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Office of Federal Procurement Policy
725 17th Street, NW.
Room 9013
Washington, DC 20503

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Director, Cost Accounting Standards Board

We are providing a response to the Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board request for information with respect to the exemption from the Cost Accounting Standard (CAS) at 48 CFR 9903.201-1(b)(14)(the overseas exemption) that states "contracts and subcontracts to be executed and performed entirely outside the United States, its territories, and possessions" are exempt from all CAS requirements.

The purpose of the Board's request is for information with respect to the overseas exemption from CAS at 48 CFR 9903.201-1(b)(14). The focus of the response is how contracts that would otherwise be subject to CAS, but for the fact that the contract is exempted because it is executed and performed entirely overseas, should be treated.

GENERAL COMMENTS

The CAS Board should periodically review the exemptions to CAS and revise them as needed. The CAS exemption for overseas contracts cannot be discussed in a vacuum devoid from the other exemptions. Fundamentally, there are numerous exemptions from CAS that would still apply if the exemption for overseas contracts was eliminated. The overseas contract exemption is one of fifteen exemptions. Two other exemptions are also available to contracts or subcontracts awarded to foreign concerns. With regard to overseas contracts, subcontracts and foreign concerns

(b) The following categories of contracts and subcontrac

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(4) Contracts and subcontracts with foreign governments or their agents or instrumentalities or, insofar as the requirements of CAS other than 9904.401 and 9904.402 are concerned, any contract or subcontract awarded to a foreign concern.

...

(13) Subcontractors under the NATO PHM Ship program to be performed outside the United States by a foreign concern.

(14) Contracts and subcontracts to be executed and performed entirely outside the United States, its territories, and possessions.

Thus, simply eliminating or revising the overseas exemption would disproportionately affect US concerns. While foreign concerns would only have to comply with 9904.401 and 9904.402. If changes are to be made, we would suggest that all the exemptions be modified to promote consistency of application among all contractors without regard to whether they are US or foreign concerns.

Currently, financial accounting is currently undergoing significant revisions with the adoption of the International Financial Reporting Standards by most countries. Such standards may eventually require revisions to CAS to promote consistent and uniform treatment of cost. Such changed requirements should be fully understood and CAS modified where appropriate before trying to apply full CAS to overseas contracts.

Congress has requested this review of the overseas contract exemption. It appears that the request was in response to audits of a number of overseas contracts that found significant contract accounting issues. However, most of the recent problems with operations and accounting for overseas contracts are not solved by CAS. Depending on the events leading to the overseas contract, the foreign country of performance may be in chaos and normal receipts or documentation of transactions that are routine in industrialized countries are not available. Urgency and mission success often can override well documented accounting practices. To solve such problems, more emphasis needs to be placed on setting standards and controls for documenting underlying transactions. Setting such financial accounting requirements is not addressed in CAS. Trying to operate companies overseas as if they were in the US is not practical or feasible in all situations. Thus, even if CAS had been required the recent accounting problems would still have existed.

There is an underlying concern for all the parties involved that changing the exemption and requiring CAS for overseas contracts. If done, it must be done in a fair and equitable way. The CAS Board needs to consider the affect on competition, US firms and foreign companies. It would need to assure both US and foreign concerns that the change would not discriminate or give an advantage to US or foreign concerns.

We believe that if any revision to the exemption for overseas contracts is made that it should be limited to only require 9904.401 and 9904.402. As discussed below, the application of full CAS may reduce competition and discriminate against US concerns.

The following are our responses to your questions concerning the exemption for overseas contracts and the applicability of CAS:

1. What is your experience with the overseas exemption:

- a. As a procuring entity (e.g., procurement office, higher tier contractor) awarding contracts/subcontracts; or**
- b. As the contractor/subcontractor claiming the applicability of the overseas exemption?**

Generally, we have found that many federal government contractors based solely in the US and working overseas do not benefit from the exemption because the contract was executed domestically, or some very small part of the contract would be performed in the United States. At the same time, foreign companies that may bid on the same or similar contracts seem to be able to retain the exemption. For foreign owned subsidiaries of US companies, the exemption appears to be useful. Many US firms, without foreign subsidiaries, feel that the exemption puts them at a competitive disadvantage with foreign firms that are not subject to the Cost Accounting Standards.

For obtaining subcontracts, it is one less hurdle to overcome and makes it easier to obtain companies willing to bid on the US government subcontracts. Administering and closing such subcontract in foreign countries is eased, because CAS requirements are not an issue. The important cost measurement and allocation issues are addressed in FAR Part 31.

2. How often has the Overseas Exemption been claimed?

Based on the other fourteen exemptions available for CAS, the overseas contract exemption does not apply to the vast number of smaller procurements. Also, foreign firms are exempt from full CAS except from CAS 401 and 402. Contracts awarded overseas generally are not the same size or magnitude for fully CAC covered contracts except in wartime situations.

3. What problems would eliminating the overseas exemption cause?

It would mostly affect US firms or their foreign subsidiaries. Since foreign firms would be exempt from all but CAS 401 and 402. The brunt of compliance would fall on US firms. This would put them at a competitive disadvantage. Only full CAS would apply to US firms together with its reporting and implementation requirements.

Operating in a foreign country is not the same as being in the US. Underlying documentation and support from other companies can be radically different. Local laws and regulations can also be cumbersome and restrictive. US firms operating in such countries normally adhere to the local accounting conventions just like their foreign competition. However, foreign concerns still have another exemption under 9903.201-1(b)(4) releasing them from complying with 17 of 19 Standards. Only the US firms would have to comply with Full CAS coverage. The exemption for overseas contracts occasionally helps US companies compete on the same level as foreign firms.

So the unintended consequence of eliminating the exemption would be to make US companies less competitive with foreign companies that compete for work overseas.

4. How does the overseas exemption help, or not help, to implement the CASB's mandate "to achieve uniformity and consistency in the cost accounting standards governing measurement, assignment, and allocation of costs to contracts with the United States"?

Applying full CAS to overseas contracts would not necessarily enhance measurement, assignment or allocation of costs to federal government contracts. This is because only US firms would be subject to full CAS. Being less competitive may mean that foreign organizations would get the work and would only have to comply with CAS 401 and 402. FAR Part 31 already requires much of the measurement requirements of CAS.

Applying CAS 401 and 402 may enhance the consistency in the assignment and allocation of costs to contracts. It also would not have the same affect on competition for federal government contracts. But eliminating the exemption for overseas contracts goes well beyond applying CAS 401 and 402 for US contractors.

CAS is also not a substitute for sound financial accounting practices and internal controls. Consistency will be better served by all companies adopting the same financial reporting standards.

5. What are the arguments for, and against, the requirement in the overseas exemption to require execution of the contract overseas?

The execution of the contracts for a US firms for work overseas is often done in the US and therefore it is not eligible for the overseas exemption. The execution of the contract should not be sufficient enough to prevent the overseas exemption from being claimed. This places many US firms at a disadvantage in competing with foreign firms for US government projects.

6. What are the arguments for, and against, the requirement in the overseas exemption to require performance of the contract overseas?

Overseas contracts are subject to a myriad of laws and regulations of the country of performance and also treaty obligations. Applying CAS to such contracts would effectively limit competition and increase the costs of performance for US companies. Even if CAS were applicable, foreign concerns are limited at most to CAS 401 and 402. Thus, an exemption for work overseas makes logical sense to promote competition and to allow US companies to compete for such work.

Enforcing CAS for overseas contracts would also be complicated by the fact that the work would be subject to the local legal system and other requirements that could complicate the administration and enforcement of CAS.

If the exemption were eliminated, an argument is that US companies that are fully subject to CAS are exempt solely because the contract was awarded and executed overseas and that the cost accounting should be subject to the same CAS requirements. But many of the problems that the Federal Government has encountered would not be affected by applying CAS. Also, US companies are not automatically awarded contracts and the increased cost of compliance may allow non-US concerns that are not subject to full CAS to obtain the contracts.

An argument could be made that eliminating the exemption would promote uniformity and consistency in the measurement, assignment and allocation of cost, however, foreign concerns will still not be subject to full CAS. Thus, much of the benefit would be lost because foreign firms would only comply with CAS 410 and 402.

If the exemptions were rewritten to require all concerns both foreign and US companies to comply with full CAS coverage, the affect would be to reduce competition from foreign firms and may be viewed as a method to favor US firms. This could receive significant resistance from countries where there are free trade agreements.

OTHER ISSUES

For foreign concerns including CAS in contracts could be seen as a negative. CAS has evolved over the year from being a set of standards that were neutral to the parties involved to one where the Standards are written to favor the Federal Government. The expansion of CAS to civilian agencies has greatly complicated many of the rules. The limitation on offsets among contract types, Federal Agencies and determining cost impact to the Federal Government has hampered new and better cost accounting practices from being adopted. CAS is punitive on non compliant practices, unapproved or undesirable changes. Negotiations are complicated when multiple agencies are involved. Thus, adopting CAS for overseas contracts would increase the cost of performance for both US and foreign companies. Many US companies would have an advantage if they already perform CAS covered contracts because they may have some expertise in dealing with CAS requirements and would understand the controls that would be needed to minimize the administration of CAS. Foreign concerns would have an initial and ongoing cost of compliance, may not understand the consequences of cost accounting practice changes and may have difficulty in dealing with US Government auditors and contract administrative staff.

CONCLUSIONS

Eliminating the exemptions from CAS for overseas contracts would disproportionately affect US concerns because foreign firms have another exemption to CAS except for 9904.401 and 9904.402.

CAS will not significantly improve the cost accounting practices for such contracts and may actually increase the cost to the US government. Many foreign concerns may likely not bid on US government contracts if there are significant increases in complying with full CAS. If foreign concerns only comply with 9904.401 and 9904.402 while US firms have to comply with all CAS requirements, foreign concerns may have a competitive advantage and win the bulk of awards. Thus, the application of CAS to cost accounting practices would only have a minimal effect.

Requiring CAS 9904.401 and 9904.402 as an alternative for overseas contracts would promote more consistent cost accounting and would be less difficult to implement given accounting practices that may be followed in foreign countries.

The procedures and processes that would affect the accuracy of the accounting for US government contracts the most are not addressed by CAS. Such other practices and procedures must be developed and adopted through other means.

IFRS is in the midst of being developed and adopted throughout the world. Currently, forcing existing CAS requirements on overseas contracts would not be the best practice. Adoption of IFRS will need to be addressed by CAS and may require some significant revisions. Such changes to CAS would likely trigger cost accounting practice changes and significant administrative cost.

A change to the overseas exemption is not needed and not desirable at this time. It will generate additional costs for the federal government and US contractors, reduce competition, and increase the cost of administering CAS covered awards. If a change were to be made to the exemption, it should apply 9904.401 and 9904.402 to overseas contracts.

If you have any questions or would like additional information, please contact Charles L. Bonuccelli at 703-752-7381.

Yours truly,

A handwritten signature in black ink, appearing to read 'Charlie Bonuccelli', written in a cursive style.

Charlie Bonuccelli
Principal