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: Notice of proposed rulemaking.

SUMMARY: The Cost Accounting Standards Board (CASB) invites public comments on proposed amendments to the regulatory provisions contained in Chapter 99 of Title 48. The proposed amendments would, when issued as a final rule, *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 *add* a new Subpart 9903.4, Contractor Cost Accounting Practice Changes and Noncompliances. The proposed subpart would establish contractor notification requirements for changes in compliant cost accounting practices and delineate the process for determining and resolving the cost impact due to a compliant change in cost accounting practice or a noncompliant practice on CAS-covered contract and subcontract prices and/or costs. The proposed subpart also includes unique applicability and agency waiver provisions for educational institutions.

DATES: Comments must be in writing and should be received by December 2, 1996.

ADDRESSES: Comments should be addressed to Mr. Rudolph J. Schuhbauer, Project Director, Cost Accounting Standards Board, Office of Federal Procurement Policy, 725 17th Street, NW., Room 9001, Washington, DC 20503. Attn: CASB Docket No. 93–01N. To facilitate the CASB's review of your submitted comments, please furnish a three point five inch (3.5″) computer diskette copy of your comments in a format that is compatible with WordPerfect 6.1 or 5.1.

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

SUPPLEMENTARY INFORMATION:

A. Regulatory Process

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

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

(2) Promulgate an Advance Notice of Proposed Rulemaking.

(3) Promulgate a Notice of Proposed Rulemaking.

(4) Promulgate a Final Rule.

This proposal is step three 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. On April 9, 1993, the CASB published a Notice in the Federal Register, 58 FR 18428, requesting public comments from interested parties concerning a Staff Discussion Paper on that topic. After consideration of the public comments received in response to the Staff Discussion Paper, the CASB published an Advance Notice of Proposed Rulemaking (ANPRM) on April 25, 1995 (60 FR 20252) which proposed certain amendments to Chapter 99 of Title 48 that, when issued as a final rule, would revise the current definitions and illustrations governing changes in cost accounting practices. The ANPRM also included (1) proposed revisions regarding the language contained in the contract clauses for ''Full'' and ''Modified'' coverage, Federal agency responsibilities, and desirable change determinations; and (2) the proposed addition of a new Subpart that would establish contractor notification requirements for changes in a contractor's cost accounting practices and set forth the process for determining and resolving the cost impact on covered contract prices and/or contract costs when a contractor makes a change to a compliant cost accounting practice or follows a noncompliant practice.

Public Comments

Twenty-two sets of public comments were received in a timely manner from contractors, professional associations, Federal agencies, accounting organizations, and other individuals. A number of commenters supported the proposed amendments contained in the ANPRM. Some did not.

The more significant comments and concerns expressed by commenters are summarized below.

—*The proposed definitions are too broad.*

Several contractors and contractor industry associations opined that the proposed ANPRM definitions of the terms ''cost accounting practice'' and a ''change to a cost accounting practice'' are too broad. They believed that if the proposed definitions were adopted, the number of cost impact submissions would increase significantly in comparison to current levels. This, in turn, would dramatically increase administrative costs for contractors and the Government.

—*No consensus on an acceptable definition.*

Some commenters in the contractor community recommended retention of the existing definitions. Others acknowledged that a change in cost accounting practice occurs when existing pools and bases that contain different functions are combined but that an accounting change would not occur if two pools that contained similar functions were combined. Such contractors argued that an accounting change occurs only if ongoing functions are combined with dissimilar ongoing functions.

On the other hand, Federal commenters agreed with and supported the CASB's proposed amendments which specified that pool combinations, pool split-outs and transfers of functions were cost accounting practice changes.

—*Cost impact process.*

Both the contractor community and the Government agency representatives generally supported the Board's proposal to establish a new Subpart to delineate the notification and cost impact process.

The various comments, as well as the concerns, expressed by the commenters are discussed in greater detail under Section E, Public Comments. The Board Members and the CASB staff express their appreciation for the divergent views and constructive suggestions provided by the commenters. Their expressed concerns and suggestions aided the CASB's deliberations and formed the basis for the development of the new and/or revised proposed amendments which the Board has included in the Notice of Proposed Rulemaking (NPRM) being promulgated today.

Conclusion

After consideration of the public comments timely received, the Board concluded that contractors and Federal officials continue to interpret the Board's rules and regulations governing changes in cost accounting practice under CAS-covered contracts differently. There appears to be general support for the proposed cost impact process. However, even with the proposed promulgation of a more explicit and flexible cost impact process, some commenters remain concerned that the administrative costs associated with that process may still deter CAS-covered entities from initiating organizational changes that could result in more efficient and effective operations. They believed that if an organizational change were to also result in a change in cost accounting practice, the administrative costs that would still be required to initiate and conclude contract price and/or cost adjustments for existing contracts and subcontracts could negate the anticipated cost savings. Thus, it is argued, some contractors may not make the changes. The higher cost levels being experienced would continue to be passed on to their Federal customers in the form of higher proposed costs for future contracts.

As further explained in Section E, Public Comments, the Board proposes to resolve the described issues and concerns by amending Chapter 99 as follows:

—*Definitions:* Revise the definitions and illustrations governing cost accounting practice changes, for purposes of making it explicit that a change in the manner in which ongoing costs are accumulated in cost pools for allocation to final cost objectives constitutes a change in cost accounting practice, including the combination of existing pools, the split-out of an existing pool, or the transfer of an existing function from one pool to one or more different cost pools.

—*Exceptions:* Retain, with certain modifications, the existing exceptions for circumstances that are not considered to be a change in cost accounting practice, and, by adding a new exception for the transfer of an existing function to a different pool when the costs of that function are directly allocated back to the original pool for reallocation to final cost objectives.

—*Exemptions:* Establish new exemptions from the Board's contract price and cost adjustment requirements and cost impact process for changes in cost accounting practices that result from:

(i) Organizational changes involving changes in cost accumulation practices that result due to the transfer of functions or merger of cost pools which are undertaken for improved management efficiencies and effectiveness and which involve the physical realignment or reduction of facilities or personnel.

(ii) The consolidation of existing pools or the expansion of an existing pool into two or more pools when the merged or split-out pools accumulated pooled costs and the respective pools' accumulated allocation base activity amounts involve similar proportional and homogeneous relationships, before and after the change.

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

Benefits

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

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

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

Significant administrative cost savings should also evolve from the Board's proposal to exempt from the current contract price and cost adjustment requirements, changes in cost accounting practices that result from organizational changes made by management to attain more efficient and effective operations. This exemption should encourage, not discourage, such organizational changes in the future. Also, the proposed exemption for routine cost pool combinations or split-outs of ongoing functions that are not undertaken to primarily improve the economies and efficiencies of existing operations but meet the Board's proposed similarity criteria should further mitigate the administrative cost concerns expressed by commenters. As a result, these proposed regulatory amendments should generally further the goal of acquisition streamlining and reform, and should lead to much greater simplification of the contract administration process as related to the administration of the Cost Accounting Standards. These goals have been endorsed by the so-called ''Section 800'' Panel (*Report of the Acquisition Law Advisory Panel to the United States Congress*, January 1993).

Proposed Amendments

A brief description of the proposed amendments follows:

Part 9903, Contract Coverage

Changes in Cost Accounting Practices. 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 Section 9903.302–1, Cost Accounting Practice, the definition is amended to incorporate proposed language changes and to add clarifying guidance. Section 9903.302–2, Change to a cost accounting practice, is revised to make explicit the types of changes that are a change in cost accounting practice, a new exception from the definition of a change in cost accounting practice is added and new exemptions from the contract price or cost adjustment provisions of CAS-covered contracts and the cost impact process for certain specified changes in cost accounting practices are added. 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 are proposed to provide additional guidance regarding the revised definitions of the terms

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

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

Changes in Cost Accounting Practices. Proposed for inclusion in 9903.301, are two definitions to clarify the terms ''Function'' and ''Intermediate cost objective'' as used in Part 9903. The proposed amendments to 9903.302–1(c), *allocation of cost to cost objectives*, specify that the systematic manner in which the costs of specific activities are accumulated and distributed to intermediate and final cost objectives constitutes a cost accounting practice. Additional subparagraphs are proposed to precisely set forth and amend the existing examples of cost accounting practices and to clarify what is meant by the selection and composition of the pools and the 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. The transfer of an existing ongoing function from an existing indirect cost pool to a different pool when the costs are directly allocated back to the original pool for reallocation to final cost objectives and the costs of the function continue to be separately identified and accumulated in the original pool is proposed to be added as a new exception. A new subparagraph is added to exempt from the contract price or cost adjustment provisions of CAS-covered contracts and the cost impact process those changes in cost accounting practices that result from (1) organizational changes that involve improved management efficiencies and economies, and the physical realignment or reductions of facilities or personnel and (2) overhead and general and administrative (G&A) expense pool combinations or split-outs that meet proposed ''similarity'' criteria.

Within 9903.302–3, an introductory paragraph is added regarding the use of the illustrations provided, and 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 proposed to be replaced by new illustrations depicting changes in cost accounting practice, consistent with the revised definitions. One illustrating the use of a different base for the allocation of indirect costs to final cost objectives. Additional illustrations are proposed to be 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.

Contract Price and Cost Adjustments. The proposed amendments, when promulgated as a final rule, will:

Contract Clause Provisions. 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 and the corrective actions required if a contractor's estimated cost proposal was based on a noncompliant practice and/or actual contract cost accumulations were based on a noncompliant practice.

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

Cognizant Federal Agency Responsibilities. Require Federal agencies 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 official responsible for administering each CAS-covered contract and subcontract performing under agency awards,
—Delegate contracting authority to designated agency officials, as required, for the negotiation of cost impact settlements and associated contract price or cost accumulation adjustments, under the agency's CAS-covered awards.
—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.

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

Proposed section 9903.405, Changes in Cost Accounting Practices, includes subsections on the following areas: notification on changes in cost accounting practices; determinations of adequacy and compliance; contractor cost impact submissions; and negotiation and resolution of the cost impact action.

Section 9903.405 includes required and suggested time frames by which the various actions in the cost impact resolution process should be completed. It provides a streamlined process which does not require submissions of cost impact estimates or contract price adjustments for every CAS-covered contract affected by a change in accounting practice. It provides flexibility to the cognizant Federal agency official in determining the level

of detail required for a cost impact proposal and materiality thresholds for required contract price and cost adjustments. To this end, it creates a two-step process to include (1) a general dollar magnitude estimate of the accounting change by contract type along with a cost impact settlement proposal, and if required, (2) a detailed cost impact proposal for contracts exceeding Government determined materiality thresholds. The proposed procedure encourages settlement of the cost impact process based on the cost impact 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.

The Board has included clarifying rules for the use of the offset process. It allows for the use of the offset process to reduce the number of contract price and cost adjustments required as a result of a change in cost accounting practice, while still providing for adjustments of individual contracts when the cost impact amount is material. The rules clarify that offsets of increased costs against decreased costs should 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 as a result of a voluntary change in cost accounting practice. It clarifies how increased costs 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 of firm fixed-price contracts subject to adjustment as a result of a voluntary change in accounting practice.

Proposed section 9903.406, Noncompliances, provides detailed rules and regulations for handling noncompliant actions. It outlines procedures for when the parties agree and disagree on whether a noncompliant condition exists. The Board has added separate sections on estimating practice noncompliances and cost accumulation practice noncompliances to clarify the actions, particularly to recover increased costs, that need to be taken under these different noncompliant conditions. It also provides procedures to be followed when the noncompliant condition does not result in material increased costs paid.

C. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96–511, does not apply to this proposal because this proposal would impose 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.* The purpose of this proposal is to decrease the current burdens (including current paperwork burdens) associated with the administration of the Cost Accounting Standards by covered Government contractors and subcontractors.

D. Executive Order 12866 and the Regulatory Flexibility Act

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

E. Public Comments

This NPRM is based upon proposed amendments to the CASB's rules and regulations that were made available for public comment through the Board's ANPRM that was published in the Federal Register on April 25, 1995, 60 FR 20252, wherein public comments were invited. The comments received and the Board's actions taken in response thereto are summarized in the paragraphs that follow:

Cost Accounting Practice Definitions, Exceptions, Exemptions

Comment: Changes in make or buy decisions do not equate to changes in cost accounting practice changes.

Response: Changes in make or buy decisions are not a change in cost accounting practice. This response presumes that the segment responsible for administering and performing the covered contract affected by a make or buy change will accumulate and report the actual costs of contract performance for in-house production and for goods and services acquired from other sources consistently in accordance with the performing segment's established and/or disclosed cost accounting practices. Changes in make or buy decisions are not subject to the CASB's rules, they are subject to applicable procurement regulations.

Comment: Changes in the place of contract performance do not equate to changes in cost accounting practice.

Response: The CASB's rules and regulations pertain to the performing contractor's or segment's established and, if required, disclosed cost accounting practices. The Board's rules and regulations presume that the proposed contract (or subcontract) work will be performed by the segment (or segments) identified in the contractor's cost proposal as the performing segment and that the costs of contract performance will be estimated, accumulated and reported by that proposed segment in accordance with that segments' established and, if required, disclosed cost accounting practices. Any change in a compliant cost accounting practice, failure to comply with an applicable CAS or failure to consistently follow established cost accounting practices, experienced by that performing segment may result in contract price or cost adjustments under the Board's rules and regulations.

When the proposed segment and performing segment are different because the contractor transfers the responsibility for administering and performing a covered contract to a different segment, the commenters are correct in that neither segment's cost accounting practices may have changed. However, the cost accounting practices used by the original segment to estimate, accumulate and report the costs of contract performance before the transfer will not necessarily be the same as the practices used by the different performing segment after the transfer. Of more importance is the fact that the specific costs being allocated to the transferred contract will be different.

Such changes in the place of contract performance are subject to applicable procurement regulations which may require consideration and/or Government approval for such transfers. Where the Government negotiates the conditions for and approves the complete transfer of responsibility for performing a covered contract from one segment to another segment, any contractor submission of estimated costs to complete the transferred contract or the subsequent submission of costs

incurred to complete the transferred contract would be estimated, accumulated and reported in accordance with the applicable performing segments' compliant cost accounting practices. In such cases, the contract price and cost adjustment provisions of the CAS contract clause contained in the transferred contract would not apply. Rather, the Board believes that the contracting parties must resolve the cost implications of such changes in the place of contract performance in accordance with applicable procurement regulations.

Comment: The Board's proposal should be treated as a rule change, not as a ''clarification.''

Response: The proposed amendments contained in this NPRM, when promulgated as a final rule, would apply prospectively to covered contracts and subcontracts awarded after promulgation of the final rule. However, the Board is also proposing that Subpart 9903.4 be applied to preexisting CAS-covered contracts and subcontracts if the contractor or subcontractor receives a CAS-covered contract or subcontract after Subpart 9903.4 becomes effective. Then, for compliant changes in cost accounting practices or noncompliant practices that occur after Subpart 9903.4 becomes effective, Subpart 9903.4 would apply to such preexisting contracts. The proposed coverage is intended to facilitate the resolution of the cost impact of compliant and noncompliant cost accounting practice changes affecting CAS-covered contracts awarded after the proposed Subpart 9903.4 is in effect. Where such changes in cost accounting practices and/or noncompliances also affect covered contracts awarded prior to the promulgation of Subpart 9903.4 as a final rule, the Board does not expect the contracting parties to comply with two separate cost impact processes for changes that occur after the effective date of the Board's anticipated final rule. Where changes in cost accounting practices and/or noncompliances do not become subject to Subpart 9903.4, the contracting parties would normally continue to follow the ''cost impact process'' incorporated in the preexisting covered contracts and subcontracts unless the contracting parties mutually agree to follow the Subpart 9903.4 procedures.

Comment: A number of commenters suggested that the terms ''function'' and ''intermediate cost objective'' be modified.

Response: The ANPRM definitions have been revised.

Comment: A number of commenters recommended that the proposed amendments to the introductory paragraph at 9903.301–1 be revised or deleted.

Response: The proposed ANPRM language has been deleted.

Comment: Several commenters suggested revision or deletion of the ANPRM proposed amendments to 9903.301–1(c) that would have changed the paragraph heading and content to highlight the importance of the term accumulation of cost. One commenter advocating that the basic definition not be revised stated:

> * * * The triumvirate of measurement, assignment and allocation have served * * * well over the years. If changes are needed make them in the subparagraphs that follow.

Response: The proposed ANPRM language changes have been deleted. The proposed amendments being promulgated in the NPRM retain the traditional term ''allocation of cost to cost objectives'' in 9903.301–1(c). However, the Board continues to hold the opinion that the manner in which costs are accumulated is an essential cost accounting practice that is integral to the concept of cost allocation. Therefore, the Board is proposing certain modifications to make explicit that cost accumulation and the selection of pools used to accumulate specific costs are cost accounting practices. Additional subparagraphs are proposed to further explain what is meant by the selection and composition of the pools and bases.

Comment: Federal and industry commenters disagreed on whether the combination of existing pools or the transfer of an existing function from one pool to a different new or existing pool did or did not constitute a change in cost accounting practice. Several industry commenters acknowledged that a change in cost accounting practice occurs when existing pools and bases that contain different functions are combined but that an accounting change would not occur if two pools with similar functions were combined.

Such contractors argued that an accounting change occurs only if ongoing functions are combined with dissimilar functions.

Response: Although some industry commenters appeared to agree that a cost accounting practice change may occur when dissimilar functions are combined, the reason why a change in cost accounting practice occurred was not attributed to change in how specific costs were accumulated for subsequent allocation to specific final cost objectives. Assuming overhead Pool A accumulated the costs of two functions and overhead Pool B accumulated the cost of two other but relatively very similar types of functions, the commenters reasoned that there would be no change in a contractor's cost accounting practices if the two pools were combined. A corollary assumption was that the costs accumulated in both pools were allocated to final cost objectives by use of the same type of base activity accumulated at the two locations. Since the disclosure statement descriptions of the two pools before the change and the one pool after the change would be ''identical,'' the commenters appeared to infer that there was no change in cost accounting practice.

The arguments presented appear centered more on the commenters' limited interpretations of the Board's existing regulatory language which is used for determining when contract price or cost adjustments are required due to a change in a contractor's cost accounting practices rather than on the actual manner by which contractors accumulate specific costs in individual pools for their subsequent allocation to the specific final cost objectives included in the pools respective allocation bases.

The commenters did not acknowledge that the use of two pools would result in the allocation of the specific costs accumulated in each pool to only the specific final cost objectives included in each of the separate allocation bases that were applicable to each pool. Pool A costs would be allocated to only those individual final cost objectives that pass through Pool A's allocation base. After the pools are combined, the specific costs originally included in the two cost pools will now be allocated to different groupings of final cost objectives. Consequently, the specific costs would be allocated differently to individual final cost objectives. The specific indirect costs originally included in Pool A would be allocated proportionately to both the final cost objectives that would have been included in the allocation base for Pool A as well as to all of the final cost objectives that would have been included in the allocation base for Pool B. Pool B costs would experience the same type of change in cost allocation. It is the Board's opinion that the described type of change in cost accumulation (the use of one pool instead of two) is a cost accounting practice change because the method used to accumulate cost for the ''allocation of cost to cost objectives'' has changed. The change is that the specific ongoing costs that would previously have been accumulated and included in Pool A and allocated *only*

to the individual final cost objectives included in the *Pool A* allocation base would now be allocated to all of the individual final cost objectives that previously would have been included in the allocation base for Pools A *and B*. The specific costs that would previously have been accumulated and included in Pool B would experience the same type of change.

Furthermore, the commenters' concepts of ''similar'' and/or ''identical'' functions would prove difficult to establish and administer. To be similar, must the functional operations be identical? Must the product being fabricated or the service being performed be identical? How would disparate levels of cost incurred by separate functions be considered? If the costs accumulated in the original pools were not proportionally similar to the amounts of activity accumulated in their respective allocation bases would the functions being combined still be judged similar? Would the combination of the pools and their respective allocation bases be considered compliant under applicable Standards (e.g., under the homogeneity requirements of CAS 9903.418)?

The Board continues to believe that the combining of pools, whether they contain similar or dissimilar functions, constitutes a change in cost accounting practice. To avoid potential disputes and endless debate on what constitutes ''similar'' functions and when a change in cost accounting practice should require the adjustment of contract prices or costs, the Board, in the NPRM being promulgated today, proposes to resolve this matter by establishing definitions, exceptions and exemptions as follow:

1. *Definitions.* Amend the definitions of a cost accounting practice and a change to a cost accounting practice to state that the combination or split-out of an existing pool and/or the transfer of an existing function from one pool to a different pool, constitutes a change in cost accounting practice.

2. *Exceptions.* Retain the existing exceptions to a change in cost accounting practice but add a modification to indicate that different segments may apply different cost accounting practices when the same type of cost is incurred for the first time at each location. Add a new exception indicating the transfer of an existing function when the cost of that function is directly allocated back to the original pool for cost accumulation and reallocation to final cost objectives is not a change in cost accounting practice.

3. *Exemptions.* Add two exemptions from contract price and cost adjustments, for cost accounting practice changes resulting from:

(i) Functional combinations and transfers resulting from significant organizational changes made to achieve economies and efficiencies. This provision is proposed to provide a clear distinction between changes in operations and changes in cost accounting practices. It also responds to commenters' concerns that the Board's rules and regulations governing contract price and cost adjustments are viewed by some as an impediment to the implementation of more efficient and economical operations.

Where significantly lower levels of operating costs resulting from the physical realignment or reduction in facilities or personnel are reasonably expected to occur due to operational changes, attendant savings will normally be experienced in the long run under all of a contractor's work affected by the change, including existing and future CAS-covered contracts. Accordingly, the Board is considering the establishment of the proposed exemption based on the concept that if a cost accounting practice change results in such circumstances, it may not be necessary to require contract cost or price adjustments under existing CAS-covered contracts that are immediately affected by such operational changes. Whether specific operational changes qualify for this proposed exemption would be determined on a case-by-case basis by the cognizant Federal agency official.

The Board's existing requirements for contract price and cost adjustment would continue to be applied when there is no significant physical change in the contractor's ongoing operations and/or production activities but a change is made to the contractor's established cost accounting practices. In such cases, while a contractor's actual operations and overall total cost levels for those ongoing operations are not expected to change appreciably, the Board's rules and regulations would continue to require the adjustment of individual contracts for any significant greater or lesser allocation of cost to individual covered contracts that may occur due to the change in cost accounting practice.

Because changes resulting in improved economies and efficiencies would be exempt from the contract price and cost adjustment, the Board has deleted from this NPRM proposal, the ANPRM provision proposed for desirable changes involving changes made to improve the economy and efficiency of operations.

Public comments on this proposed exemption would be particularly helpful (see proposed 9903.302–2(c)(1)).

(ii) Overhead or G&A pool combinations where the cost variability between the original pools and the resultant pool or pools is relatively similar so that resulting cost allocations to individual final cost objectives will not be significantly affected by the change. Pools would be considered similar if certain proposed criteria are met. When met, this exemption would obviate the need for contractor preparation and submission of the cost impact documents required under Subpart 9903.4.

Comment: A commenter recommended the addition of an introductory provision to clarify that the illustrations in 9903.302–3 and 9903.302–4 are not all inclusive.

Response: Clarifying provisions have been added.

Contract Clauses

Comment: A commenter recommended that the definition of a cost accounting practice at 9903.302–1 be incorporated by reference into paragraph (a)(2) of the clause.

Response: To clarify that Part 9903 is incorporated in its entirety, including all of the definitions in Part 9903, paragraph (a) was revised to incorporate by reference the definitions and requirements of Part 9903. Paragraph (a)(4)(ii) was also revised to conform with the definition of the term ''increased cost'' contained in Subpart 9903.4.

Comment: A commenter recommended that paragraph (a)(3) should require the contractor to maintain a system for identifying all CAS-covered contracts and subcontracts by their periods of performance.

Response: The proposed requirement at 9903.401–1(b) for identifying covered contracts and subcontracts is incorporated into proposed paragraphs (a), (a)(4) and (a)(5) of the applicable contract clauses.

Comment: Revise paragraph (a)(4) to reference disclosed as well as established cost accounting practices and use the term ''cognizant Federal agency official'' in lieu of ''Contracting Officer.''

Response: The suggestions were adopted.

Comment: A commenter suggested that paragraph (c), access to records, be updated to include modern record storage mediums.

Response: The suggestion was adopted.

Comment: One commenter supported the proposed contract clause provisions

in paragraphs (a)(4) of the proposed contract clauses, requiring a Contractor to agree to price adjustments if CAS-covered subcontractors make required, voluntary or desirable changes to their cost accounting practices pursuant to the subcontracts' terms and conditions. One commenter felt there was no need to extend a contractor's liability for subcontractor changes. The commenter argued that prime contractors have no control over a subcontractor's cost accounting practices.

Response: Under CAS-covered contracts, prime contractors are responsible for inserting CAS flow down provisions into their subcontracts and for administering the covered subcontracts. If a subcontractor claims proprietary data is involved, the prime contractor can obtain the necessary data in summary form through the cognizant Federal agency official. However, the proposed provision provides for the adjustment of the prime contract price and/or higher-tier subcontract price if affected due to a lower-tier subcontractor's compliant change in cost accounting practice and/or noncompliance. The referenced provision was retained.

Desirable Changes

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

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

Comment: One commenter suggested that the proposed provision requiring the cognizant Federal agency official to determine that a change in cost accounting practice made to remain in compliance with a Standard to be a ''desirable'' change be deleted and treated instead as a ''required'' change.

Response: The contract clause provision referred to as a ''required'' change only pertains to a change in cost accounting practice that is made in order to comply with a new Standard, modification or interpretation thereto when it first becomes applicable to an existing covered contract through the award of a subsequent CAS-covered contract or subcontract. It does not apply to changes in cost accounting practices made subsequently by a contractor due to changed circumstances in order to remain in compliance with an existing Standard already applicable to an existing contract. By treating such subsequent changes as a ''desirable'' change, the contracting parties can negotiate equitable adjustments for covered contracts and/or subcontracts materially affected by subsequent changes that the cognizant Federal agency official has determined, on a case-by-case basis, were necessary in order for the contractor to remain in compliance with an applicable Standard. To distinguish subsequent changes from first time ''required'' changes, the proposed word ''required'' has been changed to ''necessary'' in the proposed provision.

Comment: Some contractors advocated that a change in cost accounting practice recommended by the cognizant Federal agency official and implemented by the contractor be considered a desirable change. A Federal agency recommended deletion of the proposed provision because in their view this provision would rarely be used and it would avoid contractor interpretations of discussions held with Federal officials as representing recommended changes.

Response: The word ''should'' has been changed to ''shall'' and a requirement for a written recommendation has been added.

Cognizant Federal Agency Responsibilities

Comment: A Federal agency recommended editorial changes to paragraph (a) and deletion of proposed paragraphs (b), (c) and (d) at 9903.201–7. The primary concerns were that the proposed amendments were already addressed by the Federal Acquisition Regulation (FAR), at FAR 30.6 and 42.3., and that the proposed responsibilities for obtaining funding may go beyond the control of the cognizant Federal agency official.

Response: The Board recognizes that the responsibility for administering CAS resides with the various Federal agencies, including the civilian agencies that are subject to CASB's rules and regulations. The Board, in reviewing the CAS cost impact process at a number of contractor locations, concluded that this process was generally not being accomplished in a timely or efficient manner. One contributing factor was that neither the Board's rules nor applicable agency regulations clearly set forth the complete process to be followed or actions to be taken. The Board is taking action today by proposing a precise yet flexible approach for the submission of cost impact data due to changes in cost accounting practices and noncompliances and for determining the resultant contract price or cost adjustments required under the Board's rules and regulations. The Board believes such specificity will facilitate the CAS administrative process, reduce administrative costs and improve timeliness. This proposal represents a first step toward the improvement of the process. Without more explicit implementing agency policies and procedures, however, the Board remains concerned that the timeliness of the contract price and cost adjustment process may not improve significantly and that the administrative costs associated with the cost impact process will not be curtailed.

Funding availability and the process for obtaining funds needed to effect CAS contract price adjustments is an example of where agency regulations for administering CAS should be made explicit. A recurring contractor concern with the Board's cost impact adjustment process was that contractors believe that the funds required to effect the necessary CAS contract price adjustments are generally not made available to the administering official. Contractors also believe that the lack of funding often was the determining factor in why a compliant change in cost accounting practice was not considered

to be a ''desirable'' change subject to equitable adjustment under the Board's rules.

The Board is fully aware that contract obligations can not be made in violation of applicable appropriations law and that funding availability is governed by each agency's administrative control of funds requirements. The proposed agency responsibilities are designed to permit each agency, in accordance with its funding systems, to establish appropriate internal procedures that are to be followed by programmatic, financial and procurement officials when additional funding is required to effect CAS contract price adjustments. While contract funds can be deobligated immediately, for equity's sake, under the Board's proposal, contract price increases and decreases due to a change in cost accounting or a noncompliance would be processed concurrently. The cognizant Federal agency official would not effect deobligations until the funding needed to increase contract prices under other contracts affected by the same change are made available for obligation by the affected agencies.

The Board believes the proposed amendments address the areas that need to be clarified by implementing agency regulations and that the proposed concurrent processing requirement does not go beyond the control of the cognizant Federal agency official. Accordingly, the proposed provisions have been retained. The ANPRM language in 9903.201–7 (a) and (d)(2)(iii) was revised based on the commenter's editorial suggestions and expressed concerns on funding.

Cost Impact Process

Comment: A number of commenters expressed the view that proposed rules for the cost impact process were too rigid and did not allow sufficient flexibility. Others feared that existing local agreements on cost impact methodology could not continue once the proposed rule becomes a final rule.

Response: The intent of the ANPRM was to place emphasis on materiality and to allow alternative methods with regard to resolving a cost impact due to changes in accounting practices. The Board believes that the frequent use of the concept of materiality throughout the proposed 9903.4; the allowance for use of ''other suitable techniques'' in 9903.405–5(c)(3) and 9903.405–5(d)(5); the flexibility in establishing appropriate materiality thresholds; and the allowance for alternative formats for the General Dollar Magnitude (GDM) and Cost Impact Settlement Proposal; provide sufficient latitude to the contracting parties to resolve a cost impact and does not constitute a ''rigid'' process.

Comment: Several commenters suggested that the GDM and Cost Impact Settlement Proposal formats included in the ANPRM be deleted since they may be construed to be required ''forms'' or the only acceptable formats by some cognizant Federal agency officials.

Response: The illustrated formats are not to be considered required ''forms'' or the only acceptable formats. They are included as an example of one acceptable presentation of a GDM and Cost Impact Settlement proposal. Inclusion of an acceptable format aids those cognizant Federal agency officials, as well as contractors, that have little experience with the cost impact process, particularly in the civilian agencies. To further emphasize that other formats may be used, the Board has added a clarifying sentence at 9903.405–4(a)(4) and substituted the word ''acceptable'' for ''suggested'' prior to the display of the illustrated formats.

Comment: One commenter suggested deletion of various provisions included in the ANPRM based on the view that they represented opinion or detailed instructions and do not belong in the Board's rule or regulation.

Response: The Board agrees in part and has deleted some, but not all, of the provisions suggested by the commenter.

Comment: A number of contractor respondent's requested that specific timing requirements be included in 9903.4 for the actions to be taken by the cognizant Federal agency official. They saw an inequity in specifying timing requirements for contractors, but not for Government officials.

Response: The Board expects that the various Federal agencies will establish appropriate regulations to implement the procedures and suggested time frames included in proposed Subpart 9903.4, and believes that such agency regulations are the appropriate place to detail specific administrative timing requirements for cognizant Federal agency officials. The Board encourages the Federal agencies to place appropriate emphasis on timeliness in completing the cost accounting change cost impact process in order to avoid the inefficiency problems caused by delays in the process which have been experienced in the past.

Comment: Other industry respondents requested a provision which would provide for an irrevocable presumption of adequacy and compliance of an accounting practice change in the event that the cognizant Federal agency fails to make a formal determination within the suggested 60 day period included at 9903.405(c)(i) in the ANPRM.

Response: The Board disagrees. A contractor's cost accounting practices must comply with applicable Cost Accounting Standards. Failure by Federal officials to act in a timely manner does not create a waiver from the Board's rules and regulations. As previously mentioned, the Board encourages timely action by all responsible parties, including Federal agencies. For this reason, the Board has retained, in the NPRM being promulgated today, suggested time frames for when actions are to be taken by the cognizant Federal agency official.

Comment: One commenter objected to the requirement precluding use of planned changes in cost accounting practices in price proposal estimates, claiming that contractor's can use changed practices for estimating immediately.

Response: The Board, in researching this issue, learned that a lack of consistency exists when contractors begin using a changed cost accounting practice to estimate costs in price proposals. Some used immediate implementation, while others waited until the cognizant Federal agency official made a determination of adequacy and compliance. The Board believes that a consistent and uniform approach is desirable and that waiting for an adequacy and compliance determination is the preferable method. Obtaining an adequacy and compliance determination prior to implementation will avoid the potential implementation of a noncompliant cost accounting practice when estimating costs in price proposals. The Board notes that the proposed period of delay in implementation of the new practice in only a maximum of 60 days. To make this requirement equitable and to prevent potential financial harm to contractors, the Board is also proposing to establish a new exemption from the voluntary change increased cost preclusion provisions for contracts negotiated between the notification date and effective date of a planned change in cost accounting practice. This new exemption appears at 9903.405–2(f) and 9903.405–5(d)(7).

Comment: Several commenters opined that requiring advance notification of a change in accounting practices made to comply with a new or revised Standard that would become applicable to existing covered contracts only through the subsequent award of a covered contract, i.e., a required change, was unreasonable, if not impossible. They suggested that notification be made sometime after the award of the contract which made the new or revised Standard applicable to a CAS-covered

contractor, rather than 60 days prior to the effective date of the new or revised Standard.

Response: The Board agrees that notification prior to the effective date of the Standard may not always be required or practical, but disagrees that notification should be delayed until after award of the contract which made the new or revised Standard applicable. The effective date of a new or revised Standard is the Standard's specified effective date after which a CAS-covered contractor must comply with the new or revised Standard when estimating costs for a contemplated contract, that if awarded, will make the Standard applicable to the contractor. Therefore, if a contractor's current practice does not comply with the new or revised Standard, the contractor must use a compliant practice in the first such price proposal submitted after the Standard's effective date. A decision to make this required change obviously must be done some time before the submission of the proposal. Clearly, if a contractor has used a compliant practice for estimating purposes which is different than an established practice due to a required change, it is not unreasonable to expect that the contractor will disclose this to the cognizant Federal agency official. Therefore, the Board proposes to require that advance notification of such required changes in cost accounting practice shall occur no later than 60 days prior to the submission of the price proposal in which the contractor must first use the required change to estimate costs for a potential CAS-covered contract, or other date to which both parties mutually agree.

Comment: Several commenters took exception to the requirement to use estimates-to-complete in lieu of original cost estimates for computing the cost impact due to a compliant change in cost accounting practices on individual contracts. One respondent commented that estimates-to-complete should only be used when a significant part of the contract effort has been performed.

Response: The Board believes that use of estimates-to-complete in lieu of original estimates better measures the true impact of a change in cost accounting practice because it applies the new practice only to the contract effort for which the new practice will be used for cost accumulation and reporting purposes. Distortions between planned contract performance and actual contract performance can lead to distorted cost impact computations if original estimates are used. The use of estimates-to-complete is also consistent with the prescribed methodology for pricing change orders which add and/or delete contract work. The Board acknowledges that in cases where little contract effort has been performed, there should be virtually no difference between using an estimate-to-complete as compared to the original estimate methodology.

Comment: One commenter stated that the computation and completion of a GDM was a difficult and costly exercise.

Response: Current Federal regulations already require the submission of GDM estimates by contract type and by agency, and have so for a long time. The Board's proposed GDM approach requires summary data only by contract type. The Board anticipates the existing requirement for summary data by agency would eventually be deleted from the procurement regulations because of the emphasis the Board is placing on the individual contract data included in the cost impact settlement proposal. Any agency having a CAS-covered contract that is significantly affected by an accounting change will receive adequate coverage and protection via the submission of a cost impact settlement proposal based on materiality thresholds. Although computing an accurate and reliable GDM may be difficult in some circumstances based on the complexity and number of accounting practice changes, the information is essential to the cognizant Federal agency official in determining the appropriate adjustments required to protect the financial interests of the Government when a change in cost accounting practice occurs.

Comment: A number of commenters suggested combining the GDM and Cost Impact Settlement Proposal into one consolidated submission.

Response: The GDM and the contractor cost impact settlement proposal submissions serve different purposes. The GDM is intended to provide summary data by contract type of the overall impact to the Government as a result of an accounting change. The cost impact settlement proposal is intended to provide a basis for resolving the cost impact proposal without requiring a detailed cost impact proposal. To streamline contractor submissions, the two may be combined provided that the GDM is separately presented on the first page of the combined submission.

Comment: One commenter objected to the requirement to submit additional contract data during the cost impact settlement proposal stage, suggesting that, if no settlement can be reached based on the data initially submitted, a detailed cost impact settlement proposal should be required.

Response: The Board believes that the interests of both the Government and CAS-covered contractors are served best if the data submission requirements are kept to a minimum. The Board visualizes instances where a contractor could supplement contract data included in the initial cost impact settlement proposal with a few additional contracts in order to provide sufficient information to resolve a cost impact. The proposed supplemental approach would be less costly and should result in a more timely resolution of a cost impact than if a contractor had to put together a separate and distinct detailed cost impact proposal having different and significantly more data requirements. The Board believes that once this process is put into actual practice, the superiority of the supplemental data approach over a detailed cost impact proposal will be borne out.

Comment: A number of commenters suggested switching the definitions of offsets and netting.

Response: Although never previously defined in a formal rule or regulation, the term ''offsets'' has acquired a connotation that most individuals familiar with the cost impact process have adopted over the years, i.e., the process of combining cost increases with cost decreases to arrive at a net smaller cost impact number than the individual contract cost impact amounts. The term offset has also taken on the concept of a technique used to reduce the number of individual contract price or cost adjustments that need to be made as a result of a change in cost accounting practice, or a failure to comply with cost accounting standards or established practices. The Board does not wish to disturb these accepted connotations and concepts. On the other hand, the process of determining to what extent increased costs may occur as a result of a voluntary change in cost accounting practices, although always required, has never been specifically identified. The Board believes that for clarity's sake, the process should be defined, and has dubbed this process ''netting''.

Comment: Several commenters expressed the view that offsets should be permitted between different types of contracts.

Response: The proper application of offsets has long been a source of confusion and controversy. For this reason, the Board has chosen to make it explicit that offsets shall only be made within the same type of contract. The primary rule of offsets is that use of the

technique should not result in costs paid by the Government that are materially different from that which would result if all affected contract prices had actually been adjusted. This rule cannot be met if offsets are applied to different types of contracts, particularly between flexibly priced and firm fixed-price contracts. The Board believes that use of the offset technique will be minimized by the individual contract materiality threshold concept included in the proposed 9903.405.

Comment: One commenter asked if offsets will be limited to the ''all other contract'' category under the proposed rule.

Response: For single changes in cost accounting practices within an individual business unit or segment, offsets will in most, but not necessarily all, cases be limited to the ''all other contract'' category. The provision at 9903.405–5(b)(3) does allow for the offset technique to be applied to individual contracts, provided that it does not materially reduce the amount of the price adjustment to contracts exceeding the individual contract materiality threshold, or reduce the cost impact to these contracts to an amount below the threshold. For multiple changes within the same business unit, offsets are applied to the same contract to the extent that one or more changes may have an upward impact while other changes have a downward impact on the same contract, as provided by 9903.405–5(b)(4). Offsets are also applied between different business units or segments for changes that affect multiple segments to mitigate action that needs to be taken to preclude increased costs, as provided by 9903.405–5(b)(6).

Comment: One commenter suggested that the Board add an illustrative chart at 9903.405–5(d) to clarify what adjustments should or should not be made to the various types of contracts in order to preclude payment of increased costs when a voluntary change is made.

Response: The Board agrees that such a chart would provide useful clarifying information and has inserted a chart at 9903.405–5(d)(3).

Comment: One commenter suggested that the concept of ''potential increased cost paid'' be added to the definition of ''increased cost paid''.

Response: The Board finds no useful purpose to such a definition. The Board has defined increased costs as they relate to changes in accounting practices, cost estimating noncompliances and cost accumulation noncompliances. These definitions, when taken together, constitute potential increased costs paid. Increased costs paid occurs when the increased costs to CAS-covered contracts, as defined, is actually paid by the United States. Procedures described in 9905.405–5(d), 9903.406–3 and 9903.406–4 set forth action that can be taken to preclude or reduce the payment of increased costs, as well as appropriate action to recover the increased costs once they have been paid.

Comment: One commenter argued that the Board had exceeded its authority as a result of the definition of increased cost on firm fixed-price contracts and the method prescribed to recover such increased costs, and further suggests that such recovery is tantamount to an unauthorized penalty.

Response: The Board strongly disagrees with these arguments. When a downward price adjustment is made to a fixed-price contract to reflect a lesser allocation of costs resulting from a change in cost accounting practices, no penalty is placed on the contractor. The adjustment does no more than reduce the contract price so that it is consistent with those accounting practices actually used during contract performance. Without this adjustment, the contractor would receive an unjustified enlargement of profit due merely to a shift of costs caused, not by the elimination of costs, but by a change in cost accounting practices. Clearly, payment of this unwarranted windfall represents increased costs to the Government. The contract price adjustment provisions for changes in cost accounting practices included in the CAS contract clause are meant to preclude the payment of these increased costs, as well as to adjust contract values so that they are consistent with the contract costs accumulated during contract performance.

Comment: One commenter asked that the Board develop and prescribe specific materiality threshold amounts for contract price adjustment purposes.

Response: Consistent with the Board's decision not to specify precise amounts in the materiality provisions at 9903.305, the Board believes the establishment of specific materiality threshold amounts for adjustments of contract prices due to changes in cost accounting practice is best left to the cognizant Federal agency official based on the individual circumstances involved and discussions with the contractor.

Comment: A number of commenters expressed concern about the difficulty in obtaining the funding to effect the contract price adjustments negotiated for changes in cost accounting practices.

Response: Although the funding issue is a legitimate concern, it is one which all of the contracting parties that are affected by changes in cost accounting practices must work with the cognizant Federal agency official to overcome.

Comment: Several contractor commenters expressed the view that a noncompliance that does not result in a material increase in costs to the Government should not be considered a noncompliance, and asked that the provision on Technical Noncompliance at 9903.406–5 be deleted.

Response: The Board does not agree with the commenters' position. Once a cognizant Federal agency official determines that a practice is noncompliant, there is no reason why some subsequent determination has to be made again in the future. Any significant increased costs paid as a result of the noncompliant condition in the event that the impact of the noncompliance subsequently becomes material, should be immediately recoverable by the Government with applicable interest. This serves to discourage the continued use of a noncompliant practice, regardless of materiality and best protects the interests of the Government when a noncompliant practice exists.

Restructuring Activities

Comment: The ANPRM will discourage restructuring activities.

Response: Some commenters *erroneously* interpreted the Board's proposal to mean that the net savings attributable to restructuring activities will be included in the measurement of the cost impact of any cost accounting practice changes resulting from the restructuring activities. The cost impact process deals only with the greater or lesser allocation of total ongoing costs to individual contracts resulting from a change in cost accounting practice. Savings due to reductions in the costs of ongoing functions or changes in the level of costs are not subject to adjustment under CAS and are not to be included in cost impact estimates.

Educational Institutions

Comment: A university suggested that the Board comment on how the cost impact process should be handled during periods when predetermined rates are in effect. When would GDM and Cost Impact Settlement Proposals be required? The Board should consider the effect of the proposed regulation on educational institutions if extended to grant and cooperative agreements awards under OMB Circular A–21.

Response: In a predetermined rate environment, the basic underlying

assumption is that the educational institution's cost accounting practices, e.g., the classification of a cost as either a direct cost or an indirect cost, will be followed consistently during the multi-year periods covered by such rates. The predetermined indirect cost rates are predicated upon cost data for one base year which may be adjusted to reflect future year cost levels for the periods to be covered. The base year data is accumulated and forecasted in accordance with the institution's established cost accounting practices.

Once established, the predetermined indirect cost rates are applied to appropriate estimated base costs to determine the estimated indirect costs included in cost proposals for potential awards. After award, as sponsored agreements are actually performed, the predetermined rates are also applied to the actual base costs that are accumulated in accordance with the institutions's established cost accounting practices.

To be consistent, the cost accounting practices used to determine indirect pool costs and allocation base costs forecasted for the covered years must be followed consistently when proposal costs are estimated and when actual costs are accumulated and reported during the covered periods. Should there be any changes in cost accounting practices (e.g., if an indirect cost were to be reclassified as a direct cost), while a sponsored agreement is actually performed, the set of assumptions or conditions regarding the composition of the pools and allocation bases used to establish the predetermined rates and the estimated cost proposal would be changed to a different set of conditions. In such cases, the continued application of the same predetermined indirect cost rate in such circumstances could result in the inconsistent allocation of costs and inequitable claims for the reimbursement of actual costs. A contract price or cost adjustment may be required for such changes under the Board's rules.

To minimize or preclude over- or under-payments resulting from ''compliant'' changes in cost accounting practices, educational institutions are required to notify their cognizant Federal agency officials of any planned changes in cost accounting practice. If necessary, appropriate revisions to reflect the cost impact of a change in cost accounting practice on a predetermined rate should be effected promptly. This could minimize or preclude the need for subsequent cost or price adjustments attributable to a compliant accounting change.

The Board agrees with the commenter that the cost impact process should be uniformly applied in an efficient and economical manner for all Federal awards affected by a compliant cost accounting practice change or a noncompliance. Therefore, certain unique provisions, including specified agency waiver authority, applicable solely to educational institutions that are subject to OMB Circular A–21, have been included in the NPRM being promulgated today.

Comment: One university suggested that the contract clause for educational institutions at 9903.201–4(e) also be updated.

Response: The referenced clause became effective on January 9, 1995, and the Board does not believe sufficient time has elapsed to warrant its revision at this time. Further comments on the desirability of conforming the clause with the language being proposed today for the ''Full'' and ''Modified'' clauses are requested. If there is support for such revision, the Board will consider updating the clause in the final rule.

F. Additional Public Comments

Interested persons are invited to participate by submitting data, views or arguments with respect to this NPRM. All comments must be in writing and submitted to the address indicated in the **ADDRESSES** section of this NPRM. Computer diskette copies of your comments in WordPerfect 6.1 or other format that is compatible with WordPerfect will be appreciated.

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

Changes in cost accounting practices:

—Proposed 9903.302–2(c) would exempt certain changes in cost accounting practices from contract price or cost adjustment and the cost impact process.

Contract price and cost adjustment process:

—Proposed 9903.201–6(b) establishes new criteria for determining when a voluntary change in cost accounting practice may be treated as a desirable change.

—Proposed 9903.405–2(b)(1) requires CAS-covered contractors to notify the Government of and fully disclose changes in cost accounting practices that are required to comply with a new or modified Standard or interpretation thereof 60 days prior to the submission of a price proposal in which the contractor first uses the required change to estimate costs for a potential CAS-covered contract or subcontract.

—Proposed 9903.405–2(b)(2) establishes new notification requirements for voluntary and desirable changes.

—Proposed 9903.405–2(f) provides a new equitable adjustment provision for contracts negotiated within 60 days after a contractor notifies the Government of a voluntary change that would otherwise be subject to a CAS-covered contract's no increased cost provision.

—Proposed 9903.405–4(b) provides for the use of a cost impact settlement proposal that would permit early resolution of the estimated cost impact in lieu of the use of a detailed cost impact proposal.

List of Subjects in 48 CFR Part 9903

Cost accounting standards, Government procurement.

Richard C. Loeb,

Executive Secretary, Cost Accounting Standards Board.

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

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

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

PART 9903—CONTRACT COVERAGE

Subpart 9903.2—CAS Program Requirements

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

9903.201–4 Contract clauses.

(a) *Cost Accounting Standards—Full Coverage.* (1) The contracting officer shall insert the clause set forth below, 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.

* * * * *

COST ACCOUNTING STANDARDS—FULL COVERAGE

(AUGUST 1996)

(a) The provisions of Part 9903 of 48 CFR, Chapter 99, including the definitions and requirements contained therein, are

incorporated herein by reference and the Contractor, in connection with this contract, shall—

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

(2) Changes in Cost Accounting Practices. Follow consistently the Contractor's cost accounting practices in accumulating and reporting contract performance cost data concerning this contract. If any change in cost accounting practices is made for the purposes of any CAS-covered contract or subcontract, the change must be applied prospectively from the date of applicability to this contract and the Contractor's Disclosure Statement must be amended accordingly. If the contract price or cost of this contract is materially 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 materially 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 materially 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 materially affected by a change in cost accounting practice made by the contractor or a subcontractor that the cognizant Federal agency official finds to be desirable change.

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

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

(c) Access to records. The Contractor shall permit any authorized representatives of the Government to examine and make copies of any books, records, documents, papers, or records, regardless of form (e.g., machine readable media such as disk, tape, etc.) or type (e.g., data bases, applications software, data base management software, utilities, etc.) relating to compliance with the requirements of this clause.

(d) Flowdown to Subcontracts. Unless the subcontract is exempt under 9903.201, 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, including any applicable modifications or interpretations thereto, in effect on the subcontractor'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, except that if the subcontract is awarded to a business unit which pursuant to 9903.201–2 is subject to other types of CAS coverage, the substance of the applicable clause set forth in 9903.201–4 shall be inserted.

(End of clause)

* * * * *

(c) *Cost Accounting Standards—Modified Coverage.* (1) The contracting officer shall insert the clause set forth below, 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 clause below requires the contractor to comply with CAS 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 1996)

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

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

(2) Changes in Cost Accounting Practices. Follow consistently the Contractor's cost accounting practices in accumulating and reporting contract performance cost data concerning this contract. If any change in cost accounting practices is made for the purposes of any CAS-covered contract or subcontract, the change must be applied prospectively from the date of applicability to this contract and the Contractor's Disclosure Statement must be amended accordingly. If the contract price or cost of this contract is materially 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 materially 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 materially 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 materially affected by a change in cost accounting practice made by the contractor or a subcontractor that the cognizant Federal agency official finds to be a desirable change.

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

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

(c) Access to records. The Contractor shall permit any authorized representatives of the Government to examine and make copies of any books, records, documents, papers, or records, regardless of form (e.g., machine readable media such as disk, tape, etc.) or type (e.g., data bases, applications software, data base management software, utilities, etc.) relating to compliance with the requirements of this clause.

(d) Flowdown to Subcontracts. Unless the subcontract is exempt under 9903.201, 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, including any applicable modifications or interpretations thereto, in effect on the subcontractor'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, except that if the subcontract is awarded to a business unit which pursuant to 9903.201–2 is subject to other types of CAS coverage, the substance of the applicable clause set forth in 9903.201–4 shall be inserted.

(End of clause)

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

9903.201–6 Desirable changes.

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

(b) The determination as to whether or not a change in cost accounting practice is desirable should be made on a case-by-case basis in accordance with, but not limited to, the following criteria:

(1) A change in cost accounting practice shall be deemed to be desirable and not detrimental if the cognizant Federal agency official determines that, for a Cost Accounting Standard which the contractor has complied with, the change is necessary in order for the contractor to remain in compliance with that Standard.

(2) The cognizant Federal agency official shall determine that a change in cost accounting practice is desirable and not detrimental if the change from one compliant practice to another compliant practice was recommended in writing by the cognizant Federal agency official and the Contractor agrees to make the change.

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

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

9903.201–7 Cognizant Federal agency responsibilities.

(a) The requirements of 48 CFR Chapter 99 shall, to the maximum extent practicable, be administered by the cognizant Federal agency responsible for a particular contractor organization or location, usually the Federal agency responsible for negotiating indirect cost rates on behalf of the Government. The cognizant Federal agency should take the lead role in administering the requirements of Chapter 99 and coordinating CAS administrative actions with all affected Federal agencies. When multiple CAS-covered contracts and/or subcontracts or more than one Federal agency are involved, the cognizant Federal agency official and affected agencies shall coordinate their activities in accordance with the responsibilities specified in paragraph (d) of this section. Agencies should discourage agency officials from individually administering CAS on a contract-by-contract basis. 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) *Responsibilities.*

(1) The cognizant Federal agency official shall:

(i) Make all required determinations for all CAS-covered contracts and subcontracts.

(ii) Coordinate with affected agencies when developing the Government's negotiation position regarding settlement of the overall cost impact and 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) Request affected agencies to prepare implementing contract modifications and to obtain implementing subcontract modifications from their 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.

(vi) 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:

(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.

Subpart 9903.3—CAS Rules and Regulations

5. Section 9903.301 is amended by adding two definitions to read as follows:

9903.301 Definitions.

(a) * * *

* * * * *

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

* * * * *

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

* * * * *

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

9903.302 Definitions, explanations, and illustrations of the terms, ''cost accounting practice'' and ''change to a cost accounting practice.''

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 systematically 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 determinations made on:

(i) How a cost is to be accumulated in the contractor's cost accounting system,

(ii) Whether a cost is to be directly or indirectly allocated to final cost objectives,

(iii) The selection and composition of cost pools, and

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

(2) The selection of cost pools involves the determination to establish one or more homogeneous cost pools for the accumulation of specific costs to be allocated to other intermediate and/or to specific final cost objectives at specified locations. Normally, separate pools are established for specific functional activities, e.g., for a specified assembly operation within a particular segment. The composition of cost pools involves the determinations to identify and accumulate, by specific 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 activity (e.g., labor hours, square footage) or cost data (e.g., labor dollars, total cost input) will be used as the basis for the allocation of the total costs accumulated in each pool to intermediate and/or final cost objectives at specified locations. Normally, the allocation base activity selected for each pool is the activity that best represents the causal or beneficial relationship between the pooled costs and the base activity. The composition of an allocation base involves the determination to collect and accumulate the selected base activity data for a particular function, or group of functions, associated with each established pool. The composition of a business unit allocation base includes the specific cost and/or functional groupings within the base. The composition of a home office allocation base includes the grouping of segments within the applicable base. Examples of allocation bases include direct engineering labor hours for a specific direct engineering function performed at a specified location, total cost input of a particular segment, total payroll costs for specific segments reporting to the same group or home office.

* * * * *

7. Section 9903.302–2 is 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 from an existing indirect cost pool to a different pool or pools.

(b) *Exceptions.*

(1) The initial adoption of a cost accounting practice for the first time a cost is incurred, or a function is created, is not a change in cost accounting practice. This exception shall be applied at the segment or company-wide 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 segment to another 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.

(4) The transfer of an existing ongoing function from a segment's existing overhead or G&A indirect cost pool to a different pool is not a change in cost accounting practice *provided*:

(i) The ongoing costs are directly allocated back to the original pool for reallocation to final cost objectives, and

(ii) The segment continues to identify and accumulate the directly allocated cost of the function within the same pool in the same manner as was done before the change.

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

(1) Changes in cost accumulation practices that result due to a transfer of functions or merger of cost pools which are undertaken for improved management efficiencies and effectiveness and which involve the physical realignment or reduction of facilities or personnel.

(2) Changes in the selection and/or composition of an overhead or general and administrative expense pool resulting from the consolidation of existing pools or the expansion of an existing pool into two or more pools that are not exempt under paragraph (c)(1) of this section but meet all of the following conditions:

(i) The elements of cost and the functions included in the original and resultant merged or split-out pools remain the same. After the change, the costs of the ongoing functions are identified and accumulated in the resultant merged pool or split-out pools in the same manner and at the same level of detail.

(ii) The selected activity used as the allocation base remains the same for the affected pools. After the change, the merged allocation base activity or split-out allocation base activity is identified and accumulated in the new merged allocation base or split-out allocation bases.

(iii) The merged or split-out pools involve the allocation of similar pooled overhead or G&A costs to similar final cost objectives where the underlying levels of pooled costs and allocation base activity involve similar proportional relationships. Pools shall be considered similar if, after the change, the resultant pools are homogeneous (see 9904.418–50(b)) and the rates (or rate) used to allocate pooled indirect costs to final cost objectives fall within a corridor of plus or minus one percent of the rate (or rates) that would have resulted if the combination or expansion had not occurred. The comparison shall be based on the same level of ongoing pooled costs and allocation base activity that is expected to occur after the change is made. For example, if under the original cost accounting practices followed for a single pool the overhead recovery rate would be 200%, then the resultant split-out rates must fall within the corridor of 198% to 202%. In the case of a combination of pools and their respective allocation bases, the corridors around the two original rates that would result if there were no combination must converge or overlap to be considered similar, e.g., if the continued use of two pools would result in rates of 101% and 99%, their respective corridors of 100% to 102% and 88% to 100% would overlap.

* * * * *

8. Section 9903.302–3 is 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)(11) 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 through analysis of the circumstances of each individual situation based on the definitions and exceptions specified in 9903.302–1 and 9903.302–2.

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

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

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

Description	Accounting treatment
* * * *	* * *
(3) The contractor changes to a different allocation base.	(3)(i) Before change: The contractor used a direct manufacturing labor hours base to allocate costs accumulated in the manufacturing overhead pool to final cost objectives. (ii) After change: The contractor uses a direct manufacturing labor dollars base to allocate costs accumulated in the manufacturing overhead pool to final cost objectives. (iii) The described change from a direct labor hours base to a direct labor dollars base represents a change in the selection of the allocation base activity.

Description	Accounting treatment
(4) A Segment combines two similar ongoing functions. (i) For internal management and financial reporting purposes, the ongoing direct and indirect assembly operations at Plants A and B are merged into a new combined plant-wide pool.	(4)(i) Before change: The Segment established separate assembly overhead pools to accumulate the indirect costs applicable to Plant A's and Plant B's respective assembly functions. Pooled costs were allocated to individual final cost objectives based on Plant A's and Plant B's respective assembly direct labor dollars allocation bases. (ii) After change: The indirect costs of the two ongoing assembly functions are combined and accumulated in one indirect assembly cost pool. Pooled costs are allocated to individual final cost objectives based on a total assembly direct labor dollars allocation base applicable to the two plant locations. (iii) A cost accounting practice change occurred because the selection and composition of the pool has changed and the composition of the allocation base has changed. (iv) Because the pools were combined, the specific indirect costs associated with Plant A and Plant B are now accumulated in one pool and are allocated to all individual final cost objectives performed at both Plants A and B.
(5) Assume the same circumstances as in (4) above except that Plant A is closed. (i) The contractor's total overall costs of operations are reduced. (ii) The change involves reductions and/or transfers of employees and the sale of various physical assets by both Segments.	(5)(i) The merging of the two indirect cost pools into one indirect cost pool and the merging of the two allocation bases resulted in a cost accounting practice change for the same reasons cited in (4) above. (ii) The change resulted in economies and efficiencies due to physical changes and reductions in personnel. The CAS-covered contracts that were affected by the change in practice are not subject to contract price and cost allowance adjustment or the cost impact process under the exemption provided by 9903.302–2(c)(1).
(6) Assume the same circumstances as in (4) above except that the two ongoing assembly functions continue to operate in the same manner before and after the change and that the two plants otherwise remain unchanged.	(6)(i) The merging of the two indirect cost pools into one indirect cost pool and the merging of the two allocation bases resulted in a cost accounting practice change for the same reasons cited in (4) above. (ii) If the merged indirect cost pools were determined to be similar under the exemption criteria provided at 9903.302–2(c)(2), then the CAS-covered contracts that were affected by the change in practice would not be subject to contract price and cost allowance adjustment or the cost impact process.
(7) Assume the same circumstances as in (4) above except that Plants A and B are separate Segments A and B that are combined as Segment C for management reporting purposes.	(7)(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 (4) above, a cost accounting practice change has occurred. Because the number of pools established by the contractor has changed, the specific costs associated with Segments A and B are now allocated to all of the individual final cost objectives performed by both Segments A and B. (iv) If either one of the exemptions contained in 9903.302–2(c) applies, then the CAS-covered contracts that were affected by the change in practice would not be subject to contract price and cost allowance adjustment or the cost impact process.
(8) 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.	(8)(i) Before change: The indirect costs applicable to the manufacturing and assembly functions were accumulated in a plant-wide indirect cost pool and allocated to final cost objectives by use of a direct labor dollars base comprised of manufacturing and assembly direct labor dollars. During each cost accounting period, a single plant-wide indirect cost rate was used to allocate the accumulated indirect costs to individual final cost objectives. (ii) After change: The ongoing indirect manufacturing and assembly costs are split-out and accumulated separately in a manufacturing pool and assembly pool. The pooled costs are allocated to final cost objectives by use of a manufacturing direct labor dollars base and an assembly direct labor dollars base, respectively. Two indirect cost rates are now used to allocate the ongoing indirect costs to individual final cost objectives.

Description	Accounting treatment
	(iii) The decision to accumulate the ongoing costs of the manufacturing and assembly functions separately, in two pools instead of one, represents a change in the selection and composition of the pool. The decision to allocate the accumulated pool costs to final cost objectives by use of separate allocation bases for the manufacturing and assembly functions instead of one plant-wide allocation base represents a change in the composition of the base.
(9) The contractor transfers the incoming materials inspection function. (i) Incoming materials are inspected in the same manner before and after the change.	(9)(i) Before change: The cost of performing the incoming inspection function was accumulated in an intermediate cost objective that was included in the Segment's manufacturing overhead expense pool. Accumulated pool costs were allocated to final cost objectives based on manufacturing direct labor dollars. (ii) After change: The accumulated cost of the incoming inspection function is included in the Segment's materials handling overhead pool. These pooled costs are allocated to final cost objectives based on direct material costs. (iii) The decision to include the accumulated cost of the ongoing inspection function in a different cost pool represents a change in the composition of the two pools. 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 activity for the incoming inspection function.
(10) 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 contractor's new 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.	(10) As of the effective date of acquisition, the contractor requires the new segment to group, accumulate and distribute 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 cost of the ongoing functions will be grouped and accumulated in different indirect expense pools and allocated to different final cost objectives by use of two allocation bases split-out from the previously used single base. (i) The changes made by the acquiring contractor represent changes in the selection and composition of the pools and the composition of the bases for the acquired CAS contracts. Unless one of the exemptions at 9903.302–2(c) applies, 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.
(11) A contractor expands the existing product line of Segment A by acquiring another company. Both entities are performing CAS-covered contracts. (i) The acquired company will be absorbed by Segment A. (ii) Segment A will complete the acquired CAS-covered contracts that were novated from the prior company to the contractor.	(11)(i) As of the effective date of acquisition, Segment A merges the continuing costs of the acquired company's ongoing functions into Segment A's indirect cost pools and allocation bases, in accordance with Segment A's established cost accounting practices. Segment A's pool and base now include the ongoing functions of both Segment A and the acquired company. (ii) The costs of the contractor's existing contracts will be accumulated and reported differently than when the contract costs were estimated. The newly established allocation bases and indirect cost pools include both the existing and acquired ongoing functions. (iii) The pool and base combinations made by the acquiring contractor represent changes in the selection and composition of the pools and bases for the existing Segment and acquired company. Unless one of the exemptions at 9903.302–2(c) applies, the cost accounting practice changes are subject to the contract price and cost adjustment provisions of the existing and acquired CAS-covered contracts. (iv) The exceptions 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 existing or acquired CAS-covered contracts.

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

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

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

Description	Accounting treatment
* * * *	* * *
(h)(1) The contractor consolidates the accounting functions performed directly by Segment A and Segment B. A new service center is established within Segment B to perform the accounting function for several segments.	(h)(1) (i) Before the change, Segments A and B each directly identified and accumulated the cost of their accounting functions in intermediate cost objectives that were included in their respective G&A expense pools. (ii) After the change, the costs of performing the accounting function for Segment A and the other segments are accumulated directly by Segment B in a newly established accounting service center cost pool. Segment B allocates the accumulated service center costs to the benefiting Segments based on actual usage factors. Segments A and B continue to identify and accumulate the accounting service cost charges received from Segment B in their respective Segment G&A expense pools. (iii) Since Segments A and B continued to specifically identify and accumulate the contractor's costs of performing Segment A's and B's accounting functions in their respective G&A expense pools, before and after the change, no change in the contractor's established cost accounting practices has occurred.
(h)(2) Assume the same circumstances as in (h) above, except that after the change the function is performed by a home office.	(h)(2) (i) Before the change, Segment A directly identified and accumulated the cost of its accounting functions in an intermediate cost objective that was included in its G&A expense pool. (ii) After the change, the costs of performing the accounting function for Segment A and the other segments are accumulated directly by the home office and the accumulated costs are allocated to the benefiting Segments based on actual usage factors. Segment A continues to identify and accumulate the accounting service cost charges received from the home office in the Segment's G&A expense pool. (iii) Since Segment A continued to specifically identify and accumulate the contractor's costs of performing Segment A's accounting functions in the G&A expense pool, before and after the change, no change in the contractor's established cost accounting practices has occurred. (iv) A change in cost accounting practice would occur if Segment A no longer accumulated the costs of its ongoing accounting functions in the same intermediate cost objective, in the G&A pool, e.g., if Segment A were unable to do so because the contractor accumulated the costs of the accounting functions with other costs at the home office and allocated the combined costs to Segments on a common usage base or as residual expense.
(i) The contractor transfers an inspection department employee from Plant A to Plant B.	(i)(1) Before the transfer, the employee's salary was identified and accumulated as inspection labor in Plant A's overhead pool. (2) After the transfer, the employee's salary is similarly identified and accumulated in Plant B's overhead pool. The salaries of all other employees performing the inspection function at Plants A and B continue to be identified and accumulated in their respective pools. (3) Since the cost of the inspection functions at Plants A and B continue to be identified and accumulated within the same pools, before and after the change, no change in cost accounting practice has occurred.
(j) 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.	(j)(1) After change: The costs of the contractor's home office continue to be accumulated and allocated to segments in the same manner. The new segment is added to the home office allocation base or bases used to allocate home office costs to all segments. (2) The addition of the new segment to the 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 pool and applicable allocation bases were not otherwise changed, the described home office change is not a cost accounting practice change requiring contract price or cost adjustments.
(k) Assume the same circumstances as in (j) above, except that: (1) The contractor acquired a new segment that is performing CAS-covered contracts from another company.	(k)(1) For the reasons stated in (j) above, the described home office change is not a cost accounting practice change.
(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.	(2) At the segment level, the first time incurrence of the acquiring contractor's home office cost allocation is an initial adoption of a cost accounting practice (see exception at 9903.302(b)(1)). Since the contractor adopted the acquired segment's previously established cost accounting practices, no change in established cost accounting practices occurred for the acquired CAS-covered contracts.

10. Section 9903.302–5 is added to read as follows:

9903.302–5 Mergers and Acquisitions.

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

(b) When a contractor or a segment performing a CAS-covered contract is acquired by a different contractor through a merger or acquisition, the acquired contractor 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 contractor or segment. 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.

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

9903.306 [Removed and Reserved]

11. Section 9903.306 is amended by removing and reserving the section.

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
9903.403 Definitions.
9903.404 Materiality determination for making adjustment.
9903.405 Change in Cost Accounting Practice.
9903.405–1 General.
9903.405–2 Notification of Changes in Cost Accounting Practices.
9903.405–3 Determination of Adequacy and Compliance and Request for General Dollar Magnitude (GDM).
9903.405–4 Contractor Cost Impact Submissions.
9903.406 Noncompliances.
9903.406–1 General Types of Noncompliances.
9903.406–2 Determination of Noncompliance.
9903.406–3 Cost Estimating Noncompliance.
9903.406–4 Cost Accumulation Noncompliance.
9903.406–5 Technical noncompliances.
9903.407 Illustrations.
9903.407–1 Change in Cost Accounting Practice—Illustrations.
9903.407–2 Compliance 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) Subpart 9903.4 rules and regulations are to be applied uniformly to all CAS-covered contracts and subcontracts affected by a compliant change in cost accounting practices 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 noncompliance actions and changes 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 (a) for processing noncompliance actions and changes in cost accounting practices, 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) Subpart 9903.4 rules and regulations apply 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 contract price or cost adjustments for material cost impacts attributable to compliant changes in cost accounting practices and/or to noncompliant practices. Subpart 9903.4 establishes procedures for determining the required adjustments. Other Federally sponsored agreements that do not contain a CAS contract clause are subject to similar requirements under OMB Circular A–21, Cost Principles for Educational Institutions, which incorporated the Board's Disclosure Statement (Form CASB DS–2) and the CAS in part 9905. OMB Circular A–21 also requires adjustments for sponsored agreements affected by material cost impacts due to changes in compliant cost accounting practices or due to the application of a noncompliant practice used to estimate, accumulate or report the costs of sponsored agreements.

(b) The CASB and OMB requirements were designed 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 cost impact data and when determining the adjustments that may be required for individual CAS-covered contracts and other Federally sponsored agreements affected by the same change or noncompliance. The procedures applied to all Federally sponsored agreements, including CAS-covered contacts and subcontracts, should be consistent with subpart 9903.4 requirements and objectives.

(c) *Waiver authority for compliant changes.* When an educational institution changes a compliant cost accounting practice 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 section 9903.405 requirements for affected CAS-covered contracts and subcontracts if deemed necessary in order to establish appropriate alternative procedures or methods for obtaining 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 notification requirements in 9903.405–2 or the adequacy and compliance determinations required by 9903.405–3.

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 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, pursuant to such changes. Section 9903.405 also establishes procedures for adjustments of contract amounts that are materially

affected by 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 correct the noncompliant practices 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.

Applicability date means (a) 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; and (b) 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 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.

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.

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; and

(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, on contracts subject to adjustment.

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

(1) For flexibly priced CAS-covered contracts, when a greater amount of cost will be allocated to the contract than would have been allocated to it had the contractor not changed its cost accounting practices; and

(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 had the contractor not changed its cost accounting practice(s).

Increased costs due to a cost accumulation noncompliance means increased costs resulting from a contractor's failure to comply with applicable Cost Accounting Standards, modifications or interpretations thereto, or to follow its disclosed or established cost accounting practices consistently when accumulating costs under CAS-covered contracts, and such failure results in a higher amount of costs allocated to a flexibly-priced CAS-covered contract than would have been allocated to the contract 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 increased costs resulting from a contractor's failure to comply with applicable standards, modifications or interpretations thereto, or to follow its disclosed or established cost accounting practices consistently when estimating proposal costs for a contemplated contract (or subcontracts), and such failure results in a higher contract price than would have been negotiated had the contractor complied with applicable standards, modifications or interpretations thereto, or followed its cost accounting practices consistently.

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

Netting process means the technique used to determine if action needs to be taken to preclude the payment of increased costs for voluntary accounting changes not deemed desirable, by comparing the net higher allocation of costs by contract type to the net lower allocation of costs to other contract types for contracts subject to adjustment.

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

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

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

Technical noncompliance means a noncompliant cost accounting practice that does not produce material increased costs paid by the Government.

Voluntary change means a change in cost accounting practice from one compliant practice to another that a contractor with CAS-covered contracts elects to make.

9903.404 Materiality determination for making adjustment.

Contract price adjustments or actions to preclude or recover the payment of increased costs resulting from 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. A cognizant Federal agency official's determination of materiality will require judgment based on individual circumstances and discussions between the contracting parties. Such judgments, discussions and decisions should take place as soon as practicable after receipt of contractor notification of a change, or final determination of noncompliance, so as to lead to a timely resolution of the cost impact action. The cognizant Federal agency official may forego submission of a general dollar magnitude estimate or a cost impact proposal, or to adjust contracts, if the cognizant Federal agency official determines that the amount involved is immaterial based on other available data.

9903.405 Changes in Cost Accounting Practice.

9903.405–1 General.

A CAS-covered contractor shall make changes to its established or disclosed cost accounting practices when required in order to comply with applicable Cost Accounting Standards, including any modification and interpretations promulgated thereto. A contractor may change its established cost accounting practices voluntarily, provided the cognizant Federal agency official is notified of the change and the new practice complies with applicable Cost Accounting Standards. CAS-covered contracts and subcontracts affected by changes in cost accounting practices that are either required to comply with Cost Accounting Standards, modifications or interpretations thereto, or are made voluntarily for which the cognizant Federal agency official has made a finding that the change is desirable in accordance with 9903.201–6 are subject to equitable contract price adjustments. For all other voluntary accounting changes, disclosed in accordance with 9903.405–2, the cognizant Federal agency official shall take action to preclude the payment of increased costs by the United States as a result of the change, as prescribed in 9903.405–5(d). With the exception of such action to preclude the payment of increased costs for voluntary changes, the administrative procedures for handling potential contract price or cost adjustments will be consistent for all accounting changes, as set forth in the remaining paragraphs of 9903.405. Any changes in cost accounting practices that are implemented without the required notification as set forth in 9903.405–2 will be considered a failure to follow a cost accounting practice consistently, and shall be processed as a noncompliance condition in accordance with 9903.406.

9903.405–2 Notification of Changes in Cost Accounting Practices.

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

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

(1) Required changes shall be determined and disclosed as soon as practicable, but no later than 60 days before the price proposal in which the contractor first uses the required change to estimate costs for a potential CAS-covered contract, or other date to which both parties mutually agree.

(2) Voluntary and desirable changes 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 the earlier of the applicability date or 60 days before the effective date. The effective date on which the contractor shall begin using the new practice for cost estimating and negotiating purposes is the earlier of:

(i) 60 days after notification of the change in accounting practice; or

(ii) The date of determination by the cognizant Federal agency official that the revised accounting practice is adequate and compliant (or other date to which both parties mutually agree).

(c) Contractors are encouraged to make early notification of changes in cost accounting practices in order to increase the time between the effective date and applicability date. This will decrease the number of contracts existing on the applicability date that were awarded based on the old cost accounting practice. Early use of the new practice in estimating proposal costs should lessen the number of contracts and subcontracts subject to adjustment as a result of the change, the total dollar impact of the accounting change for existing contracts, and the likelihood that a detailed cost impact proposal will be required.

(d) For voluntary and desirable changes, the notification date generally should occur more than 60 days prior to the applicability date. If a contractor desires to make the applicability date of the change 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. Regardless of whether notification occurs before or after the applicability date, the contractor should not implement any retroactive changes until at least 60 days after giving notification to the cognizant Federal agency official.

(e) For desirable changes, the contractor, when requesting that a voluntary change be deemed desirable, shall provide rationale demonstrating that the accounting change is desirable and not detrimental to the Government's interests (see 9903.201–6). The cognizant Federal agency official should make a decision with regard to this finding promptly after the change is determined to be adequate and compliant.

(f) The contractor shall not implement a new cost accounting practice to estimate or accumulate costs prior to the cognizant Federal agency's official's determination of adequacy and compliance or 60 days after the notification date, whichever comes first. For voluntary changes, any contracts awarded between the notification and effective dates of the new practice that were based on the old practice will be subject to an equitable adjustment based on the effect of the application of the new accounting practice.

(g) *Data submission requirements:* The description of any change in cost accounting practice will include the relevant Disclosure Statement pages affected by the change, 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) Exempt from contract price and cost adjustment pursuant to 9903.302–2(c) (1) or (2),

(2) 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,

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

(4) One that warrants retroactive implementation.

9903.405–3 Determination of Adequacy and Compliance and Request for General Dollar Magnitude (GDM).

(a) 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. The notification date will then be revised to the date of receipt of a revised description of a planned change that is subsequently deemed adequate and compliant. 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. This generally should occur within 60 days of the contractor's notification of the change in accounting practice.

(b) After a determination of adequacy and compliance has been made, the cognizant Federal agency official will request a GDM estimate of the cost impact of the change and a cost impact settlement proposal, as described in 9904.405–4 (a) and (b), unless a determination is made that the practice change is exempt under 9903.302–2(c) or the impact of the change on CAS-covered contracts and subcontracts is obviously immaterial based on information provided by the contractor in the notification of the change. The request should specify a date for submission of the GDM and cost impact settlement proposal, generally 30 to 60 days after the cognizant Federal agency official's request, depending on the complexity of the changes. The cognizant Federal agency official will use the GDM and cost impact settlement proposal to determine if a detailed cost impact proposal is required, and if individual contract price and cost adjustments are necessary to achieve equity.

9903.405–4 Contractor Cost Impact Submissions.

(a) General Dollar Magnitude (GDM).

(1) The purpose of the GDM estimate is to provide information to the cognizant Federal agency official on the 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. The GDM is used together with the cost impact settlement proposal 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 9903.405–4(c).

(2) The GDM 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.

(3) In computing the GDM, the contractor shall use a consistent data baseline for the before and after change amounts. In most cases, the after change cost baseline should be used because this is the same cost baseline that will be used to determine the revised forward pricing rates and current contract estimates-to-complete based on the new accounting practice.

(4) Any format which reasonably shows the aggregate impact by contract type is acceptable. One acceptable GDM format is illustrated below.

SUMMARY.—GENERAL DOLLAR MAGNITUDE ESTIMATE OF TOTAL COST IMPACT ON ALL COVERED CONTRACTS AWARDED PRIOR TO APPLICABILITY DATE

[Required changes, voluntary changes, desirable changes]

	Estimate to complete (1)		Difference cost impact (A – B)	Proposed adjustment amounts (4)
	Old practice (2) (A)	New practice (3) (B)		
Contract types:				
CPFF				
CPIF				
FPI				
FFP				
T&M				
Totals				

Instructions:

1. 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.
2. Enter total estimated cost to complete all of the CAS-covered contract backlog based on 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.
3. Enter total estimated cost to complete the CAS-covered contract backlog based on 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 base costs, as appropriate.
4. Enter total amounts from cost impact settlement proposal.

(5) The illustrated GDM format is an example of one GDM 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. The GDM shall be adequately supported, and generally should 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 the cognizant Federal agency official. If a GDM 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 9903.405–4(c).

(b) Cost Impact Settlement Proposal.

(1) The purpose of the cost impact settlement proposal is to provide a sufficient number of individual contract and/or subcontract cost impact estimates to: support the accuracy of the GDM; assist the cognizant Federal agency official in determining whether any individual contract or subcontract price adjustments will be required; and allow for the settlement of the cost impact of a change in cost accounting practice without requiring a detailed cost impact proposal. The cost impact settlement proposal will be furnished simultaneously with the GDM.

(2) One acceptable format for the submission of a cost impact settlement proposal is illustrated below.

COST IMPACT SETTLEMENT PROPOSAL

[Summary of specific contract price or cost allowance adjustments]

	Estimate to complete (1)		Difference cost impact (a – b)	Proposed adjustment amounts (2)
	Old practice (a)	New practice (b)		
Contracts:				
(3)				
CPFF				
1.				
2.				
''All other''				
Total				(4)
CPIF				
3.				
4.				
''All other''				
Total				(4)
FFP				
5.				
6.				
''All other''				
Total				(4)

Instructions:
1. List each contract for which an individual cost impact statement has been prepared and enter the indicated data.
2. If a voluntary change that is not determined ''desirable'' and there are increased costs, in the aggregate, attach an explanation detailing the proposed action(s) that will be taken to preclude the payment of any net increased costs.
3. Enter contracts needed to resolve ''material'' amounts identified in GDM.
4. Enter proposed settlement totals on the GDM, for each contract category.

(3) The illustrated cost impact settlement proposal format is an example and does not preclude the use of any other format or method that achieves the purpose of supporting the accuracy of the GDM and determining whether the impact on any individual contracts are significant enough to require price adjustments. The individual contracts selected by the contractor for inclusion in the cost impact settlement proposal shall be those contracts with the largest dollar impact. The cognizant Federal agency official should attempt to use the GDM and cost impact settlement proposal to resolve the cost impact process to the maximum extent possible. If additional individual contract data is needed to resolve the cost impact, the cognizant Federal agency official should specify the criteria for the additional data, e.g. contracts with a dollar impact exceeding a specific dollar amount. The contractor will then resubmit the cost impact settlement proposal based on the specified criteria. The revised proposal should be submitted within 30 days of the request for additional data.

(4) If the impact is immaterial in both the aggregate by contract type as shown in the GDM, and for the individual contracts included in the cost impact settlement proposal, the cost impact process may be concluded without any adjustments. If the cognizant Federal agency official determines that the cost impact either in the aggregate by contract type or on individual contracts is material, the procedures in 9903.405–5, Negotiation and Resolution of the Cost Impact, should be followed. The requirement for adjustments should be based on separate materiality thresholds for: individual contracts; the ''all other contracts'' amounts; and the aggregate by contract type. The materiality thresholds, as used here, are the amounts below which no adjustments are required. The ''all other contract'' amount is the difference between the aggregate amount by contract type and the net sum total of the impact of the submitted individual contracts by contract type. If the cognizant Federal agency official cannot resolve the cost impact based on the data submitted in the GDM and the cost impact settlement proposal, the cognizant Federal agency official should request a detailed cost impact proposal in accordance with 9903.405–4(c). 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 contract. Such determination should be made promptly after the submission of the cost impact

settlement proposal, including any revisions thereto.

(c) Detailed Cost Impact Proposal.

(1) A detailed cost impact proposal is required when the GDM cannot be adequately supported or the cost impact settlement proposal does not contain sufficient data to resolve a cost impact due to a change in cost accounting practices. It will be used by the cognizant Federal agency official in lieu of the cost impact 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.

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

(3) The detailed cost impact proposal shall be submitted within a specified time period, generally 60 days after receipt of the cognizant Federal agency official's request, depending on the complexity of the changes(s) and the number of contracts involved.

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

9903.405–5 Negotiation and Resolution of the Cost Impact.

(a) *General* (1) The cognizant Federal agency official shall negotiate any required contract price or cost adjustments due to changes in cost accounting practices or noncompliances on behalf of all Government agencies. Negotiation of price and cost adjustments may be based on a cost impact settlement proposal or a detailed cost impact proposal and should be concluded within a reasonable period of time after final submission of the proposal by the contractor.

(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 aggregate impact shown on the GDM.

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

(1) Use of the offset process shall not result in 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 shown on the GDM.

(2) The offset process shall only be applied to contracts that are of the same contract type, e.g., CPFF, CPIF, FPI or FFP.

(3) The offset process shall not be used to materially reduce the amount of the price adjustment to any one contract that exceeds the individual contract cost impact materiality threshold established for individual contract price adjustments. It also shall not be used to reduce the adjustment for these contracts to an amount below the established threshold. The offset process may be used to determine the action required for contract adjustment purposes for the ''all other contract'' category.

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

(i) within the same contract to determine if the aggregate impact on individual contracts exceed the materiality threshold;

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

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

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

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

(c) *Contract Price and Cost adjustments.*

(1) Once the cost impact 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.

(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 by the Government or net upward adjustments to contracts. Even if a change produces a zero aggregate impact on the costs of all affected contracts, it still may be necessary to adjust the prices of one or more contracts of each contract type. Such adjustments may be necessary to:

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

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

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

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

(3) Whether the cognizant Federal agency official decides to resolve the cost impact by adjusting the price of one or more contracts of each contract type,

or selects some other method for settlement as allowed under 9903.405–5(a)(2), the negotiated net adjustment for each contract type should approximate the aggregate impact shown on the GDM.

(4) To aid in the determination as to whether contract price or cost adjustments are required, the cognizant Federal agency official should establish materiality thresholds based on the circumstances of each change. Thresholds for individual contract price adjustments may be based on cost impact dollar values, percentage of 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, or any other appropriate materiality basis. Individual contract thresholds should be set high enough so that only contracts with significant cost impacts will be adjusted. If a contractor's cost impact settlement proposal includes all contracts that have cost impacts that are reasonably close to the established individual contract materiality threshold, it should be used as a basis to resolve the cost impact.

(5) For accounting changes involving shifts of costs between contracts, generally no adjustments will be required if no individual contract's cost impact exceeds the individual contract cost impact threshold established, since the aggregate amount will, in most cases, be smaller than the highest impact on any one individual contract. 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 other than for individual contracts exceeding the established individual contract cost impact threshold, unless considered necessary to achieve equity.

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

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

(d) Action to Preclude Increased Cost Paid for Voluntary Changes.

(1) In the absence of a finding pursuant to 9903.201–6 that a voluntary change is desirable, no agreement may be made with regard to a voluntary change in cost accounting practice that will result in the payment of increased costs by the United States. For these voluntary 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 accounting changes, take action to ensure that increased costs are not paid as a result of a change.

(2) The netting process (see 9903.403) is used to determine if a potential increased cost condition exists as a result of a voluntary change. To decide if action is required to preclude the payment of such 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 once all potential contract price adjustments are considered. This occurs when the estimated aggregate higher allocation of costs to contracts subject to adjustment exceeds the estimated aggregate lower allocation of costs to other contracts subject to adjustment.

(3) The cognizant Federal agency official may preclude increased costs on 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. Increased costs may also be precluded by disallowing 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 actions required when netting contracts in a voluntary change—no increased cost situation.

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

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

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

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

(7) For voluntary changes, any contract prices negotiated between the notification and effective dates of the change where the estimated contract costs were based on the previous cost accounting practice shall not be subject to the increased cost prohibition. Further, failure to reflect the new practice in contract prices negotiated during this period will not result in any

additional increased costs precluded by the Government on contracts subject to adjustment as a result of the change. If the cost impact of the new cost accounting practice change on contract prices negotiated between the notification date and effective date is a net downward adjustment, those contracts will be included with all other contracts in the backlog subject to adjustment for the purpose of determining whether increased costs in the aggregate exist due to the voluntary change. If the cost impact on contract prices negotiated between the notification date and the effective date is a net upward adjustment, they will be subject to equitable adjustments under this exception provision and, therefore, shall be excluded from the contract backlog that is subject to the increased cost preclusion procedures described above. This exemption is illustrated at 9903.407–1(h).

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

9903.406 Noncompliances.

9903.406–1 General Types of Noncompliances.

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

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

9903.406–2 Determination of Noncompliance.

(a) When the auditor finds a potential noncompliance, the auditor should, after sufficient discussion with the contractor to ensure all relevant facts are known, immediately issue an audit report to the cognizant Federal agency official describing the accounting practice and the basis for the opinion of noncompliance. Within 15 days of the receipt of the audit report of potential noncompliance, the cognizant Federal agency official should make an initial finding of compliance or noncompliance and advise the auditor and contractor.

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

(c) 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 and allow the contractor 60 days to agree, or disagree and submit reasons why the existing practices are considered to be compliant.

(d) If the contractor agrees with the initial finding of noncompliance, the contractor will correct the noncompliance, and submit a noncompliance cost impact proposal, generally within 60 days after agreement or other date to which both parties mutually agree, showing the impact of the noncompliance on the affected CAS-covered contracts in accordance with 9903.406–3 if it is a cost estimating noncompliance, and/or 9903.406–4 if it is a cost accumulation noncompliance.

(e) If the contractor disagrees with the initial noncompliance finding, the contractor shall provide the cognizant Federal agency official 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. If the cognizant Federal agency official believes that a noncompliance situation continues to exist, he/she should explain to the contractor the rationale for refuting the contractor's position. If the contractor agrees with the noncompliance, the procedures described in 9903.406–2(d) will be followed.

(f) Once the cognizant Federal agency official reaches a final position that a noncompliance exists, he/she shall issue a final determination to inform the contractor of the Government's position and that failure to agree will constitute a dispute under the Disputes clause of the contract. A final determination of noncompliance should also include a request for corrective action and a noncompliance cost impact proposal showing the impact of the noncompliance on CAS-covered contracts and subcontracts. The cost impact proposal should generally be submitted within 60 days after issuance of the final determination in accordance with 9903.406–3 if it is a cost estimating noncompliance, and/or 9903.406–4 if it is a cost accumulation noncompliance, as applicable.

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

9903.406–3 Cost Estimating Noncompliance.

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

(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 proposal, generally within 60 days from the date of the request, for all contracts negotiated based on the noncompliant practice. The cost impact proposal will show the negotiated contract values, by contract type, and the estimated contract values that would have been negotiated had the compliant practice

been used. The cognizant Federal agency official may establish contract value thresholds so that any contracts with an immaterial cost impact may be omitted from the cost impact proposal. The cost impact proposal 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.

(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 of contract values 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.

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

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

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

9903.406–4 Cost Accumulation Noncompliance.

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

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

(c) Once the corrective action has been implemented, and the cognizant Federal agency official has determined that the accounting change, if any, meets the test of adequacy and compliance, the cognizant Federal agency official will request the contractor to submit a noncompliance cost impact proposal, generally within 60 days from the date of the request. The proposal 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, the cost impact proposal 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 9903.406–4(e).

(d) The level of detail to be submitted with a cost impact proposal for a cost accumulation noncompliance will vary with the circumstances. Normally, the cost impact proposal 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. A GDM format similar to the one shown at 9903.405–4(a)(4) may be used to present the aggregate impact of the cost accumulation noncompliance for CAS-covered contracts performed during the noncompliant period. The cost impact proposal for a cost accumulation noncompliance is primarily developed and evaluated to determine if, and to what extent, increased costs were paid on covered contracts during the period of noncompliance. The minimum level of detail that can adequately support this determination should be used for the cost impact proposal. The level of detail required 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 proposal.

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

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

9903.406–5 Technical noncompliances.

(a) If no material increased costs result, in the aggregate, as a result of a noncompliance, the cognizant Federal agency official shall notify the contractor in writing that:

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

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

(3) Corrective action should be taken.

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

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

9903.407 Illustrations.

9903.407–1 Change in Cost Accounting Practice—Illustrations.

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

(a) *Notification.*

(1) The contractor provides notification of a change in cost accounting practices in April and informs the Government that the change will have a retroactive applicability date of the beginning of the current year. In accordance with 9903.405–2(d), the contractor states that the reason for the beginning of the current year applicability date is to facilitate indirect cost allocations by use of one set of indirect cost rates for all work performed in the current year. The cognizant Federal agency official agrees to the proposed applicability date for covered contract costing purposes. After determination of adequacy and compliance, the cognizant Federal agency official requests a general dollar magnitude estimate for all contracts negotiated based on the previous accounting practice, including those negotiated after the applicability date of the change, plus a cost impact settlement proposal consisting of several contracts of each contract type which have the largest impact due to the cost accounting practice change.

(2) The contractor provides notification of a voluntary change in cost accounting practices in June with a planned retroactive applicability date at 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. The contractor is informed that 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.

(3) The cognizant Federal agency official informs the contractor that a planned change in cost accounting practice is both adequate and compliant 35 days after date of notification. In accordance with 9903.405–2(f), the contractor immediately begins using the new cost accounting practice for cost estimating and cost negotiation purposes.

(b) *General Dollar Magnitude.*

(1) In accordance with 9903.405–3(b), the cognizant Federal agency official requests a general dollar magnitude (GDM) by contract type, plus a cost impact settlement proposal 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 by using a contract 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, i.e., CPFF, cost-plus-incentive-fee, fixed-price incentive and firm fixed-price. No contracts other than some of the individual contracts submitted with the cost impact settlement proposal extend out beyond the three year period. The cognizant Federal agency official, with the assistance of the auditor and using the cost impact settlement proposal data, determines that the GDM 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(b)(1), 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 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(c)(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.

(c) *Cost Impact Settlement Proposal.*

(1) The contractor submits a cost impact 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, and reasonably supports the GDM submitted with the cost impact settlement proposal. In accordance with 9903.405–4(b)(3), 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 supplement the cost impact settlement proposal with 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 using the requested supplemental data.

(2) The same situation described in (c)(1) occurs except that the aggregate impact by contract type in the GDM can not be reconciled with the aggregate net impact of the individual contracts by contract type submitted with the cost impact settlement proposal. In accordance with 9903.405–4(b)(4), 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) After reviewing the GDM and cost impact settlement proposal for a change in a cost allocation practice, the cognizant federal agency official decides in accordance with 9903.405–4(b)(4) that, due to materiality, no additional data is needed and no contract price or cost adjustments are warranted.

(d) *Detailed Cost Impact Proposal.*

(1) In accordance with 9903.405–4(b)(4), 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]

(e) *Offset Process.*

(1) In analyzing the contractor's cost impact proposal, the cognizant Federal agency official determines that one firm

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

(2) The 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 cost impact proposal for the three business units at the home office level. As a result of considering the aggregate impact at the three business units by applying the netting process 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 impact exceeding established thresholds were adjusted upwards or downwards, as appropriate, for the amount of the cost impact.

(3) After determining the individual contracts subject to adjustment where the cost impact exceeded the established threshold for a change in 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 final cost to the Government of a lesser cost paid of $1,200,000 would be materially different than if the individual contracts making up these aggregate amounts had been individually adjusted downward resulting in a lesser cost paid of $2,200,000. To achieve the desired result, the cognizant Federal agency official, in accordance with 9903.405–5(b) (1) and (2), selects a number of high dollar contracts and adjusts flexibly-priced contracts downward by $1,000,000 and firm fixed-price contracts downward by $1,200,000. In accordance with 9903.405–5(c)(3), an alternative technique, in lieu of adjusting contract prices, which achieves the same result of lesser cost paid of $2,200,000 may also be used for the aggregate ''all other contract'' cost impact adjustment.

(f) *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 cost impact 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 (f)(1) 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(c)(3), 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 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.

(g) *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 with no increased costs allowed. The impact on the two contracts are a lower allocation of costs in the amount of $1,000,000 for contract A and a higher allocation of costs of $2,000,000 for contract B. In order to preclude increased costs paid by the United States as a result of the change, the cognizant Federal agency official, in accordance with 9903.405–5(d)(3), adjusts Contract A downward by $1,000,000, and limits the upward adjustment on Contract B to $1,000,000. This action adjusts the contracts to reflect the impact of the change to the maximum extent possible, while precluding a higher level of costs being paid by the United States.

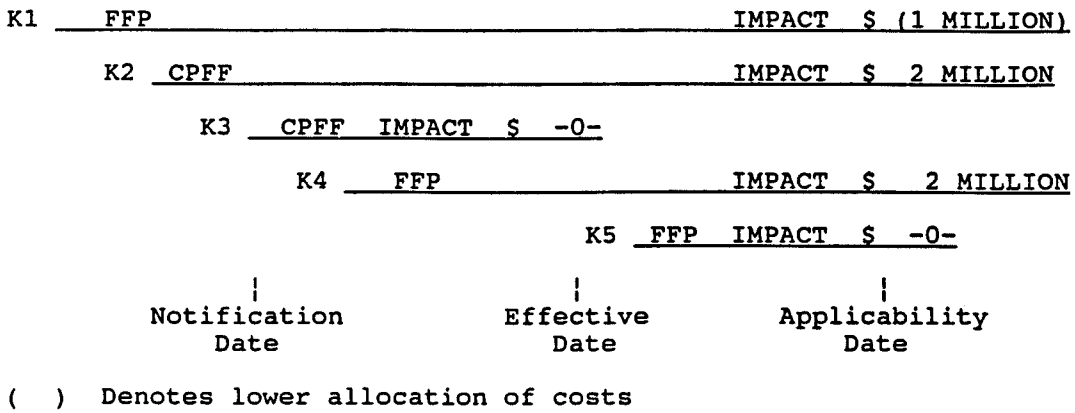
(2) The same situation described in (g)(1) occurs except that contract B is a CPFF contract. In accordance with

9903.405–5(d)(3), the cognizant Federal agency official adjusts the firm fixed-price contract downward by $1,000,000, and the estimated contract cost ceiling on the CPFF contract upward by $1,000,000. The cognizant Federal agency official determines that the higher level of costs on the CPFF contract is coming from a shift of costs from both Contract A and other contractor non-government work. In accordance with 9903.405–5(d)(1), action must be taken to preclude the additional $1,000,000 of increased cost on the CPFF contract. An appropriate adjustment technique is used to preclude the payment of the increased costs in accordance with 9903.405–5(d)(3).

(3) After analyzing the contractor's cost impact proposal, the cognizant Federal agency official determines that five contracts exceed the threshold established for contract price adjustment purposes. The impact on all other contracts, both individually and in the aggregate, is considered insignificant. The five contracts requiring adjustment are 3 firm fixed-price contracts and 2 CPFF contracts. The total impact on the 3 firm fixed-price contracts is a lower allocation of costs amounting to $3,000,000. The total impact on the 2 CPFF contracts is a higher allocation of costs of $2,000,000. The cognizant Federal agency official adjusts the contracts upward and downward for the amount of the impacts. In accordance with 9903.405–5(d) (1) and (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.

(h) *Contracts negotiated between notification date and effective date (see 9903.405–5(d)(7)).*

(1)(i) The contractor has the following covered contracts in existence during the period from the notification date to the applicability date of a voluntary accounting change subject to no increased costs:



(ii) Only contracts K1, K2 and K4 are subject to adjustment based on the accounting change, i.e., they were negotiated based on the old practice and will have costs accumulated beyond the applicability date based on the new practice. K3 was negotiated based on the old practice, but will be completed prior to the applicability date. K5 was negotiated after the effective date and, therefore, based on the new practice. Since K4 was negotiated between the notification date and effective date of the change, it is subject to an equitable adjustment and not subject to preclusion of increased costs paid. Further, the failure to base the negotiated amount of K4 on the new practice can not result in any additional costs precluded by the Government. K4 is a firm fixed-price contract. The impact of the accounting change on K4 is a higher allocation of costs in the amount of $2 million. K4 receives an upward equitable adjustment in this amount. K1 is a firm fixed-price contract with a cost impact of a lower allocation of costs in the amount of $1 million. K2 is a CPFF contract with a higher allocation of costs in the amount of $2 million. K1 is adjusted downward by $1 million. K2 is adjusted upward by $1,000,000. Although the total impact of the change is an overall higher allocation of $3 million, the Government needs to take action to preclude costs for only the $1 million on the CPFF contract which is over and above the $1 million impact on the firm fixed-price contract, since contract K4 is not subject to the no increased cost provision.

(2)(i) The contractor has the following covered contracts in existence during the period from the notification date to the applicability date of a voluntary accounting change subject to no increased costs:

```
K1  FFP                                          IMPACT  $ (1 MILLION)

    K2  CPFF                                     IMPACT  $  2 MILLION

        K3  FFP    IMPACT  $  -0-

            K4  FFP                              IMPACT  $ (2 MILLION)

                                   K5  CPFF  IMPACT  $  -0-

            |                  |                  |
   Notification          Effective          Applicability
       Date                 Date                Date
```

( ) Denotes lower allocation of costs

(ii) Only contracts K1, K2 and K4 are subject to adjustment based on the accounting change, i.e., they were negotiated based on the old practice and will have costs accumulated beyond the applicability date based on the new practice. K3 was negotiated based on the old practice, but will be completed prior to the applicability date. K5 was negotiated after the effective date and, therefore, based on the new practice. Since K4 was negotiated between the notification date and effective date of the change, it is subject to an equitable adjustment and not subject to preclusion of increased costs paid. Further, the failure to base the negotiated amount of K4 on the new practice can not result in any additional costs precluded by the Government. K4 is a firm fixed-price contract. The impact of the accounting change on K4 is a lesser allocation of costs in the amount of $2 million. K4 receives a downward equitable adjustment in this amount. K1 is a firm fixed-price contract with a cost impact of a lesser allocation of costs in the amount of $1 million. K2 is a CPFF contract with a higher allocation of costs in the amount of $2 million. K1 is adjusted downward by $1 million. K2 is adjusted upward by $2,000,000. There is no need for the Government to take action to preclude increased costs after making contract price adjustments because the downward adjustments on K1 and K4 exceed the higher allocation of costs on K2, resulting in net decreased costs paid of $1 million as a result of the change.

(3)(i) The contractor has the following covered contracts in existence during the period from the notification date to the applicability date of a voluntary accounting change subject to no increased costs:

```
K1  CPFF                                         IMPACT  $ (1 MILLION)

    K2  FFP                                      IMPACT  $  2 MILLION

        K3  CPFF   IMPACT  $  -0-

            K4  CPFF                             IMPACT  $  3 MILLION

                                   K5  FFP  IMPACT  $  -0-

            |                  |                  |
   Notification          Effective          Applicability
       Date                 Date                Date
```

( ) Denotes lower allocation of costs

(ii) Only contracts K1, K2 and K4 are subject to adjustment based on the accounting change, i.e., they were negotiated based on the old practice and will have costs accumulated beyond the applicability date based on the new practice. K3 was negotiated based on the old practice, but will be completed prior to the applicability date. K5 was negotiated after the effective date and, therefore, based on the new practice. Since K4 was negotiated between the notification date and effective date of the change, it is subject to an equitable adjustment and not subject to preclusion of increased costs paid. Further, the failure to base the negotiated amount of K4 on the new practice can not result in any additional costs precluded by the Government. K4 is a CPFF contract. The impact of the accounting change on K4 is a higher allocation of costs in the amount of $3 million. K4 receives an upward equitable adjustment in this amount. K1 is a CPFF contract with a cost impact of a lesser allocation of costs in the amount of $1 million. K2 is a firm fixed-price contract with a higher allocation of costs in the amount of $2 million. K1 is adjusted downward by $1 million. K2 is adjusted upward by $1 million. There is no need for the Government to take action to preclude increased costs after making contract price adjustments because the upward adjustment on K2 has been limited to the downward adjustment of K1 (since K2 is a firm fixed-price contract the additional $1 million will not be paid by the United States) and K4 is not subject to preclusion of increased costs.

(4)(i) The contractor has the following covered contracts in existence during the period from the notification date to the applicability date of a voluntary accounting change subject to no increased costs:

```
K1  FFP                                          IMPACT  $  2 MILLION
    K2  CPFF                                     IMPACT  $  3 MILLION
        K3  CPFF   IMPACT  $  -0-
            K4  CPFF                             IMPACT  $  2 MILLION
                                  K5  FFP  IMPACT  $  -0-
          |                  |                  |
   Notification          Effective          Applicability
       Date                Date                Date
```

( ) Denotes lower allocation of costs

(ii) Only contracts K1, K2 and K4 are subject to adjustment based on the accounting change, i.e., they were negotiated based on the old practice and will have costs accumulated beyond the applicability date based on the new practice. K3 was negotiated based on the old practice, but will be completed prior to the applicability date. K5 was negotiated after the effective date and, therefore, based on the new practice. Since K4 was negotiated between the notification date and effective date of the change, it is subject to an equitable adjustment and not subject to preclusion of increased costs paid. Further, the failure to base the negotiated amount of K4 on the new practice can not result in any additional costs precluded by the Government. K4 is a CPFF contract. The impact of the accounting change on K4 is a higher allocation of costs in the amount of $2 million. K4 receives an upward equitable adjustment in this amount. K1 is a firm fixed-price contract with a cost impact of a higher allocation of costs in the amount of $2 million. K2 is a CPFF contract with a higher allocation of costs in the amount of $3 million. No upward adjustment is made to K1 or K2 because they are subject to the no increased cost provision. Further, the Government must take action to preclude the increased costs of $3 million from being paid on the CPFF contract. The cognizant Federal agency official does not have to take action to preclude the payment of the higher allocation of costs on K4 since this contract is not subject to the no increased cost provision.

(5)(i) The contractor has the following covered contracts in existence during the period from the notification date to the applicability date of a voluntary accounting change subject to no increased costs:

```
K1  FFP                                          IMPACT  $ (2 MILLION)
    K2  FFP                                      IMPACT  $  3 MILLION
        K3  FFP   IMPACT  $  -0-
            K4  CPFF                             IMPACT  $ (2 MILLION)
                                  K5  CPFF IMPACT  $  -0-
          |                  |                  |
   Notification          Effective          Applicability
       Date                Date                Date
```

( ) Denotes lower allocation of costs

(ii) Only contracts K1, K2 and K4 are subject to adjustment based on the accounting change, i.e., they were negotiated based on the old practice and will have costs accumulated beyond the applicability date based on the new practice. K3 was negotiated based on the old practice, but will be completed prior to the applicability date. K5 was negotiated after the effective date and, therefore, based on the new practice. Since K4 was negotiated between the notification date and effective date of the change, it is subject to an equitable adjustment and not subject to preclusion of increased costs paid. Further, the failure to base the negotiated amount of K4 on the new practice can not result in any additional costs precluded by the Government. K4 is a CPFF contract. The impact of the accounting change on K4 is a lesser allocation of costs in the amount of $2 million. K4 receives an downward equitable adjustment in this amount. K1 is a firm fixed-price contract with a cost impact of a lesser allocation of costs in the amount of $2 million. K2 is a firm fixed-price contract with a higher allocation of costs in the amount of $3 million. K1 is adjusted downward by $2 million. K2 is adjusted upward by $3 million. There is no need for the Government to take action to preclude increased costs after making contract price adjustments because the downward adjustments on K1 and K4 exceed the higher allocation of costs on K2, resulting in net decreased costs paid of $1 million as a result of the change.

(i) *GDM/Cost Impact Settlement Proposal Based on Contractor Model and Profile*

(1) The contractor has developed a model and profile which is used for the general dollar magnitude estimate and cost impact settlement proposal. The model and profile data are updated

whenever circumstances change and dictate revision to the data.

(2) For a voluntary accounting change, the contractor 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 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 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 function 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. He/she has also determined that $500,000 will be the adjustment threshold for the ''all other contracts'' amounts by contract type. To support the general dollar magnitude estimate, the contractor includes in the cost impact settlement proposal three (3) contracts having the largest estimate-to-complete, by contract type. Based on the profile and model 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 cost impact 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. Since this is a no increased cost change, the upward adjustments to the flexibly-priced contracts must be limited to $400,000. The cognizant Federal official decides to adjust the target cost on the CPIF contract upward by $300,000, with an appropriate upward adjustment of the target fee, in order to avoid distortions of contract incentive provisions based on the estimated higher allocation of costs (see 9903.405–5(b)(5)). He then limits the upward adjustment to the CPFF contract to $100,000. Additional action must then be taken to preclude the additional $100,000 of costs on the CPFF contract. After discussion with the contractor, the cognizant Federal agency official agrees with the contractor's proposal to delete the $100,000 from the cumulative claimed costs on the contract either when the contract reaches the estimated contract cost ceiling or prior to the submission of the final voucher, whichever comes first.

9903.407–2 Noncompliance illustrations.

The following illustrations deal with recovery of increased costs due to noncompliant practices. They are not meant to cover all possible situations, but rather to provide some guidelines in applying the procedures in 9903.406. The illustrations are meant to be considered only as examples. In actual cases, the individual circumstances need to be reviewed and considered to ensure equity for both parties.

(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 values under which the contractor used the noncompliant practice to estimate the 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 proposal for the impact of the noncompliant practice on covered contracts, as well as the amount of the increased costs paid as a result of the noncompliance. In accordance with 9903.406–3(d), the cognizant Federal agency official determines that the impact on contracts less than $10,000,000 would be immaterial, and limits the cost impact proposal to contracts of $10,000,000 or more in value. The cost impact proposal shows that the contract values are overstated (in the aggregate) by a significant

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

(b) *Cost Accumulation Noncompliance.*

(1) The cognizant Federal agency official makes a final determination that the contractor is using an accounting practice for cost accumulation purposes that is noncompliant with an applicable Cost Accounting Standard. He/she 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. At the direction of the cognizant Federal agency official, 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 cost impact proposal 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 proposal 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 some, but not all, of its CAS-covered contracts. Since the noncompliance involves accounting for direct costs as indirect costs, the cognizant Federal agency official determines that individual contract data is required in order to compute the extent of increased costs paid, if any, as a result of the noncompliance. In accordance with 9903.406–4(d), the cognizant Federal agency official, with the assistance of the auditor, determines and discusses with the contractor the level of detail needed to compute the impact on costs paid as a result of the noncompliance. The cognizant Federal agency official submits a written request to the contractor for a noncompliance cost impact proposal that specifies the level of detail required. After analyzing the cost impact proposal, the cognizant Federal agency official determines that the amount of the increased costs paid is immaterial and does not warrant action to recover the increased costs, plus applicable interest. The cognizant Federal agency official takes action in accordance with 9903.406–5, Technical Noncompliance.

(3) The cognizant Federal agency official determines that the contractor is using a practice for cost accumulation purposes that is noncompliant with an applicable Cost Accounting Standard. He/she 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 Government, in accordance with 9903.406–4(b), requests two separate cost impact proposals to cover increased costs. The cost impact proposal for the overstated contract prices will be in accordance with the cost impact proposal described in 9903.406–3, and the cost impact proposal for the overbilled accumulated costs will be as described in 9903.406–4.

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