated changes in cost accumulations (increases or decreases) for individual contracts to contract price adjustments and/or other actions that may be required to preclude the payment of increased costs or to otherwise reflect the cost impact of ''voluntary'' cost accounting practice changes.
- Determine if increased cost to the Government, in the aggregate, occurred in the event a noncompliant cost accounting practice was used to estimate contract costs and/or to accumulate contract costs.
- Correct noncompliant conditions.

The purpose of the foregoing discussion is intended to guide interested parties in commenting on the Board's proposal.

Alternative Procedures

Some commenters advocated that the use of other approaches might better serve the Government and its contractors. The thrust of their arguments was that other measurement criteria for evaluating the reliability of contractor cost submissions and remedies for ''unreliable'' cost submissions might be developed with the result that the contracting parties would incur less administrative costs. General references were made to recent regulatory changes established by the procurement community in response to acquisition reform legislation that produced ''streamlined'' acquisition regulations for contract awards where contract prices are generally based on ''adequate price competition,'' e.g., the use of ''past performance'' evaluations for determining responsible sources and ''Process Oriented Contract Administration Services (PROCAS),'' a ''team approach'' review program developed by the Defense Logistics Agency that establishes increased reliance on contractor internal control procedures so that Government surveillance can be lessened. How such alternative processes might be related to the implementation of the Board's statutory requirements for negotiated cost-based contracts was not, however, detailed. Any alternative system, if designed to provide the basis for making meaningful evaluations regarding compliance with the Board's CAS and the resulting submission and use of contractor prepared cost information, would require a baseline or benchmark against which submitted cost information could be measured, verified and equitably adjusted if unreliable cost information had been submitted. Additional contractor reporting systems and new measurement criteria relative to the Board's statutory requirements would need to be developed and implemented. Team reviews also consume considerable resources, pose scheduling delays, and are generally invoked only at the largest contractor locations.

In a cost-based contracting environment, the use of such alternative processes may not be as effective or less costly than the Board's administrative requirements. The Board has carefully considered the commenters' views and believes that its regulatory requirements (once amended as proposed in this SNPRM–II) and Standards result in a reasonably efficient and effective process for administering contractor cost accounting matters that affect the pricing of negotiated cost-based Government contracts and subcontracts.

Cost Benefit Issues

Cost Accounting Practice Definition

A number of commenters opined that the costs of implementation of the Board's proposed amendments would exceed any cost savings the Board might expect from the potential recovery of increased costs paid by the Government. The commenters premised their concerns on the notion that the proposed amendments to the Board's definitions of a ''cost accounting practice'' and ''change to a cost accounting practice'' will increase the number of cases (cost accounting practice changes) that will need to be reported to the Government and subjected to the Board's cost impact process. They reasoned that the increased number of cases will, in turn, increase the Government's and contractors' administrative costs over the levels currently being experienced. Consequently, they generally recommended that the Board field test and/or further study the impact its proposal will have on contractors and the Government and then reconsider the need for the proposed amendments. It is their belief that the Board will find that the Government's and contractors' administrative cost levels would increase substantially while any increase in the levels of ''increased costs'' to be recovered by the Government would not justify the higher administrative cost levels.

The Board acknowledges that for some contractors the *reported* number of cost accounting practice changes that would become subject to the Board's contract price or cost adjustment process may increase when compared to the number currently being reported. The possible increase would not be due to the actual number of ''changes'' made each year, but rather due to those changes that have been made routinely in the past but were not treated by the contractor as a ''change to a cost accounting practice'' (e.g., pool combinations, pool split-outs, and transfers of ongoing functions from one pool to another pool). Some contractors do not believe such changes are currently subject to the Board's consistency requirements and CAS contract price and cost adjustment provisions due to their interpretations of the Board's existing definitions, illustrations and rulemaking history regarding the definition of a change to a cost accounting practice.

Such cost pool changes normally impose additional non-CAS driven administrative burdens on both the Government and contractors because they generally require the negotiation of revised sets of forecasted indirect cost rates for contract cost estimating purposes and the establishment of revised sets of provisional and actual indirect cost rates for the payment of accumulated actual contract costs. These revisions are required whenever changes in the accumulation of pooled costs significantly affect estimated and/or actual contract cost accumulations. However, this additional administrative cost burden does not appear to be a contractor concern since these corollary administrative actions were not mentioned. Also not considered was the impact of the alternative outcomes and

alternative administrative actions that would result if the CAS cost impact process were not applied to uniformly resolve individual contract cost overruns or under-runs that may result from such changes.

A study of Government cost recoveries is not needed since the Board does not expect that only contract price reductions will occur due to the promulgation of this proposed rule. The contract price and cost adjustments made under the CAS cost impact process generally increase and decrease individual contract prices and costs in synchronization with the increase or decrease in actual cost accumulations expected to result from the practice change. If the Government determines a practice change to be a ''desirable change'', then the Government may increase, not decrease, contract prices in the aggregate. The objective is to track the expected changes in cost accumulation for the individual covered contracts and to adjust individual contract prices, if necessary. It is not to gain an advantage for the Government. The ''savings'' will accrue through the Government's continued reliance on contractor cost submissions, the Government's ability to adjust contract prices and costs to preclude the payment of increased costs (as defined by the Board), and the implementation of a less burdensome cost impact system.

The commenters' ''cost savings'' rationale avoided the basic issues under consideration by the Board, i.e., what constitutes a change in a contractor's established cost accounting practices used to estimate, accumulate and report costs for covered contracts, and, has the Board's statutory requirement to preclude the payment of ''increased costs'' been implemented in an effective manner? Their arguments were limited to the premise that if the proposed amendments increase existing administrative cost levels to the contractor and/or there is no significant increase in the level of amounts recovered by the Government, promulgation of the proposed amendments is not justified.

Throughout this rulemaking process, contractors continued to advocate that, from a technical prospective, the definition of a change to a cost accounting practice should not be amended, i.e., the Board's contract price and cost adjustment provisions should not be triggered if a contractor's estimated cost proposal was predicated on the accumulation of estimated pooled costs in a particular manner and, after contract award, the contractor elected to accumulate actual pooled costs differently and thereby altered the amount of actual contract costs accumulated for individual contracts. This administrative cost burden argument is really an extension of those technical arguments which are addressed elsewhere in this Preamble. However, as presented, the burden argument ignores the potential direct ''cost'' risk to the Government in terms of increased contract prices or costs that may result and be billed to the Government due to such post-award changes. By objecting on the basis that the Board's proposed amendments will increase the administrative cost burden, some contractors are really arguing that the CASB's requirements for adjusting contract prices to reflect the changes in the accumulation of pooled costs allocated to individual contracts, should not be applied. If such ''burden'' arguments were accepted, the CASB's cost impact process would not be used to uniformly resolve individual contract cost shifts resulting from such changes. The Board does not agree with such views. The Board does not believe that the commenter's arguments have technical merit or that the Board's proposal will materially increase the overall administrative cost burden level currently imposed by the Government on cost-based contractors.

The Board's objective is to consistently treat unilateral changes made by contractors that alter the manner by which the costs of ongoing functions are accumulated in cost pools for subsequent allocation to intermediate and final cost objectives as a change in cost accounting practice. Such contractor changes are viewed as a constant. They occur irrespective of the Board's rules, regulations and Standards. Therefore, the issue is simply whether changes in the accumulation of pooled costs that alter the flow of costs to intermediate and final cost objectives are also to be recognized as changes in a contractor's cost accounting practices for contract pricing purposes.

To ensure that equity results from the Government's cost-based contract pricing process, the Board is of the opinion that a change made by a contractor which alters the flow of costs to cost objectives, for ongoing functions, constitutes a change in cost accounting practice for contract cost or pricing purposes. In the final analysis, an approach that protects the Government's interests in an equitable manner, consistent with the Board's enabling statute, is needed in a cost-based contracting environment. The benefits of commonly understood definitions that result in implementation of the Board's statutory requirements will tend to negate the administrative costs of implementation even if some administrative cost levels were to increase for a short time. This is because the Board's existing rules have not resulted in an effective, easily understood and agreed to regulation. The contracting parties have experienced contentious disagreements and legal disputes concerning amounts paid under covered contracts after contractors made ''changes'' that altered the flow of costs to intermediate and final cost objectives which in turn altered the aggregate amount of accumulated contract costs. Settlement of these disagreements and adjudication of the resulting legal cases, particularly when extended over long periods of time, have produced significant ''administrative costs'' to both the Government and contractors. It is the Board's expectation that finalization of this proposal to more precisely define what constitutes a ''change to a cost accounting practice'' will reduce the potential for such disagreements and therefore will obviate the cost of protracted legal proceedings for many such changes in the future.

Cost Impact Process

The Board found that the administrative process for making the contract price and cost adjustments has not always been implemented in a uniform manner, and that the ''undocumented'' procedures and processes for making such adjustments is not widely understood by the Government or its contractors. The proposed cost impact process delineates the entire process to be followed when a contractor changes a compliant cost accounting practice, or is required to correct a non-compliant practice. It addresses when notification of a practice change is required and specifies a flexible process for determining and resolving the cost impact of a cost accounting practice change or noncompliance. The Board believes that the proposed process, when promulgated as a final rule, will prove to be more flexible and less burdensome than current practices. It will also facilitate user comprehension of the process and thereby tend to reduce the overall amount of administrative effort currently being expended to resolve individual cases.

In Summary

The Board's continuing objectives are to maintain its existing rules and Standards in a manner that is consistent with its enabling statute. The purpose of the Board's current proposal is to focus

on the two basic issues that are an essential part of the Board's overall contract price and cost adjustment process, i.e., what constitutes a ''cost accounting practice'' and how to administer CAS-covered contracts in the event a contractor or subcontractor makes a change to its otherwise compliant cost accounting practices or a contractor or subcontractor does not comply with an applicable CAS when estimating, accumulating or reporting costs. Based on the public comments received throughout this proposed rulemaking, it is clearly evident that disagreements still exist over what should constitute a change in a contractor's established cost accounting practices for purposes of triggering the CAS contract price and cost adjustment process. Accordingly, the Board believes that the amendments being proposed today are needed to facilitate implementation of the Board's statutory mandate concerning the payment of increased costs attributable to contractor cost accounting practice changes, and that the contracting community will benefit from the promulgation of a flexible cost impact process that is designed to achieve a more flexible and less burdensome administrative process.

The Board does not believe that its proposed amendments, when promulgated as a final rule, will increase the level of administrative costs currently being experienced by contractors and Government agencies by any appreciable margin. In the long run, the benefits accruing from a more precise definition of a ''change to a cost accounting practice'' and a more flexible cost impact process should reduce, not increase, the overall administrative burden currently being experienced by contractors and agencies.

Proposed Amendments

A brief description of the proposed amendments follows:

Part 9903, Contract Coverage—Proposed Amendments

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 provide exemption criteria for determining if a voluntary change in cost accounting practice associated with certain restructuring activities can be exempted from the contract price or cost adjustment requirements prescribed in part 9903. Subsection 9903.201–7 is amended to establish criteria for determining when a voluntary change in cost accounting practice is desirable and not detrimental to the Government's interests and to establish alternate processes for resolving desirable changes. Subsection 9903.201–8 is added 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 to a 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:

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 voluntary change in cost accounting practice associated with restructuring activities can be exempted from contract price or cost adjustment.

Provide criteria for determining when a non-exempted voluntary change in cost accounting practice can be determined to be a desirable change that is not detrimental to the Government's interests.

Provide a more flexible process for resolving the cost impact of certain desirable changes.

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, 9903.301 is amended to incorporate two definitions to clarify the terms ''Function'' and ''Intermediate cost objective.'' The amendments made to 9903.302–1(c), *Allocation of cost to cost objectives*, make explicit the methods and techniques that are considered to be a cost accounting practice, including the methods and techniques used to accumulate the cost of specific activities in cost pools. Additional subparagraphs are added to clarify the concepts associated with 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 added regarding the use of the illustrations that follow. Introductory paragraphs (a), (b) and (c) are revised to clarify that the illustrations involve ''cost accounting practices'' that have changed. The

illustration at 9903.302–3(c)(3) is 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 a 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 new 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 for the submission of ''cost savings'' data that will enable the cognizant Federal agency official to promptly determine if a voluntary change can be exempted from contract price or cost adjustment. For changes in cost accounting practices that can not be exempted, 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 proposed 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 addresses 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 on individual contracts 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, details the processes 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 proposal 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 proposed rule was developed after consideration of the public comments received in response to the Board's NPRM (61 FR 49196, 9/18/96) and the SNPRM–I (62 FR 37654, 7/14/97) that were published in the **Federal Register**, wherein public comments were invited. The NPRM comments received and the Board's actions taken in response thereto were reflected in the SNPRM–I. The supplemental comments received in response to the SNPRM–I and the Board's actions taken in response thereto are summarized in the paragraphs that follow:

Contract Price and Cost Adjustment Exemption

Comment: Although commenters remained concerned regarding the level of detail that would be needed to obtain an exemption, they expressed strong support for the creation of a provision that would exempt from the Board's contract price and cost adjustment requirements those voluntary changes in

cost accounting practices that are associated with management changes made to improve the efficiency and effectiveness of a contractor's operations.

Response: The Board's deliberations focused on how a voluntary change to a contractor's established cost accounting practices should be treated under the Board's rules when the practice change is directly associated with management actions undertaken to improve the economy and efficiency of the contractor's operations. It is the Board's continuing belief that the Government should be informed of any changes made to the contractor's established cost accounting practices that are being used to accumulate and report the costs of performing existing CAS-covered contracts. Such notification facilitates the contract administration process and beneficially reduces the potential for disputes, particularly if a disclosure statement is required. However, in cases where a change in cost accounting practice is made in conjunction with contractor restructuring activities that are undertaken to reduce personnel or facilities in order to significantly lower the contractor's overall costs of operations, the contract price and cost adjustment process contractually required for changes in cost accounting practices under existing CAS-covered contracts may not be necessary or appropriate.

For example, assume that after contractor restructuring activities and associated practice change(s) are implemented concurrently, a reduction in the contractor's future overall operating costs is expected and the aggregate costs accumulated for existing covered contracts are also expected to be less than the aggregate costs that would have been accumulated if the restructuring activities had not been made by management. In such cases, it would generally be inappropriate to separately adjust existing contract prices or costs *only* for the cost impact of the change in cost accounting practice. That is because the aggregate CAS cost impact calculation for a practice change is based on the application of the original and changed cost accounting practices to the contractor's lower level of costs expected to result after restructuring changes are implemented. It does not give consideration to the impact that the lower overall operating cost levels (cost savings) expected to result from the restructuring activities will have, in the aggregate, on accumulated contract costs for existing covered contracts. Nor would the CAS cost impact adjustments give consideration to the effects of any resulting contract ceiling or target price adjustments or decisions that may otherwise be made by the Government based on the expected aggregate reductions in accumulated costs for the existing contracts as reported in the contractor's restructuring cost savings submissions or contract cost performance status reports. For such actions, the Government's decision(s) would be based on reported cost information that already reflects the application of the new changed cost accounting practices to the lower level of costs expected to occur after the restructuring changes are made by management. Consequently, an independent CAS contract price or cost adjustment made for the shift in costs attributable only to the cost accounting practice change(s) might alter, in part, the contractor's reported cost savings estimates and/or any resultant actions otherwise taken by the Government.

After considering this matter at length, the Board proposes to establish contractor notification requirements for any changes made to the contractor's established cost accounting practices (at 9903.405–2). The Board also proposes to establish an exemption from its contract price and cost adjustment requirements for certain voluntary changes made to a contractor's cost accounting practices (at 9903.201–6). The proposed exemption would become applicable when the cognizant Federal agency official determines that the Board's promulgated criteria for granting the exemption has been met: i.e., when a contractor adequately demonstrates that a planned restructuring activity is expected to result in cost savings to the Government; the practice change would not occur but for the planned restructuring activity; reductions in contractor personnel or facilities will occur; and reduced contract cost accumulations are expected to occur, in the aggregate, for existing flexibly priced contracts, and all expected future CAS-covered contracts and subcontracts.

If a change in cost accounting practice directly associated with planned restructuring activities were exempted, existing flexibly priced contracts would, however, remain subject to applicable contract terms and conditions prescribed in agency procurement regulations. Accordingly, the Contracting Officer may still make individual contract cost ceiling and/or target cost adjustments or otherwise take action to address any potential contract cost overrun and/or underrun conditions that are expected to result due to the restructuring activities.

The administrative process for requesting the exemption and granting an exemption is also proposed at 9903.405–2 and 9903.405–3. When a contractor requests an exemption, the submission of some contractor information is necessary concerning the contract cost accumulation changes and cost savings that are expected to result from the planned restructuring activities. Otherwise, the cognizant Federal agency official would not have a reasonable basis for determining, in a meaningful manner, if a planned cost accounting practice change meets the Board's specified exception criteria, and should be exempted, or if the practice change should be subjected to the Board's standard contract price and cost adjustment process.

Comment: A Federal agency supported the establishment of an exemption for improved management efficiency and effectiveness. It recommended, however, that the exemption only be granted when the contractor meets the Board's stated requirements *and* the cognizant Federal agency official makes a determination, based on the facts and circumstances of the situation, to grant the exemption. A related concern was that flexible contract adjustment provisions were needed so that adjustments can be made for shifts in contract costs resulting from changes made in cost accounting practices to ensure that contractor completion of flexibly priced contracts would not be jeopardized.

Response: In considering the establishment of an exemption, the Board did not expect to establish a mandatory exemption provision that would obviate the need for determinations, on a case-by-case basis, by the cognizant Federal agency official on whether a cost accounting practice change should be exempted. A unilateral exemption decision by the contractor was not envisioned, e.g., the draft ''Option B'' language included in the SNPRM–I provided that the contractor would request an exemption and the cognizant Federal agency official would notify the contractor if the Board's exemption criteria had been met and that the voluntary change would be exempt.

The Board's objective is to not discourage restructuring activities. Consequently, the Board is proposing an exemption provision so that cognizant Federal agency officials will not be required to apply the Board's contract price and cost adjustment process for certain changes in cost accounting practice that are directly associated with certain restructuring activities. The exemption would only apply when a

cognizant Federal agency official finds that contract price and cost adjustments otherwise required under the Board's regulations for existing contracts are not considered necessary to protect the Government's interest. This would occur where the cognizant Federal agency official determines that a contractor has met the Board's proposed exemption criteria which includes a demonstration that aggregate reductions in contract cost accumulations for existing flexibly priced CAS-covered contracts and future CAS-covered contracts are expected to result from the planned restructuring activity. However, when such ''cost savings'' to the Government are expected to occur in the aggregate due to restructuring and a voluntary cost accounting practice change is made concurrently with the restructuring change, then the two changes made in unison may produce cost underrun and/or overrun conditions for some individual flexibly priced type contracts. In such cases, the Board would expect that, as a normal contract administration matter, the contracting parties would mutually agree to concurrently decrease or increase the affected contract ceiling or target prices, and revise funding obligations, as necessary, to reflect the lower cost accumulations (cost savings), expected in the aggregate, for all affected flexibly priced contracts. The overall objective of such actions would be to recognize the aggregate ''cost savings'' and to address (correct) any individual contract cost overrun conditions that might result under existing CAS-covered contracts and subcontracts.

When the aggregate cost accumulations for existing flexibly priced contracts are expected to increase due to planned restructuring activities, then the cognizant Federal agency official may grant the exemption if a determination is made that the ''cost savings'' expected to result under future covered contract awards exceed the aggregate increase for such existing contracts. However, the resulting cost overrun conditions for such exempted CAS-covered contracts would remain subject to the same Contracting Officer actions that are normally taken to address cost overruns in accordance with the existing contracts' other terms and conditions that are prescribed in applicable agency procurement regulations.

The Board's intent is to provide flexibility to cognizant Federal agency officials administering CAS-covered contracts and subcontracts while also providing assurance to contractors that requests for the proposed exemption will generally be granted when the Board's specified criteria are applied. The granting or use of the Board's proposed exemption should not otherwise disrupt the Government's ongoing administration of CAS-covered contracts.

In response to the commenter's concerns, the Board proposes to establish a ''finding'' requirement at 9903.201–6 to clarify that a cognizant Federal agency determination is needed before a voluntary change in cost accounting practice can be considered exempt from a CAS-covered contract's contract price and cost adjustment provisions. The establishment of an adjustment provision for flexibly priced contracts to address the potential cost overrun conditions attributable to a change in cost accounting practice associated with a planned restructuring activity was not considered necessary.

Comment: A number of commenters advocated that if an exemption provision is promulgated, the coverage should not be limited to ''transfers of functions'' or ''merger of cost pools.'' Several commenters recommended that the exemption language not be limited to cost accounting practice changes resulting from ''organizational changes.'' Conversely, some commenters objected to the promulgation of an exemption based on their belief that an exemption for economy and efficiency changes would be abused. They opined that virtually every change in cost accounting practice could be covered as a change made for ''improved management efficiency and effectiveness.''

Response: The exemption criteria being proposed today has been expanded to include any changes in the ''allocation of cost to cost objectives'' (9903.201–6(c)) that occur within a cost accounting period, i.e., ''intra-period'' cost shifts. Changes involving the ''measurement of cost'' or the ''assignment of cost to cost accounting periods'' are not subject to exemption.

The Board also shares the concerns expressed by those commenters advocating that no exemption be provided in order to avoid the potential for abuse. In that regard, the SNPRM–I ''Option B'' exemption criteria has been modified to require an adequate contractor demonstration that the planned restructuring activities, when implemented, are expected to result in cost savings to the Government, in the aggregate. With regard to the latter, this proposed rule also requires a demonstration of the expected impact on projected cost accumulations for existing CAS-covered FFP contracts. Contract price adjustments normally required to resolve the cost impact resulting solely from a voluntary change in cost accounting practice would not, however, be required for existing CAS-covered FFP contracts, if the practice change is exempted. But the data submission in a FFP environment would provide support for the determination that similar offsetting ''cost savings'' can be reasonably expected to occur in future CAS-covered contracts.

The Board will revisit this matter if subsequent events reveal that the proposed exemption is ''abused'' after promulgation as a final rule.

Comment: A commenter opined that the proposed language would limit the exemption only to organizational changes that involve ''physical'' actions. The commenter recommended that a clarifying revision be made to permit changes that make more efficient use of existing facilities and personnel or increase productivity of those facilities and personnel.

Response: The proposed requirement for physical actions to evidence that a significant nonrecurring management change was being made to improve the economy and efficiency of operations has been retained in the exception being proposed today. The Board's intent is to provide a clear distinction between management actions taken to lower overall operating cost levels through reductions in personnel or facilities (physical changes) where any associated voluntary change to a cost accounting practice should be exempted, and other management actions taken to otherwise improve the economy and efficiency of operations where any associated voluntary change in cost accounting practice would remain subject to the cost impact process required for existing CAS-covered contracts. The proposed provisions are intended to facilitate overall contract administration activities, protect the Government's interests and reduce the potential for disagreements over whether a particular management change resulting in a voluntary change to an established cost accounting practice is an ''exempt'' or a ''desirable'' change under the Board's rules.

Comment: The draft Option B exemption should be applicable to all organizational changes (both internal and external) that meet the benefit test.

Response: The exemption criteria being proposed today applies to all restructuring activities as defined by the Board at 9904.406–61(b). It is not limited to ''external restructuring activities'' as currently defined in the Defense Federal Acquisition Regulation

Supplement (DFARS) at DFARS 231.205–70(b)(2).

Contract Price and Cost Adjustment Exemption for Changes in the Composition of Overhead and General an Administrative Expense Pools

Comment: A number of commenters felt the CASB staff's draft ''Option C'' presented for the Board's consideration was not useful. A few commenters believed that the draft ''Option C'' exemption concept was feasible and that it provided adequate protection to the Government.

Response: The Board has not incorporated this concept in this proposed rule.

Desirable Changes

Comment: Several commenters who supported the draft ''Option B'' exemption provision also advocated that the Board retain the proposed SNPRM–I mandatory ''desirable change'' provisions requiring the cognizant Federal agency official to find as ''desirable'' all voluntary cost accounting practice changes made to improve the efficiency and effectiveness of a contractor's operations.

A Federal agency recommended that the proposed mandatory desirable change criteria for changes in cost accounting practice that result in ''cost savings'' be deleted because the proposed criteria precludes consideration of other relevant facts and circumstances. In addition, if ''cost savings'' form the basis for granting a requested exemption, as advocated by the commenter, then contractors should not have the ability to choose between an exemption or a desirable change provision.

A Federal agency, with oversight responsibilities, recommended deletion of the SNPRM–I proposed amendment mandating desirable change findings for contractor changes made to improve the economy and efficiency of operations, and strongly supported the draft exemption provisions included as ''Option B'' because it offered ''* * * controls to protect the Government * * *'' The commenter felt that the proposed SNPRM–I amendments for desirable changes, at 9903.201–6(c)(2), did not offer adequate protection to the Government.

Response: A desirable change determination permits the contracting parties to increase existing CAS-covered contract prices, in the aggregate, to reflect the aggregate increased costs to the Government (as defined by the Board) that are expected to result from a contractor's voluntary change in cost accounting practice. In such cases, equitable contract price adjustments are negotiated to resolve the cost impact of the changes in contract cost accumulations that are estimated to result for the existing CAS-covered contracts due to the practice change. Where the cost impact of a practice change on existing CAS-covered contracts does not result in increased costs to the Government, in the aggregate, a desirable change determination is not needed to effect the required contract price and/or cost adjustments, in the aggregate. Only if the cost impact of a practice change on existing contracts results in aggregate ''increased costs'' after the change is made, would a desirable change determination serve a useful purpose.

In the SNPRM–I, the proposed mandatory desirable change determination criteria included changes in cost accounting practices attributable to organizational changes where ''cost savings'' were expected to occur under existing and/or future CAS-covered contracts. That provision was proposed as a stand alone amendment in the SNPRM–I, on the premise that the proposed mandatory provision would not be accompanied by an exemption provision for changes in cost accounting practices associated with management changes that are expected to result in more economical and efficient operations or cost savings (see the introduction to item 2 of the draft ''Option B'' provisions, in the SNPRM–I, which indicated that the desirable change criteria proposed at 9903.201–6(c)(2) for economy and efficiency improvements would be deleted or modified if the ''Option B'' draft exemption were established (62 FR 37671, 7–14–97)).

The Board believes the underlying merits of cost accounting practice changes that result in aggregate ''increased costs'' to the Government, as defined by the Board, need to be evaluated on a case-by-case basis. It would be inappropriate to mandate that ''all'' voluntary practice changes made ostensibly for improved economy and effectiveness reasons be deemed desirable changes that are not detrimental to the Government if expected cost savings to the Government cannot be demonstrated for existing and/or future contracts.

As specified under *''Contract Price and Cost Adjustment Exemption,''* the Board concluded that contract prices and costs should not be separately adjusted to only reflect the cost impact of a change in cost accounting practice when that practice change is associated with planned restructuring activities that are expected to produce cost savings to the Government. Furthermore, it would be inappropriate to establish two provisions, an exemption provision and a desirable change provision to cover cost accounting practice changes made for the same reason, i.e., restructuring changes that produce cost savings. The contracting parties would undoubtedly experience endless debate over which one of the two provisions should be applied in a particular circumstance.

The Board has therefore concluded that one consistent approach is needed for cost accounting practice changes that are associated with management actions which are expected to produce costs savings. In consideration of the comments received, the Board's current proposal is to require the following:

Where the cognizant Federal agency official finds that cost savings to the Government are expected to result from planned restructuring activities in accordance with the Board's prescribed criteria, the changes in cost accounting practice directly associated with such restructuring activities will be exempted from the CAS contract price and cost adjustment requirements, unless a determination is made that the exemption would otherwise be detrimental to the Government's interests.

—Where the cognizant Federal agency official finds that cost savings to the Government are expected to result from planned management changes, including planned restructuring activities that do not result in an exemption determination in accordance with the Board's proposed exemption criteria at 9903.201–6, the changes in cost accounting practice directly associated with such management changes will generally be treated as a ''desirable change.'' In such cases, the CAS contract price and cost adjustments normally required to resolve the resulting cost impact of the practice change may be otherwise resolved, without requiring the submission of additional data in the form of a cost impact proposal, provided a determination is made that an alternative resolution (based on the contractor's previously submitted expected ''cost savings'' and contract cost accumulation changes data (see 9903.405–2(e)) is not detrimental to the Government's interests. The Board believes that the proposed ''cost savings'' demonstration and alternative resolution determination requirements should provide adequate controls to protect the Government's interests.

—All other voluntary changes in cost accounting practices made for any other reason will remain subject to the Board's voluntary change ''no increased cost'' prohibition and other related desirable change provisions (see proposed 9903.201–7(c)(3)).

In conjunction with the exemption being proposed today, the Board has modified the mandatory desirable change amendment that was proposed in the SNPRM–I at 9903.201–6(c)(2). Essentially, the Board's current proposal is to amend its existing desirable change criteria to provide that a voluntary change to a cost accounting practice, including those associated with restructuring activities but not exempted under 9903.201–6(a), shall be deemed to be desirable change if the contractor can demonstrate cost savings to the Government, in the aggregate, for existing flexibly priced and all future CAS-covered contracts or otherwise demonstrate desirability of the practice change (see 9903.201–7(c) (2) and (3)).

Comment: A Federal agency responded that contract disputes have arisen as to when a voluntary change in cost accounting practice can be considered to be a desirable change. The agency recommended that the rule state a voluntary change is not to be considered desirable until the cognizant Federal agency official notifies the contractor the change has been determined to be a desirable change.

Response: Proposed provisions have been added, at 9903.201–7(b), to clarify the purpose of a desirable change determination and that until the cognizant Federal agency official determines that a change is desirable and not detrimental to the Government, the change shall be considered to be a voluntary change for which the Government will pay no increased costs.

Comment: A Federal agency recommended that more flexibility would be provided for making desirable change determinations if the phrase ''provided there is a reasonable expectation that benefits will accrue to the Government in future awards'' were deleted from the last sentence proposed in the SNPRM–I at 9903.201–6(d).

However, many industry commenters argued that the cost impact on future CAS-covered contracts should be considered by the cognizant Federal agency official in determining how to resolve the cost impact of a voluntary change in cost accounting practice that results in ''increased'' cost to the Government. The commenters opined that inequitable results that penalize a contractor may occur if decreased cost accumulations expected to result for future CAS-covered contracts, after the voluntary change is made, are not considered.

Response: One of the Board's statutory mandates is to preclude the payment of increased costs, as defined by the Board, under CAS-covered contracts due to voluntary changes in cost accounting practices made by contractors after contract award. Under the terms and conditions of the Board's implementing contract clauses, a contractor agrees to consistently follow its established cost accounting practices when accumulating and reporting the costs of contract performance after contract award. A contractor also agrees that if a voluntary change is made, the Government will not pay any aggregate increased cost for existing covered contracts whose negotiated prices were predicated on cost estimates that were premised on the consistent application of the contractor's previously established cost accounting practices.

The Board's voluntary change—no increased cost prohibition, limits potential contract price and/or cost adjustments, so that any resultant increased costs to the Government under existing contracts are not paid, i.e., after the change, the amounts paid by the Government in the form of adjusted contract prices and/or increased contract cost accumulations, in the aggregate, can not be more than the aggregate amount the Government would have paid under the terms of the existing CAS-covered contracts if the contractor had continued to consistently apply its established cost accounting practices for the accumulation and reporting of contract costs. In essence, the Board's no increased cost prohibition provides that the Government's liability to pay contractually specified sums, in the aggregate, can not be increased unilaterally by a contractor that makes a voluntary change to its established cost accounting practices after contract award. The objective is to encourage the consistent application of a contractor's established cost accounting practices and to discourage voluntary changes that would otherwise result in the payment of increased costs by the Government under existing covered contracts. It would therefore be inappropriate for the Board to mandate that the cost impact expected to occur on potential future covered contracts, which may or may not be awarded, be considered when determining the cost impact that a voluntary change will have on existing contracts for purposes of mitigating the application of the prescribed no increased cost prohibition provisions to existing contracts.

Since future contract prices will reflect estimated costs that are already based on the application of the new cost accounting practice, they require no adjustments and there is no cost impact calculation required for such contracts. The cost impact calculation due to changes in cost accounting practices is limited to existing covered contracts. The calculation is based on the differences in accumulated contract costs that are expected to result for the existing covered contracts based on the application of the old and new cost accounting practices to the projected ongoing level of costs expected to occur after the practice change is made. For voluntary changes, the no increased cost prohibition is then used to limit any upward contract price or cost adjustments, in the aggregate, to the aggregate amount of downward adjustments being made for the existing CAS-covered contracts.

The Board believes, however, that equitable solutions can be achieved under the rules being proposed today. In cases where a continuing long term relationship between the Government and a contractor is evident and when a voluntary change in cost accounting practice is not otherwise determined to be exempt from contract price or cost adjustment (9903.201–6), a contractor may request the cognizant Federal agency official to determine that the voluntary change is not detrimental to the Government (9903.201–7) so that the affected existing covered contracts and subcontracts desirable change provisions can be applied (9903.405–2(e) and 9903.405–2(f)(3)). To support the request, a contractor should demonstrate to what extent cost accumulations for projected new CAS-covered contract work included in the contractor's forecasted business base are expected to decrease as a result of the voluntary change. The calculations should also be based on the differences in accumulated contract costs that are expected to result for the anticipated future CAS-covered contracts based on the application of the old and new cost accounting practices to the same projected ongoing level of costs expected to occur after the practice change is made that is used to determine the cost impact on existing contracts.

The cognizant Federal agency official may consider such data, from an equity standpoint, when determining if the existing contract prices should be increased, in the aggregate, under a contract's desirable change provisions.

In consideration of the commenters' expressed concerns, the proposed proviso of concern to the Federal

commenter has been deleted. In addition, paragraph 9903.201–7(d) has been expanded to clarify that a desirable change determination may be appropriate to the extent there is a reasonable expectation that the costs of anticipated future CAS-covered contract awards will decrease after a voluntary change is made by a contractor.

Cognizant Federal Agency Responsibilities

Comment: A Federal agency recommended that the SNPRM–I proposed responsibilities at 9903.201–7(d)(1) and (2) for the cognizant Federal agency official involving the processing of contract price modifications be deleted because it duplicates and conflicts with existing coverage currently included in FAR Part 30, at FAR 30.601(a) and 30.602–1(c).

Response: A change in cost accounting practice made by a contractor may affect some or all existing CAS-covered contracts awarded by one or more agencies, e.g., agencies within the Department of Defense or other defense or civilian agencies. The proposed responsibilities in question are premised on the concept that a cognizant Federal agency approach shall be followed to resolve the cost impact that a particular change in cost accounting may have on all affected CAS-covered contracts regardless of the number of awarding agencies involved. The proposed requirements recommended for deletion would, if finalized, require the cognizant Federal agency official to coordinate all actions needed to implement the negotiated cost impact settlement on behalf of the Government with the contractor.

When the cognizant Federal agency official negotiates contract price adjustments to resolve a cost impact, the current FAR provisions cited by the commenter do not establish a coordinated systematic approach to effect the necessary contract price adjustments. The cognizant Federal official is excused from any further actions after the negotiation memorandum is distributed to affected agencies. No follow up action by the cognizant Federal official is required if all the contract prices that the contractor and cognizant Federal agency official have agreed to modify are not so modified. The contractor would have to follow up with the other agencies on an individual basis in order to obtain the necessary contract price adjustments. This could prove to be a difficult task, particularly in cases where the other agencies are expected to increase the price of their CAS-covered contracts. Additionally, the FAR does not require the other agencies to support the cognizant Federal agency official. The proposed provisions are considered appropriate in the circumstances and have been retained at 9903.201–8.

Contract Clauses

Comment: Federal agencies suggested that the proposed provisions on interest should be conformed throughout the rule to cite Section 6621(a)(2) of the Internal Revenue Code and that the contract clause interest provisions through out the proposed rule be conformed.

Response: The suggestions were adopted. The proposed contract clause provisions were conformed for consistency with the interest provisions specified in proposed 9903.4 for estimating noncompliances and cost accumulation noncompliances.

Comment: Why was the provision in the contract clause paragraph (a)(4) at 9903.201–4(a) that reads ''* * * agree to an equitable adjustment as provided in the Changes clause * * *'' deleted?

Response: The CAS contract clauses' equitable adjustment provisions are not dependent upon another contract clause. The Board's proposed amendments provide for equitable adjustments in accordance with the contract clause and part 9903.

Comment: A Federal agency recommended that the contract clauses for educational institutions and United Kingdom contracts be updated and conformed with the amended Full and Modified contract clauses.

Response: The Clause 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 one commenter responded to the NPRM and the SNPRM-I on this matter. Accordingly, the Board believes that such amendments are not currently warranted.

Intermediate Cost Objective Definition

Comment: Commenters suggested that the definition of the term ''intermediate cost objective'' would be easier to implement and understand if the phrase ''* * * included in specific indirect cost pools * * *'' were deleted from the proposed definition.

Response: The concept of an intermediate cost objective evolved from the Board's promulgation of CAS 9903.402, in 1972, when a definition of the term ''indirect cost'' was promulgated. That definition introduced the concept that a cost was not direct if it was identified with two or more final cost objectives or with at least one ''intermediate cost objective.'' The latter term, however, remained undefined. How costs are grouped for cost accumulation purposes and their subsequent allocation to intermediate and final cost objectives constitutes a cost accounting practice, i.e., the ''accounting methods or techniques used to accumulate costs'' (9903.302–1(c)). Also, it is recognized that at times, for reasons of economy and efficiency, certain costs of a direct nature may be accumulated in cost pools that are subsequently allocated to final cost objectives as direct cost.

In view of the commenters' concerns, the proposed definition was revised to clarify that different cost elements and the costs of various functions can be accumulated in a varying number of intermediate cost objectives that are included in specific cost pools, e.g., overhead cost pools, G&A expense pools, service center expense pools and other expense pools, and/or cost pools that are allocated as direct costs. All such pooled costs are subsequently allocated to other intermediate and/or final cost objectives in accordance with applicable CAS and/or the contractor's established, and, if required, disclosed cost accounting practices.

Cost Accounting Practice Change Definitions and Illustrations

Comment: A number of commenters stated that the proposed amendments have improperly expanded the meaning of the term ''cost accumulation'' and that such expansion is unfortunate since almost any change in the flow of cost to contracts will be treated as a cost accounting practice change.

Response: The Board does not agree with the commenters' rationale. To accumulate cost, a contractor must apply its established, and, if required, disclosed cost accounting practices, i.e., the accounting methods or techniques used to accumulate cost for CAS-covered contracts. The Board's definition at 9903.302–1(c) presently states that one of the examples of a cost accounting practice involving the allocation of cost to cost objectives are ''the accounting methods or techniques used to accumulate cost . . .'' The Board has not expanded the definition or proposed a new requirement. The reason for the Board's proposed

amendments is that under the present definition, some contractors have concluded that the methods or techniques used to accumulate costs in cost pools are not a cost accounting practice and that changes made to the methods or techniques used to accumulate costs in cost pools are not a change in cost accounting practice. Some contractors, in their responses to the SNPRM–I, specified that they do not believe that a change in cost accounting practice occurs when cost pools are combined or split-out, or when ongoing functions are transferred from one cost pool to another cost pool; based, presumably, on their interpretation of the Board's existing definition. With regard to changes which alter the flow of costs to contracts, the commenters' inferences appear contrary to the basic consistency requirements of CAS 9904.401 or 9905.501, as applicable, which require that a contractor's established cost accounting practices be applied consistently when estimating, accumulating and reporting costs.

The Board's proposed amendments would make it explicit that the methods or techniques used to accumulate costs in cost pools are to be considered a cost accounting practice when a contractor estimates, accumulates and reports costs, and that a change made to the methods or techniques used to accumulate cost in cost pools is a change in cost accounting practice under the Board's rules. In response to the commenters' expressed concerns, some editorial changes were made to clarify the Board's stated concepts regarding use of the phrase ''accumulate cost.''

Comment: A Federal agency recommended that the words ''item of cost or a group of items of cost'' proposed for inclusion at 9903.302–1(c) be replaced with the words ''accumulate and distribute.'' They believe that the proposed wording might be interpreted, by some, to mean that the transfer of one direct labor employee from one plant to another plant could be viewed as a change in cost accounting practice. Some contractor representatives also expressed concern that the SNPRM–I proposal introduced uncertainty with regard to the transfer of personnel from one functional activity to another.

Response: The agency's suggestion was adopted. The words ''accumulate and distribute'' were previously proposed in the NPRM and appear to more clearly convey the primary cost accounting concept being addressed in this rulemaking, i.e., that the methods and techniques used for the allocation of cost to cost objectives include the selection and use of specific cost pools to accumulate costs for subsequent distribution to other intermediate and final cost objectives.

Comment: A Federal agency agreed with the proposed provision at 9903.302–1(c)(2), but recommended that the words ''elements of cost'' be deleted since the composition of cost pools does not include specific elements of cost. This comment also relates to the concern that an individual employee could be an ''element of cost'' and if transferred to another segment might be construed to be a change in cost accounting practice, which would conflict with the proposed illustration at 9903.302–(4)(h). The word ''specific'' in the phrase ''the accumulation of specific costs'' was also recommended for deletion.

Response: Cost pools accumulate costs by elements of cost and if required to disclose their cost accounting practices in a disclosure statement, a contractor performing a CAS-covered contract is required to disclose if an element of cost is to be treated as a direct cost or an indirect cost and which elements of cost are included in each indirect cost pool.

With the revised language change, made in response to the preceding comment made by the same agency, and the retention of the cited illustration, it should be clear that the Board does not expect the contracting parties to treat employee transfers as a change in cost accounting practice. This matter was also addressed in the SNPRM–I preamble comments (62 FR 37660, 7/14/97). Accordingly, the words of concern to the commenter were retained.

Comment: A Federal agency recommended deletion of the word ''measure'' from the proposed provision used to describe the ''allocation measurement activity'' at 9903.302–1(c)(3) to avoid potential conflict with the cost ''measurement'' term found at 9903.302–1(a). Some contractor representatives recommended similar changes.

Response: The words ''measurement,'' ''measure'' and ''activity'' were deleted as suggested in 9903.302–1(c)(3) and where they were used in a similar manner in the illustrations proposed under 9903.302–3(c).

Comment: At 9903.302–2(a)(3), the proposed coverage on functional transfers should not be limited to costs in indirect cost pools, and intra-segment transfers.

Response: The proposed coverage was revised to address the commenter's concerns.

Comment: A Federal agency recommended that the words ''home office'' be added to the exception provision in the last sentence proposed at 9903.302–2(b)(1), because functional transfers to or from intermediate home offices were excluded from the proposed coverage.

Response: The recommended change was adopted.

Comment: Some commenters objected to the proposed reference to each contract at 9903.302–2(c)(1) and recommended deletion of the proposed coverage.

Response: The reference to each CAS-covered contract refers to the terms and conditions contained in each contract. The proposed coverage was retained.

Comment: A Federal agency and some contractors commented that the proposed language at 9903.302–2(c)(2) referencing a noncompliant practice change was not clear.

Response: The proposed coverage was revised to separately address compliant and noncompliant actions.

Comment: Several commenters recommended a number of clarifying edits to the proposed language included at 9903.302–3(c)(4), (6), (7), (8), and (9).

Response: Where deemed appropriate, the referenced illustrations were revised for clarity, and to reflect the use of consistent language in similar circumstances.

Comment: Delete or revise the illustrations that mention ''intermediate cost objectives'' as the intent of the purpose of the illustration may not be clearly understood.

Response: The primary purpose of the illustrated changes was to clarify that a cost accounting practice change results if the costs of an ongoing function (which were accumulated in an intermediate cost objective established for that function) that are originally included in one cost pool are subsequently transferred to and included in a different cost pool. That concept can also be illustrated by stating if the costs of an ongoing function are or are not included in the same cost pool before and after a change is made. The illustrations at 9903.302–3(c)(7) and (9), and at 9903.302–4(h) were therefore so revised. The references to intermediate cost objectives were deleted.

Comment: A Federal agency suggested deletion of the comment that the change in cost accounting practice depicted in the proposed illustrations at 9903.302–3(c)(8)(i) and (9)(v) are subject to the acquired CAS-covered contract's contract price and cost adjustment provisions. They opined that incorporation in the proposed illustrations may cause potential confusion and disputes since similar statements were not included in all of

the proposed illustrations of changes in cost accounting practices.

Response: All changes in cost accounting practice are subject to the applicable contract clause provisions governing changes in cost accounting practices. In the case of an acquired contract, the additional comment was incorporated to emphasize that an acquiring contractor must abide with the acquired CAS-covered contract's terms and conditions governing changes in cost accounting practices in the event any changes in cost accounting practices are made after the effective date of the acquisition. If the commenter's suggestion were adopted, an acquiring contractor might argue that the referenced contract price and cost adjustment provisions do not apply since they were subsequently deleted from the Board's proposed amendments. The proposed provisions were retained.

Comment: A commenter recommended a number of clarifying edits to the proposed language included at 9903.302–4(h), (i), and (j).

Response: Where deemed appropriate, the referenced illustrations were revised for clarity.

Comment: Some commenters inquired if the use of a ''special allocation'' method (e.g., 9904.410–50(j)) is an initial adoption of a cost accounting practice or a change in cost accounting practice.

Response: If a contractor's established cost accounting practices do not include the use of a special allocation methodology when estimating and accumulating costs for CAS-covered contracts, and subsequently the contractor decides to apply a special allocation methodology while performing ongoing CAS-covered contracts, the contractor would no longer be in compliance with the consistency requirements of CAS 9904.401 and 9905.501. However, under the contract clause terms of CAS-covered contracts, the contractor can make a voluntary change to its established cost accounting practices. If material, the resultant cost impact due to the change in cost accounting practice could result in contract price or cost adjustments, at no aggregate increased cost to the Government.

The Cost Impact Process

Comment: One commenter suggested changes to the definition for ''Increased cost to the Government due to a change in compliant cost accounting practices' included at 9903.403 on the basis that, as proposed, the definition incorrectly implies that increased costs exist only when no action is taken to preclude payment of increased costs.

Response: The Board has revised the proposed language to clarify that increased costs resulting from a voluntary change in cost accounting practice represent the increase in cost to the Government that occurs after a change is made, before any actions are taken to preclude the payment of the resultant increased cost by the Government. After a voluntary change in cost accounting practice is made, increased cost to the Government occurs only when a greater amount of costs are accumulated and claimed as contract costs under existing flexibly priced contracts. For existing firm-fixed-price contracts, increased costs to the Government only occur if a lesser amount of cost is accumulated after the practice change is made, before the negotiated contract prices are adjusted downward to reflect the aggregate reduction in accumulated costs. If a downward adjustment is not made, the Government will be charged the resultant increased cost in the form of a higher fixed contract price that provided for the higher allocation of cost to the contract that would have resulted had there not been a change in cost accounting practice.

Comment: A Federal agency requested that the Board clearly state in both the preamble and the rule which provisions represent mandates and which provisions are intended to be applied at the discretion of the cognizant Federal agency official.

Response: The Board has used the word ''shall'' when referring to an action that is mandatory, and the terms ''may'' and ''should'' when referring to an action that is discretionary.

Comment: A Federal agency requested that the Board provide more flexibility with regard to the adjustment of individual contract prices that exceed established materiality thresholds.

Response: The Board has eliminated use of words that suggest absolute mandates such as ''required'', ''requirements'' and ''necessary.'' These words have been replaced with terms that make it clear that the provisions included in the rule for adjusting individual contract prices should be followed only when the cognizant Federal agency official decides to resolve a cost impact action by modifying contract prices.

Comment: A Federal agency requested that the Board add a provision at 9903.405–2 covering ''Notification of changes in cost accounting practices'' which would require that contractors notify the Government of the proposed effective and applicability dates of a change in cost accounting practice.

Response: The Board adopted the suggested change. The addition of the ''effective date'' notification requirement will help clarify which contracts were proposed and/or negotiated after the effective date of the change in cost accounting practice and should therefore not be subject to contract price and/or cost adjustment.

Comment: Many industry commenters requested that the Board eliminate the proposed requirement, at 9903.405–4(a), that some individual contract data be included in the General Dollar Magnitude (GDM) settlement proposal. They suggested that the contracting parties attempt to resolve the cost impact action based on the GDM aggregate estimate before requiring the submission of any individual contract data.

Response: The Board rejects this suggestion.

Under current Government procurement regulations governing the cost impact process, the required GDM estimate is used solely to determine whether or not the cost impact of a change in cost accounting practice is not material and, therefore, no detailed cost impact proposal will be required. If such an immateriality determination cannot be made, then the contractor must submit a detailed cost impact proposal for all existing covered contracts and subcontracts affected by the change in cost accounting practice or the estimating noncompliance. Originally, the procurement regulations required the submission of a GDM estimate by contract type and Federal agency, with no instruction as to what action the agencies should take based on the contractor's GDM estimate data. Furthermore, the GDM estimate is currently required to be submitted at the same time as the notification of the change in cost accounting practices, with a cost impact proposal to be submitted at a later date. Thus, it appears that the GDM estimate was never intended to serve as the basis for making contract price or cost adjustments to resolve a material cost impact action.

Under the Board's proposal, the contracting parties can resolve a cost impact action based on a three step process. The cost impact resulting from a change in cost accounting practice can be resolved without the submission of any contract cost data if the change is obviously immaterial (9903.405–3(d) in the SNPRM–I), or if not obviously immaterial by the submission of a GDM Settlement Proposal or a detailed cost impact proposal.

When not obviously immaterial, the cost impact of a practice change can be

resolved by the submission of a GDM estimate and some individual contract data, without having to resort to a detailed cost impact proposal. The GDM estimate and Contractor Settlement Proposal were previously proposed as two separate submission requirements in the ANPRM. Based on a public commenter's suggestions, the two submission requirements were proposed in the SNPRM–I as a combined ''GDM Settlement Proposal.'' The Board continues to believe that when material changes result in the amounts of accumulated contract costs, either in the aggregate or for individual contracts, due to a change in cost accounting practice, then the aggregate cost data included in the GDM estimate is insufficient for the cognizant Federal agency official to make an informed judgment on how to best resolve the cost impact. If no individual contract data were required at the time of the GDM estimate submission, the cognizant Federal agency official would need to obtain individual contract data in order to protect the interests of the Government, e.g., in order to: (1) evaluate the accuracy of the GDM estimate amounts by contract type; (2) determine what adjustments may be needed to resolve any resultant contract cost overrun and/or underrun conditions, and/or (3) ascertain if a detailed cost impact proposal should be requested.

The Board believes that the proposed three step process included in this proposed rule provides the contracting parties with the best opportunity to resolve the cost impact action with a minimum of contract data. Under the GDM Settlement Proposal concept, a contractor is expected to make the initial decision as to the number of individual contracts, within each contract type, for which contract data is needed to settle the cost impact action. If the cognizant Federal agency official accepts the contractor's settlement proposal, no further contract data need be submitted. Of course, if agreement to resolve the cost impact action does not occur based on a contractor's proposed settlement approach, then the cognizant Federal agency official may still request data for some additional contracts or a detailed cost impact statement, if deemed necessary. The Board's objective is to permit the contracting parties to resolve the cost impact action without having to resort to the current process which requires the submission of detailed cost impact data for all contracts.

The Board believes that the commenter's suggested approach would only serve to delay the proper resolution of the cost impact for CAS-covered contracts. The suggestions were not adopted. However, the provision at 9903.405–3(f) was revised to emphasize that a GDM Settlement Proposal is not required if the cost impact of a change in cost accounting practice is determined to be obviously immaterial.

Comment: One Federal agency recommended revising the provisions for the offset process included at 9903.405–5(b) to be ''general guidelines'' rather than ''rules.'' They stated that general guidelines should normally be followed, but the cognizant Federal agency official should be permitted to deviate from the guidelines, provided the application of the offset process results in adjustments that approximate, in the aggregate, the cost impact that would have resulted had individual contracts been adjusted.

Response: Since all of the provisions promulgated by the CASB are in essence and in fact ''rules,'' the Board has deleted the reference to ''rules of offset'' from 9903.405–5(b). The Board believes that this proposal when considered in its totality, including the offset provisions, provides the cognizant Federal agency official with sufficient flexibility to resolve a cost impact action in a manner deemed most appropriate considering both individual circumstances and protection of the Government's interests. The provisions which the Board has included for use of the offset process are designed to insure that the process, whenever used, is applied consistently and in such a way that material cost impact amounts, both in the aggregate and for individual contracts, are appropriately calculated in the prescribed manner.

Comment: One commenter suggested that the Board sanction the use of the final indirect expense rate settlement process rather than contract price adjustments as a method to resolve the cost impact action. The commenter expressed the opinion that contract adjustments should only be used as a final resort.

Response: The Board's proposed rules provide significant flexibility with regard to the method used by the cognizant Federal agency official to resolve a cost impact action by inclusion of the phrase ''other suitable technique.'' However, the Board would caution the contracting parties with regard to use of any method which results in further inconsistency between the contract price amounts and accumulated contract costs due to the cost accounting practices used to estimate proposed costs and to accumulate costs during contract performance.

Adjustment of indirect expense rates to settle a cost impact action can result in the adjustment of the wrong contracts for the impact of the change in cost accounting practices. This method also results in the establishment of final indirect expense rates that are not consistent with a contractor's established and disclosed cost accounting practices for allocating indirect costs to final cost objectives. Adjusting indirect expense rates to resolve the cost impact would in most cases require an adjustment to the indirect expense pool that exceeds the amount of the actual cost impact adjustment amount in order to ensure that the aggregate cost impact amount calculated for all affected CAS-covered contracts is recovered on the open flexibly-priced contracts being performed during the particular cost accounting period to which the ''adjusted'' rates apply. Use of this approach distorts the accumulation of costs used for contract cost and pricing purposes, in that the resultant accumulated costs recognized for CAS-covered contracts will be greater or less than the costs that would have been accumulated as actual ''booked'' costs in accordance with a contractor's established cost accounting practices had the indirect cost pools, and the indirect cost rates used to allocate such costs to final cost objectives, not been adjusted to reflect the cost impact of a change in cost accounting practice. Such pool adjustments may further distort the difference between the costs that would have originally been allocated to the affected CAS-covered contracts as actual ''booked'' costs and the costs that will be allocated to those contracts for contract costing purposes based on the adjusted final rates if multiple cost accounting periods are involved and/or if the Government's percent of participation in the allocation base is not consistent. The Board therefore disagrees with the position presented by the commenter. Adjustment of contract prices is the method which most consistently reflects the requirements of both the applicable contract clause and CAS 9904.401 or 9905.501, as applicable, regarding consistency in the cost accounting practices used to both estimate and accumulate costs on CAS-covered contracts. The Board finds inappropriate the commenter's suggestion that the Board endorse a position which holds that such adjustments should only be used as a last resort. To the contrary, the Board believes that any method that further distorts the Board's consistency requirements, such as the adjustment of

indirect expense rates, should be a method that is only used as a last resort. If the cognizant Federal agency official determines that adjustment of contract prices is not warranted to resolve the cost impact action, the Board is of the view that a transfer of funds between the Government and a contractor is the most appropriate ''other suitable technique'' that can be used to settle the action.

Comment: Federal agency and industry commenters expressed concerns regarding the SNPRM–I prefatory comments stating that:

> The Board is of the opinion that modification of contract and subcontract prices * * * 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 * * *

The Federal agency advocated that maximum flexibility be provided for the resolution of the cost impact resulting from a change in cost accounting practice. The contractor commenters recommended that no ''preference'' be stated in the final rule.

Response: The Board's contract clauses included in individual CAS-covered contracts require contractors to consistently apply their established cost accounting practices when accumulating and reporting the costs of performing CAS-covered contracts. However, the CAS contract clause provisions also permit a contractor to make a voluntary change to its established cost accounting practices, provided the cost impact resulting from the change is addressed. For voluntary changes, the contractor agrees to contract price and/or cost adjustments which are limited to a no increased cost to the Government provision. If the cognizant Federal agency official determines that the practice change is desirable and not detrimental to the Government, the contract prices can be adjusted to reflect the aggregate change in the amount of accumulated contract costs that is expected to result due to the practice change.

After contract price adjustment and/or actions taken to preclude the payment of increased costs, the cost-based contract prices (FFP or cost ceiling) are once again comparable with the increased or decreased contract costs that will be accumulated consistently in accordance with the changed cost accounting practices, after a voluntary practice change is made. Such actions taken to resolve the cost impact of a practice change also resolve any resultant potential contract cost overrun or cost underrun conditions that are attributable to the practice change. Thus, contract price and cost adjustments are generally the required, not preferred, method for resolving the cost impact resulting from a change in cost accounting practice.

In the SNPRM–I, the Board concluded that ''* * * the decision on how to best achieve an equitable solution, in the aggregate, remains a cognizant Federal agency official responsibility.'' The Board's comments were intended to acknowledge that there may be circumstances where the required contract price and/or cost adjustments need not be made. For example, this might be the case where the cost impact, in the aggregate, is considered material in and of itself, but the cognizant Federal agency determines contract price and/or cost adjustments are not warranted because contract performance would not be jeopardized (no significant cost overrun condition resulted) and the increase or decrease in expected cost accumulations would not distort or adversely impair the usefulness of the contractor's reported contract cost information (actual costs and estimated costs to complete) that is included in contract status reports. However, to achieve equity, some consideration for the cost impact should be obtained or granted. In such cases, another suitable technique may be used to resolve the cost impact, e.g., a monetary exchange between the contracting parties. This alternate approach would also produce administrative cost savings since the contracting parties would not have to process contract modifications or take further actions to preclude the payment of increased costs on individual contracts.

On the other hand, in a case where the cost impact, is considered material and, by not processing contract price and/or cost adjustments, the Government would pay increased costs (as defined by the Board), the contractor's ability to perform the contract is adversely affected, and/or the cost data included in the contractor's status reports would not be meaningful, then the required contract price and/or cost adjustments should be processed.

To address the commenters' expressed concerns, the Board is proposing additional provisions at 9903.405–5(e) to emphasize that the cognizant Federal agency official does have the flexibility to resolve a cost impact due to a change made to a compliant cost accounting practice by use of alternative actions, i.e., other than contract price adjustment or actions taken to preclude the payment of increased costs. Cautionary provisions pertaining to the use of such alternative actions were also included.

Comment: A Federal agency recommended deleting the phrase ''and negotiate'' from the description of a cost estimating noncompliance at 9903.406–1(a). They explained that an estimating noncompliance results when the contractor estimates costs using a noncompliant accounting practice. They further stated that under the proposed provision, an estimating noncompliance would exist only if the noncompliance was used for both estimating and negotiating the contract. Such a definition, they believe, will result in significant disputes as to whether a contractor's final price negotiation included or excluded the impact of the change in cost accounting practice.

Response: Only those contracts that had their contract price based on a noncompliant practice can be included in the universe of contracts subject to adjustment as a result of an estimating noncompliance. Therefore, it must be demonstrated that not only did the contractor estimate costs using a noncompliant practice for a potential CAS-covered contract, but also that the contract price was established using data that was based on the use of a noncompliant practice. There may be situations in which a contractor estimates costs using a noncompliant practice, but either the Government rejects the use of that practice to negotiate the contract amount or the contractor voluntarily changes to a compliant practice prior to the negotiation of the contract price. In such situations, the negotiated contract price or cost ceiling would not have been based on the use of a noncompliant cost accounting practice. Hence, it would not be appropriate to include these contracts in a cost impact proposal for an estimating noncompliance. For those contracts that were estimated using a noncompliant practice and that noncompliant practice was used to determine the contract price, the contracting parties must determine the impact on those contracts as a result of the noncompliant practice. In order to clarify the Board's position on this matter, the Board has revised the proposed language at 9903.406–1(a).

Comment: One commenter recommended that, in order to avoid duplication, the provision regarding situations where a noncompliant practice is used for both cost estimating and cost accumulation purposes be moved to 9903.406–1 rather than including this provision at both 9903.406–3(g) and 9903.406–4(b).

Response: The Board agrees and has adopted this recommendation (9903.406–1(b)).

Comment: One Federal agency recommended that the proposed table at 9903.406–3(d) address a cost impact due to a noncompliance in terms of the change in allocation that resulted from using a noncompliant cost accounting practice rather than in terms of the change in allocation that would have resulted had a compliant accounting practice been used. Through discussions with contracting officers, they determined that most contracting officers address the cost impact in terms of the change in allocation that resulted from using a noncompliant practice.

Response: The Board adopted this recommendation and has revised the table at 9903.406–3(d) accordingly.

Comment: One commenter recommended adding the concept of computing interest based on the midpoint of the period for a cost accumulation noncompliance described at 9903.406–4(e) to cost estimating noncompliances at 9903.406–3.

Response: Upon further review of this provision, the Board has concluded that inclusion of a method to be used to calculate the amount of interest due to increased costs paid as a result of a noncompliant practice is overly instructional and prescriptive in nature and therefore should not be included in this rule. The Board therefore has deleted the prescribed method of computing interest from the rule. Federal agencies should establish reasonable methods for determining the amount of interest to be recovered based on increased costs paid due to a noncompliant practice.

Comment: Several commenters recommended the deletion of the term ''technical'' from the provision at 9903.406–5 describing immaterial noncompliances. A Federal agency recommended deletion of the proposed provision at 9903.406–5(a)(2) which provides that a contractor is not excused from the obligation to comply with the applicable Standards or rules and regulations involved when an immaterial noncompliance exists. An industry commenter further requested deletion of the proposed requirement at 9903.406–5 which requires a contractor to notify the cognizant Federal agency official within 60 days of when the technical noncompliance becomes material.

Response: The Board has adopted all of the suggested revisions. The Board agrees that a cost accounting practice is either compliant with applicable Cost Accounting Standards or it is not. The term ''technical noncompliance'' has acquired an accepted usage by various groups that deal with CAS administration matters in referring to noncompliant practices that do not result in material increased costs. However, in order to avoid any confusion by parties not familiar with this terminology, the Board has replaced the term ''technical'' with the term ''immaterial'' in this proposed rule.

Since it should be apparent that, absent the granting of a waiver or exemption, contractors are never ''excused'' from the obligation to comply with applicable CAS Board rules and regulations, the Board proposes to delete the SNPRM–I provision at 9903.406–5(a)(2). The provision retained within 9903.406–5, which allows the cognizant Federal agency official to recover any subsequent increased costs plus applicable interest that may result from the currently immaterial noncompliance, provides adequate protection to the Government in these situations.

Comment: A Federal agency recommended deleting the specific reason used by the contractor in the illustration at 9903.407–1(a)(1) as justification for requesting a retroactive applicability date for the change. They explained that inclusion of a specific reason could be interpreted to mean that this specific reason should be determined appropriate justification for approval of a retroactive applicability date in all cases.

Response: The Board has deleted the specific reason included in the illustration.

Educational Institutions

Comment: A Federal agency recommended that the last sentence proposed at 9903.401–2(e) be revised to reflect a one time notification requirement.

Response: The suggested language was adopted.

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 document. All comments must be in writing and submitted timely to the address indicated in the **ADDRESSES** section of this document.

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

—Proposed 9903.201–6, Findings—Voluntary changes exempt from contract price and cost adjustment, which proposes to exempt certain voluntary changes to a cost accounting practice from contract price and cost adjustment when specified criteria are met. 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.

—Proposed 9903.201–7, Findings—Desirable changes, which proposes to establish criteria for determining when a voluntary change to a cost accounting practice, not otherwise exempt from contract price and cost adjustment under 9903.201–6, can be deemed to be desirable and not detrimental to the Government. Such determinations would permit the equitable adjustment of existing CAS-covered contracts that are materially affected by aggregate ''increased costs'' resulting from a voluntary change made to a cost accounting practice.

—Proposed 9903.201–7(c)(2) which includes a proposal to establish alternative processes for resolving the cost impact associated with a ''desirable'' change.

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 immediately following 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 (August 1999)

(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 cost accounting practices disclosed for this contract shall be the same cost accounting 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(a)(2) of the Internal Revenue Code of 1986 (26 U.S.C. 6621(a)(2)) for such period, from the time the payment by the United States was made to the time the increased cost payment is recovered by the United States. 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 applicable 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 an entity 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 (August 1999)

(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 cost accounting practices disclosed for this contract shall be the same cost accounting 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(a)(2) of the Internal Revenue Code of 1986 (26 U.S.C. 6621(a)(2)) for such period, from the time the payment by the United States was made to the time the increased cost payment is recovered by the United States. 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 applicable 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 an entity 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 Findings—Voluntary changes exempt from contract price and cost adjustment.

(a) Prior to making any contract price or cost adjustment under the provisions of paragraph (a)(4)(ii) 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 voluntary change in cost accounting practice can or can not be exempted from contract price and cost adjustment under the exemption criteria specified in this subsection. The cognizant Federal agency official may, however, make a finding that the voluntary change in cost accounting should not be exempted from contract price and cost adjustment under the exemption criteria specified in this subsection when such action would otherwise be detrimental to the Government's interests.

(b) The determination as to whether or not a voluntary change in cost accounting practice should be exempted from contract price and cost adjustment requirements specified in CAS-covered contracts and subcontracts shall be made on a case-by-case basis in accordance with the exemption criteria specified in paragraph (c) or (d) of this subsection.

(c) *Exemption For Voluntary Cost Accounting Practice Changes Associated With Contractor Restructuring Activities That Are Made By Management To Reduce Personnel or Facilities.* Changes in the methods and techniques used for the ''allocation of cost to cost objectives,'' including the transfer of functions from an existing cost pool, cost pool split-outs or cost pool combinations, that are associated with restructuring activities (see 9904.406–61(b)) which are undertaken to improve future operations and reduce overall cost levels in future periods through work force reductions and/or physical realignment or reduction of facilities, including plant relocations, shall not be subject to the contract price or cost adjustment requirements of part 9903, the cognizant Federal agency official determines, in writing, that:

(1) The voluntary change in cost accounting practice is being made concurrently with planned restructuring activities and would not be made but for the restructuring actions being taken.

(2) Future ''cost savings'' to the Government (i.e., the accumulation of less contract costs), in the aggregate, for existing flexibly priced CAS-covered contracts and anticipated and reasonably predictable future CAS-covered contracts, are expected to result from the planned restructuring activities.

(3) The ''cost savings'' calculation(s) represented the difference between:

(i) The total amount of costs that would be accumulated for existing flexibly priced CAS-covered contracts

and reasonably predictable future CAS-covered contracts, in accordance with the contractor's established cost accounting practices, at the estimated operating cost levels that would continue if the planned restructuring activities were not made, and

(ii) The total amount of costs that would be accumulated for such CAS-covered contracts, in accordance with the contractor's new changed cost accounting practices, at the estimated new cost levels that would result if the planned restructuring activities were made.

(d) An agency ''cost savings'' determination, made in accordance with the agency's promulgated regulations, resulting in the approval of proposed contractor restructuring activities may be used in lieu of the cost savings determinations required under paragraph (c) of this subsection.

(e) When a determination is made to grant an exemption, the cognizant Federal agency official shall notify the contractor that the voluntary change(s) to established cost accounting practices required to implement the planned restructuring activities will be exempt from the contract price and cost adjustment provisions contained in existing CAS-covered contracts that are affected by the changes.

(f) When the cognizant Federal agency official determines that a voluntary change to the contractor's cost accounting practices does not meet the exemption criteria specified in this subsection or is otherwise determined detrimental to the Government's interests, the cognizant Federal agency official shall inform the contractor of the determination and initiate the cost impact process in accordance with 9903.405–3 or otherwise proceed to resolve the cost impact pursuant to 9903.201–7(c)(2), if applicable. The contractor may request a desirable change determination in accordance with 9903.201–7 and subpart 9903.4 prior to the submission of a requested cost impact submission.

(g) If a voluntary change in cost accounting practice is made for any reason, even if the voluntary change is exempted from contract price and cost adjustment, the resultant changed cost accounting practices 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.

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

9903.201–7 Findings—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 voluntary change in cost accounting practice is desirable, as defined at 9903.403, i.e., desirable and not detrimental to the interests of the Government, and, if the voluntary change in cost accounting practice is associated with contractor restructuring activities, a finding that the change in cost accounting practice should not be exempted from contract price or cost adjustment process under the provisions of 9903.201–6(a).

(b) The determination as to whether or not a voluntary 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. The cognizant Federal agency official may, however, determine that a change in cost accounting practice is not desirable under the criteria specified in this subsection when such action would otherwise be detrimental to the Government's interests. Normally, a desirable change determination is only necessary if a voluntary change results in aggregate increased costs to the Government, for existing CAS-covered contracts, and the cognizant Federal agency official contemplates making potential contract price adjustments that would increase, in the aggregate, the existing contract prices that the Government would be obligated to pay. Pending receipt of a written notification that the cognizant Federal agency official has determined that a voluntary change in cost accounting practice will or will not be treated as desirable and not detrimental to the Government, the change shall be considered to be a voluntary change for which the Government will pay no increased costs, in the aggregate.

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

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

(2) Cost savings to the Government, in the aggregate, will occur under existing flexibly priced and reasonably predictable future CAS-covered contracts and subcontracts as a result of management changes, and associated cost accounting practice changes where there is a reasonable expectation that more efficient and economical operations will result. In such cases, the contracting officer may proceed to equitably resolve the cost impact of the practice change on all existing individual CAS-covered contracts (i.e., shifts in accumulated contract costs attributable to the practice change) by obtaining a contractor cost impact proposal and negotiating equitable contract price and/or cost adjustments pursuant to 9903.4. Alternatively, the contracting officer may otherwise resolve the matter based on the contractor's previously submitted contract cost accumulation data that was included in the contractor's written request for a desirable change determination (see 9903.405–2(e)). In that case, the contracting officer may forgo the submission of a cost impact proposal and related adjustments of individual contract prices and/or cost allowances, provided a determination is made that an alternate resolution adequately protects the Government's interests.

(3) Circumstances, other than those listed in paragraph (c)(1) and (c)(2) of this subsection, included as justification in the contractor's written request for a desirable change determination, which clearly demonstrate that the change in cost accounting practice 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 cost impact that a proposed practice change will have on a contractor's or subcontractor's current CAS-covered contracts. A voluntary change in cost accounting practice may be determined to be desirable and not detrimental to the Government's interest even though existing contract prices and/or cost allowances may increase. However, the amount of increased costs recognized by the Government when making equitable adjustments under paragraph (c)(2) of this subsection will be limited to the estimated amount of cost accumulation reductions that are expected to occur under reasonably predictable future CAS-covered contracts because of the practice change (See illustration at 9903.407–1(h)). To what degree such expected cost accumulation reductions for forecasted CAS-covered contracts may be considered requires case-by-case determinations. Such consideration should be based on data that fully supports such a condition and discussions held with the contractor, the cognizant auditor and affected Federal agency officials. Cognizant Federal agency official determinations of expected future contract cost

reductions shall not be subject to the disputes provisions of CAS-covered contracts.

5. Section 9903.201–8 and is proposed to be added to read as follows:

9903.201–8 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

6. 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 and 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. Costs allocated to specific intermediate cost objectives are accumulated in specific cost pools that include overhead pools, general and administrative expense (G&A) pools, and service center or other expense pools. These accumulated costs are 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.

* * * * *

7. 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 accumulate and distribute costs 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 accounting methods and techniques used to:

(i) Accumulate cost for cost objectives and cost pools,

(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 base for a cost pool (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 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.

8. 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 cost pool to another cost pool, segment or home office.

(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, segment, or home office 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 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. If a cost accounting practice previously used to estimate, accumulate or report costs of the acquired covered contract(s) before or after the effective date of the merger or acquisition is found to be noncompliant, the cost impact of the noncompliance shall be resolved in accordance with the requirements of part 9903.

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

9. Section 9903.302–3 is proposed to be amended by adding a new introductory paragraph, revising introductory 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.

Description	Accounting treatment
	(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 .
(4) A Segment combines the cost pools of two similar ongoing functions. (i) The ongoing 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 single assembly direct labor dollars allocation base that is generated by the two plant locations. (iii) The methods and techniques used to accumulate cost changed because the indirect cost pools selected by the segment to accumulate the cost of specific activities changed from two pools to one pool. 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 originally accumulated separately for Plants A and B is now accumulated in one combined base .
(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 costs of the manufacturing and assembly functions are split-out and accumulated separately in a manufacturing cost pool and an assembly cost pool. The costs accumulated in each pool 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 methods and techniques used to accumulate costs have changed because the indirect cost pools selected to accumulate the costs of specific functions have changed from one pool to two pools. The composition of the pools changed because the two specific functions originally included in one pool are now split-out and included in two pools. The composition of the allocation base changed because the selected allocation base previously accumulated in one plant-wide base is now accumulated separately, in two allocation bases, for the manufacturing and assembly operations.
(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 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.

Description	Accounting treatment
	(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 incoming inspection function is now included in a different pool, i.e., the composition of each pool has changed. 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 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 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 changed because the indirect cost pools selected for the accumulation of costs has changed from two pools to one pool. The composition of Segment A's pool changed because the specific functions originally included in the two indirect cost pools are now included in the one pool. The composition of the allocation base changed because the selected allocation base originally accumulated separately for Segment A and the acquired company is now accumulated in one combined allocation base. (iv) The cost accounting practice changes are subject to the contract price and cost adjustment provisions of the existing and acquired CAS-covered contracts.

10. 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 events 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.

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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 indirect inspection labor and was included in Plant A's overhead pool. (2) After the transfer, the employee's salary is similarly accumulated 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 overhead pools. (3) Since the cost of the ongoing inspection functions at Plants A and B continue to be accumulated within the same indirect cost pools 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.

Description	Accounting treatment
(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 from another company that is performing CAS-covered contracts.. (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 9903.302–2(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.

11. 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 or cost 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 the payment by the United States was made to the time the increased cost payment is recovered by the United States.

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

Subpart 9903.4—Contractor Cost Accounting Practice Changes and Noncompliances

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 Immaterial 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 contracts 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 subpart 9903.4 requirements 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 the first 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 9903.201–7 and is therefore not subject to the voluntary change—no increased cost prohibition 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.

Immaterial noncompliance means a noncompliant cost accounting practice

that does not currently result in material increased costs to the Government.

Increased costs due to a cost accumulation noncompliance means the increase in cost to the Government that results 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 due to a cost estimating noncompliance means the increased costs to the Government 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 due to a voluntary change in cost accounting practice means the increase in cost to the Government that occurs:

(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 practice, before any 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, before any contract price adjustment is made to reflect the contractor's lesser allocation of cost to the contract.

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 contractor is required to make in order to comply with applicable Standards, modifications or interpretations thereto, that subsequently become applicable to an existing CAS-covered contract due to the receipt of another CAS-covered contract or subcontract.

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 contractor cost impact submissions (9903.405–4), and not adjust contracts, if the cognizant Federal agency official determines that the amounts involved are 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 9903.201–7 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. Such notification shall include the proposed effective and applicability dates. 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 providing notification of a voluntary change, the contractor shall provide sufficient information to support the cognizant Federal agency official's determination that the planned voluntary change should or should not be exempted from contract price and cost adjustment (9903.201–6). The contractor shall state if the cost accounting practice change is or is not associated with restructuring activities; and if it is, the contractor shall:

(1) Submit a comprehensive description of the planned restructuring activities.

(2) Demonstrate, in summary fashion, to what extent the contractor's total operating cost levels are expected to decrease (or increase) as a result of the planned restructuring activities.

(3) Demonstrate that changes to the contractor's established cost accounting practices are associated with the planned restructuring activities and the resultant practice changes would not be made but for the management actions being taken.

(4) Demonstrate that aggregate cost accumulations for existing CAS-covered contracts and reasonably predictable future CAS-covered contracts, by contract types, will decrease, increase or remain the same after the planned restructuring activities are implemented. The required cost comparison calculation methodology is summarized as follows:

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

(5) In lieu of the methodology in paragraph (d)(4) of this section, the contractor may refer the cognizant Federal agency official to its ''cost savings'' proposal otherwise submitted in accordance with applicable agency regulations governing restructuring activities.

(e) 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 (9903.201–7). The contractor shall state if the cost accounting practice change is or is not associated with planned management changes; and if it is, the contractor shall:

(1) Submit a comprehensive description of the planned management changes.

(2) Demonstrate, in summary fashion, to what extent the contractor's total operating cost levels are expected to decrease (or increase) as a result of the planned management changes.

(3) Demonstrate that changes to the contractor's established cost accounting practices are associated with the planned management changes and the resultant practice changes would not be made but for the management actions being taken.

(4) Demonstrate that aggregate cost accumulations for existing CAS-covered contracts and reasonably predictable future CAS-covered contracts, by contract type, will decrease, increase or remain the same after the planned management changes are implemented. The required cost comparison calculation methodology is summarized as fellows:

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

(f) *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 (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) A voluntary change that is or is not exempt from contract price and cost adjustment,

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

(4) 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) *Voluntary change exemption determinations.* When a contractor provides notification of a planned voluntary change and submits the data required by 9903.405–2, the cognizant Federal agency official should, in accordance with 9903.201–6, determine if the voluntary change can be exempted from contract price and cost adjustment, and notify the contractor of the determination made. Notification should be made promptly after the change is determined to be adequate and compliant.

(c) *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 9903.201–7, 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, or initiate actions required to otherwise resolve the matter (see 9903.201–7(c)(2)). The notification shall also include a statement indicating that the potential modification of CAS-covered contracts are subject to the availability of funds.

(d) *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.

(e) *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(f)(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.

(f) *Request for GDM Settlement Proposal.* When the cost impact of a change in cost accounting practice is not determined to be obviously immaterial, the cognizant Federal agency official will request a GDM Settlement Proposal, as described in 9904.405–4(a), after the determination of adequacy and compliance has been made. 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 contract 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:

BILLING CODE 3110–01–U

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	PROPOSED
	OLD PRACTICE (3) (A)	NEW PRACTICE (4) (B)	COST IMPACT (A-B)	ADJUSTMENT AMOUNTS (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 actions(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.**

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(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 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 cognizant Federal agency official determines that the cost 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 cost impact either in the aggregate by contract type or on individual contracts is determined to be material, the procedures in 9903.405–5, Negotiation and Resolution of the Cost Impact, should be followed.

(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 will be requested by the cognizant Federal agency official 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 practice. 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 the formal written request for a detailed cost impact proposal.

(3) A detailed cost impact proposal will normally include the following:

(i) Cost estimates-to-complete based on the old (established) and new (changed) cost accounting practice and the resultant cost impact, grouped by contract type, for each CAS-covered contract and subcontract exceeding the specified amount.

(ii) Aggregate cost estimates to complete based on the old and new cost accounting practice and the aggregate cost impacts, by contract type, for ''all other'' CAS-covered contracts and subcontracts that are below the specified amount. The ''all other contract'' amounts are the difference between the aggregate amounts by contract type and the net sum totals of the impact of the submitted individual contracts by contract type.

(iii) Aggregate cost estimates to complete based on the old and new cost accounting practice and the aggregate cost impacts, by contract type, for all CAS-covered contracts and subcontracts that are affected by the change in cost accounting practice.

(4) 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.

(5) 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 impact increases with cost impact decreases may be used to reduce the number of individual contract price or cost adjustments or preclusion of increased cost actions required as a result of a change in cost accounting practice. In applying this process, the following provisions 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 (9903.405–5(c)(1)). 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 to determine:

(i) If the aggregate impact within the same contract exceeds the individual contract's materiality threshold;

(ii) On an overall basis, 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 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. The determination to require or not to require 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 materiality thresholds, as used in this paragraph, are the amounts below which no adjustments are required.

(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 made to:

(i) Maintain consistency between the negotiated contract costs and the costs to be allocated to the contract using the new practice, while at the same time reducing potential contract cost overrun and underrun conditions resulting from the change in cost accounting practices;

(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) If the resolution of the cost impact action will be accomplished by means of contract price adjustments, 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 with paragraph (c)(1) of this subsection, 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 Procuring 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 9903.201–7 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) 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.

(3) 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.

(4) The cognizant Federal agency official may preclude the payment of increased costs resulting from 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.

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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 downward adjustments made to flexibly-priced contract cost ceilings and/or target costs.
Lower (2)	Lower (2)	Adjust FFP and flexibly-priced contract cost ceilings and/or target costs downward by the amount of the net downward price adjustment.
Higher (1)	Lower (2)	Limit upward adjustments on flexibly-priced contracts to amount of downward adjustments on FFP contracts. Preclude payment of any excess increased costs on flexibly-priced contracts.

Notes:

(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.

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(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) *Use of another suitable technique.* The cognizant Federal agency official may otherwise resolve the cost impact of a change in cost accounting practice (e.g., by a monetary exchange between the contracting parties), when the cognizant Federal agency official determines, in writing, that contract price and/or cost adjustments or actions to preclude the payment of increased costs are not warranted because:

(1) Contract performance would not be jeopardized (the contractor agrees to absorb any resultant contract cost overrun conditions),

(2) Cost ceilings or target price reductions for flexibly priced contracts are not desired by the Government,

(3) The impact on incentive fee or profit that results from failure to adjust the target cost on incentive contracts is not material, or is otherwise considered in the cost impact settlement, and

(4) The increase or decrease in expected contract cost accumulations would not distort or adversely impair the usefulness of the contractor's reported contract cost information (actual costs and estimated costs to complete) that is included in contract status reports.

(f) *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 provision of each affected contract's CAS contract clause.

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

proposed costs on CAS-covered contracts and the noncompliant practice was used to determine the contract prices, 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 for a cost estimating noncompliance or 9903.406–4 for a cost accumulation noncompliance. If the noncompliance 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 9903.406–4.

(c) Noncompliant cost accounting practices that do not result in material increased cost to the Government should be processed as an immaterial noncompliance in accordance with 9903.406–5.

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

(a) When a Government representative encounters 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.

(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 provision included in each affected contract's CAS contract clause. 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.

(i) *Contractor cost impact submissions.* 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. 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. 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 it may be in another mutually agreeable format. The chosen format must result in the submission of cost impact data that will enable the cognizant Federal agency official to 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 following illustration is one acceptable GDM Settlement Proposal format that may be used for a noncompliant action. The illustrated 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.

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

	CONTRACT COST AMOUNT		DIFFERENCE	PROPOSED
	NONCOMPLIANT PRACTICE	COMPLIANT PRACTICE	COST IMPACT	ADJUSTMENT AMOUNTS
	(1)	(2)		(3)
	(A)	(B)	(A-B)	
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 for an estimating noncompliance:

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.**

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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 obviously immaterial, 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 (f) 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 (9903.406–2(i)), 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, including cost ceilings or target costs, as applicable, 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.

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Requiring Contract Price Adjustments For An Estimating Noncompliance

Change In Contract Cost Estimate By Contract Type Due To The Noncompliance		Actions To Be Taken
Flexibly-Priced	**Firm-Fixed-Price**	
Lower (2)	Lower (2)	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.
Higher (1)	Lower (2)	Adjust flexibly priced contract cost ceilings or target costs down to recover increased cost to Government. Limit FFP upward price adjustments to amount of flexibly-priced downward price adjustments.
Higher (1)	Higher (1)	Adjust FFP and flexibly-priced contract ceiling or target prices downward by the amount of the increased cost to the Government.
Lower (2)	Higher (1)	Adjust FFP prices downward to recover the increased cost to the Government. Limit upward adjustments on flexibly-priced contracts to amount of downward adjustments on FFP contracts.

Notes:

(1) "Higher" indicates the estimated costs submitted in the contract cost proposal were higher, due to the contractor's use of a noncompliant cost accounting practice to estimate the proposed contract costs. This represents increased cost to the Government.

(2) "Lower" indicates that the estimated costs submitted in the contract cost proposal were lower, due to the contractor's use of a noncompliant practice to estimate the proposed contract costs.

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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 obviously immaterial, 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 (e) of this subsection shall be followed.

(b) 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 (9903.406–2(i)). 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 (d) of this subsection.

(c) 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.

(d) 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.

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

9903.406–5 Immaterial noncompliances.

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

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

(b) Corrective action should be taken; and

(c) 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.

9903.407 Illustrations.

The following illustrations are not intended 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 intended 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 practice in April with a proposed retroactive applicability date of the beginning of the current year. In accordance with 9903.405–2(c), the contractor provides rationale for the beginning of the current year applicability date. The cognizant Federal agency official approves of the proposed applicability date (9903.405–3(d)). 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 practice 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 (9903.405–3(d)). 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(f), 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 (b)(3) of this subsection occurs except that the aggregate impact by contract type in the GDM Settlement Proposal can not 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 firm-fixed-price contracts for upward adjustment, in addition to the $1,000,000 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 provisions 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)(i).

(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 (the sum of the $1,000,000 cost impact on the flexibly-priced contract and the $1,200,000 cost impact on the fixed-priced contract). Therefore the contractor's proposed resolution would not result in the same aggregate cost impact as the amount that would result from adjustment of individual contracts. 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 contract 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)(4), 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)(4), 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 additional $1,000,000 of increased costs in accordance with 9903.405–5(d)(4).

(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 cost 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 impact. In accordance with 9903.405–5(d)(1) and (3), 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 (9903.405–5(b)(5)). The cognizant Federal agency official then limits the upward adjustment to the CPFF contract to $100,000. Action must also be taken to preclude payment of the additional $100,000 of costs on the CPFF contract in accordance with 9903.405–5(d)(4).

(h) *Desirable change determination.* A contractor provides notification of a proposed voluntary change in cost accounting practice and requests a cognizant Federal agency official determination that the change is desirable and not detrimental to the Government. The request is supported with data that demonstrates that aggregate cost accumulations for existing flexibly priced CAS-covered contracts and reasonably predictable future CAS-covered contracts will decrease after the planned management changes are implemented. The cost impact of the practice change on all existing individual CAS-covered contracts (i.e., shifts in accumulated contract costs attributable to the practice change) results in $500,000 of increased cost to the Government. There are expected cost reductions of $200,000 on future CAS-covered contracts. The cognizant Federal agency official determines that there is a continuing long-term relationship with the contractor and that, after the change is made, there is a reasonably predictable expectation that the estimated costs of anticipated future CAS-covered contracts, as reflected in the contractor's forecasted business base used to develop the projected indirect cost rates applied in contract cost proposals, will be lower than the estimated future contract costs that would result if the voluntary change were not made. In accordance with 9903.201–7(d), the cognizant Federal agency official determines the voluntary change is desirable and not detrimental to the Government and provides equitable adjustments in the aggregate amount of $200,000 to resolve the increased costs on existing CAS-covered contracts caused by the voluntary change.

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 valued at 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(d), 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 CAS 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(c), 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, Immaterial noncompliances.

(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 9903.406–1(b), requests two separate contractor cost impact submissions (9903.406–2(i)). The cost impact submission for the overstated contract prices will be as described in 9903.406–3(c), and the cost impact proposal for the overbilled accumulated costs will be as described in 9903.406–4(c).

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