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*The Voice of the Industrial Base*

May 29, 2009

Office of Federal Procurement Policy  
725 17<sup>th</sup> Street, N.W., Room 9013  
Washington, DC 20503  
ATTN: Raymond J.M. Wong

Ref: CASB Request for Information on the Overseas Exemption from CAS

Dear Mr. Wong:

Members of the National Defense Industrial Association (NDIA) appreciate the opportunity to respond to the CAS Board's Request for Information (RFI) on the exemption from Cost Accounting Standards for contracts executed and performed entirely outside the United States, its territories, and possessions. The RFI was published in the April 23, 2009 *Federal Register*, Volume 74, Number 77.

NDIA is a non-partisan, non-profit organization with a membership that includes more than 1,500 companies and over 71,000 individuals. NDIA has a specific interest in government policies and practices concerning the government's acquisition of goods and services, including research and development, procurement, and logistics support. Our members, who provide a wide variety of goods and services to the government, include some of the nation's largest defense contractors.

NDIA strongly supports retention of the current exemption. We believe that elimination of the exemption would have significant unintended consequences, including reducing access to the global supply chain to provide needed supplies and services. Those currently-exempt foreign concerns who would choose to accept CAS-covered contracts and subcontracts would incur additional costs to modify their accounting systems and support the associated audit requirements. This would increase the costs of the contracts, while administering CAS requirements at a significantly increased number of foreign locations would likely exceed the capacity of the government resources assigned to that task, creating delays in contracting activity. While we support the objective of reducing fraud and waste in contracting, we must respectfully express our skepticism that there is any significant linkage between problems in contracting in Iraq and this CAS exemption. We believe that the provisions of FAR Part 31, the Truth in Negotiations Act and the False Claims Act provide more relevant protections.

#### **Introduction**

The phrase "executed and performed exclusively outside the United States" is the important distinguishing characteristic of CAS exemption (b)(14). For contracts either executed or performed *inside* the U.S., both domestic and foreign concerns are expected to comply with the U.S. Government's cost accounting rules, which is logical considering these foreign concerns actively pursued either award or performance of U.S. Government contracts within the U.S. But when the U.S. Government extends itself beyond its sovereign borders and executes contracts to be performed *outside* the U.S., prospective foreign concern contractors should not be expected to

adopt U.S. Government cost accounting rules where future utility and benefit cannot be reasonably foreseen beyond the immediate contract. Therefore, we believe, the CASB's assumption that "the affected contractors are likely to be US concerns and other concerns authorized to do business in the United States" is, perhaps, inaccurate. Instead, foreign concerns are likely to be most affected should exemption (b)(14) be eliminated.

Exemption (b)(14) addresses the circumstance where the U.S. Government awards contracts or subcontracts with businesses in foreign countries, not where foreign concerns seek to win contracts with the U.S. Government within the U.S. Should exemption (b)(14) be eliminated, the consequence is to cause CAS 401 and 402 applicability (via exemption (b)(4)) and disclosure statement requirements to be imposed on *all* otherwise CAS-covered contracts and subcontracts with foreign concerns, whether or not the contract is executed and performed exclusively outside the U.S. The likely implication will be to limit the U.S. Government's access to the global supply chain by significantly reducing the number of prospective foreign concern contractors and increasing costs for those few foreign concern contractors willing and able to adopt and comply with applicable CAS requirements. Moreover, domestic concerns competing for U.S. Government contracts *outside* the U.S. should be exempt from CAS requirements so that they are not disadvantaged among CAS-exempt foreign concern competitors.

Further, some contracts executed and performed entirely outside the U.S. (that would otherwise be subject to CAS coverage) are either transitory (e.g., DoD contingency operations, USAID humanitarian and infrastructure, etc.) or cooperative (e.g., coproduction, trade offsets, international sovereign partnerships (JSF), etc) in nature. It is arguable that the express objectives of CAS (see below) are irrelevant to these contracts because CAS cannot be reasonably expected to yield the intended benefits. Moreover, it is equally arguable that, if the intended benefits of CAS cannot be expected, the costs of CAS administration and compliance should be avoided.

#### **CAS Not Intended To Prevent or Detect Fraud, Waste and Abuse**

The express objectives of the Cost Accounting Standards are to increase –

- a) uniformity in cost accounting practices among government contractors in like circumstances, and
- b) consistency in cost accounting practices in like circumstances by individual government contractors over periods of time.

CAS is not intended to prevent or detect fraud, waste and abuse, as suggested by Congress. CAS applicability would not have had a meaningful impact on these matters. We believe that the Government would not benefit from the application of CAS to contracts and subcontracts executed and performed entirely outside the United States, and the administrative costs resulting from CAS applicability to foreign concerns could be considered a new form of waste itself.

#### **Probable Negative Consequences of Eliminating Exemption (b)(14)**

Eliminating exemption (b)(14) likely will have a material adverse impact on U.S. contractors and the U.S. Government's access to the global supply chain. These probable material adverse impacts can be summarized into at least the following five areas:

- A. Increased administrative burden and costs of compliance;
- B. Reduced competition by foreign concerns
- C. Increased procurement lead time;
- D. Increased audit risk and noncompliance liability; and
- E. Stress on foreign military sale arrangements with foreign governments

Accordingly, we strongly recommend that the CASB and Congress consider such significant unintended consequences in determining whether or not this CAS exemption should be eliminated. The consequences associated with each of these areas are discussed in greater detail below.

*Increased Administrative Burden and Costs of Compliance*

If exemption (b)(14) is eliminated, all contracting parties must expect a greater CAS administration burden throughout a global supply chain. Prime contractors would be responsible for assessing the adequacy of foreign subcontractor cost accounting practice disclosures, as well as monitoring and evaluating foreign subcontractor CAS compliance. To the extent that CAS requirements must be flowed down within the supply chain, subcontractors (very likely foreign) will be responsible for the same relative to their lower-tier subcontractors (see 9903.202-8). Moreover, to the extent subcontractors assert confidentiality with respect to accounting practice disclosures, some administrative burden will shift to the Government (see 9903.202-8(c)(1)) – although the consequences of subcontractor noncompliance nevertheless ultimately will rest with the prime contractor.

These burdens are real. Some practical implications will include:

1. Difficulty for foreign concerns regarding understanding and interpreting CAS regulations, Cost Accounting Standards, and properly completing the CASB Disclosure Statement because it is provided in English only;
2. There is no explicit requirement that foreign concerns must complete the CASB Disclosure Statement in English, so the adequacy determination and compliance audit process may be complicated by submissions made in other languages;
3. Foreign concerns would often be required to comply with CAS rules as well as accounting rules of their own country; thus, foreign concerns would need to develop and maintain dual or alternative accounting systems;
4. The Government, prime contractors, and subcontractors will need to add staff capacity with requisite understanding of CAS as well as applicable foreign accounting rules to fulfill contractual CAS administration obligations. We note that locating such expertise and in sufficient quantities would be unlikely.
5. When subcontractors deny audit access to prime contractors, assist audits would need to be performed by the Government to determine Disclosure Statement adequacy and compliance. In addition, the Government would need to perform those audits where a foreign concern is the prime. We are doubtful that the Government would have sufficient auditors and Contracting Officers to handle an upsurge in this activity.
6. Prime contractors may choose to forgo certain contracts for the Government to be performed outside the U.S. to avoid the additional risk of foreign subcontractor compliance with CAS.

While it is impossible to estimate the cost of these implications, it is clear that there would be a cost. Moreover, as discussed above, we question if the compensating benefits of eliminating exemption (b)(14) outweigh these probable significant costs .

*Reduced Competition by Foreign Concerns*

The elimination of exemption (b)(14) presumes, perhaps unwisely, that a predominantly foreign concern supply chain is both willing and able to accept the applicable CAS requirements (e.g., CAS 401, CAS 402, Disclosure Statement, price adjustment for noncompliance and accounting changes, etc.). While it is reasonable to assume certain foreign concerns may be willing to accept these requirements and develop systems and expertise necessary to mitigate their risks, it is also reasonable to assume that many otherwise technically qualified foreign concerns will refuse to do

so. The consequence thus being reduced competitive alternatives within the global supply chain leading, logically, to increased acquisition costs due to both increased compliance costs and muted competitive forces.

The emergence of a global industrial base has greatly benefited the US Government, and this beneficial non-US market has developed in the absence of CAS applicability. This market comprises US contractors, foreign contractors, and partnerships between US and foreign contractors who ably compete for contracts outside the United States. However, if CAS applicability is extended to foreign contractors, a reasonable expectation would be to discourage foreign participation in the US military industrial base, in particular where the industrial base is commercial, such as in Australia. A lack of access to contractors would also be expected in places such as Iraq and Afghanistan, where militaries from the US, the UK, Australia, Canada, and the Netherlands rely on timely support from foreign contractors to keep critical military equipment in service. This means services for like-equipment, such as aircraft, used by militaries from different countries participating in an engagement could be supported readily by local foreign concerns, but the U.S. military would be deprived of the same level of access to support. In addition, we understand that the need for foreign contractors to support reconstruction and insurgency efforts has been critical in Iraq and Afghanistan and would likely be impeded by CAS applicability as well.

Furthermore, we believe that elimination of the exemption could also have a particularly harmful impact on the mission of the United States Agency for International Development (USAID). The very nature of USAID's activities requires that its primarily US-based prime contractors subcontract extensively outside the United States with local country entities. Most of this activity is in developing and lesser-developed countries where the pool of experienced accounting and financial professionals is extremely limited. Many of these subcontracts are cost reimbursable and are only exempt from CAS requirements because of the (b)(14) exemption. Applying the relatively sophisticated requirements of CAS in that environment is completely unrealistic. We strongly urge the Board to seek input from the USAID and its prime contractors on the potential impact to their mission from removing this exemption.

We note that the issue of CAS applicability being an impediment to successful contracting with foreign concerns was brought to the attention of the CASB in 1978, which was a primary consideration when promulgating (what is now) exemption (b)(4), as well as the specific waiver criteria for contracts and subcontracts awarded to domestic and foreign concerns to be performed outside the United States (§331.30(c)(1) and (2), November 14, 1978). Certainly the global economy has grown considerably in the 30 years since that time with the U.S. Government benefiting from contractors around the world competing for their contracts. The case for maintaining this exemption to secure access for the U.S. Government to the global supply chain must be even more compelling now.

#### Increased Procurement Lead Time

Because CAS, including disclosure requirements, would become applicable to a prime contractor's global supply chain if exemption (b)(14) is eliminated (assuming no other exemptions apply), a determination of Disclosure Statement adequacy must be made prior to subcontract award (9903.202-8(c)(1)), unless a subcontractor asserts confidentiality and submits its Disclosure Statement directly to the ACO and cognizant auditor. One practical implication of this is that many foreign concern subcontractors will not have a cognizant auditor or ACO, the assignment of which would represent an increased administrative burden on the Government. Additionally, unless subcontractors either have Disclosure Statements previously determined to be adequate or assert confidentiality, the subcontract award cycle will be significantly delayed as

prime contractors and higher-tier subcontractors review Disclosure Statements and make adequacy determinations prior to subcontract awards. These administrative delays would significantly impact Government missions worldwide. These same delays would be applicable where the U.S. Government contracts directly with a foreign concern as a prime contractor.

As industrial activity has globalized and supply chain development has become more sophisticated, disruptions to the supply chain have more severe impacts on delivery schedules and cost. Many industries now depend on long term supply agreements to support cost, quality and schedule objectives. The withdrawal of critical suppliers who were unwilling or unable to accept CAS requirements would be particularly damaging in industries where suppliers are subject to lengthy certification and regulatory approval processes, such as:

- Aviation
- Pharmaceuticals
- Biotechnology

In many cases, developing an alternate source is impractical due to considerations of cost, schedule and intellectual property rights.

#### Increased Audit Risk and Noncompliance Liability

Increased audit risk and noncompliance liability is a probable material adverse impact to both prime contractors and subcontractors if exemption (b)(14) is eliminated. All other probable adverse impacts aside, contractors will be required to accept greater contracting risk without commensurate increase in reward. It is the acceptance or rejection of this risk that sets in motion the other consequences addressed above.

While audit risk will permeate the entire supply chain where CAS becomes applicable as a consequence of eliminating exemption (b)(14), noncompliance liability will be most acute for the prime contractor. Certainly, prime contractors will develop a subcontract clause requiring indemnification from subcontractor noncompliance (and subcontractors will flow this clause down to lower-tier subcontractors) – but the likely consequence of this risk-shifting will be increased prime/sub disputes and litigation. This circumstance will be particularly prevalent where subcontractors assert confidentiality (and the Government oversees Disclosure Statement adequacy and CAS compliance), because inadequacies, noncompliance, and cost impacts will likely not be identified and asserted by the Government until many months or years after infractions occurred and contract performance has ended.

Moreover, where prime contractors and subcontractors (especially those with approved purchasing systems) retain oversight of Disclosure Statement adequacy and CAS compliance, it is reasonable to expect them to take these CAS administration responsibilities seriously given the increased audit risks and noncompliance liability, which will, necessarily, cause more:

- a. Increased administrative burdens and costs of compliance,
- b. Reduced competition (insofar as competition will likely be limited to only those firms where Disclosure Statements have been previously determined to be adequate and accounting systems compliant), and
- c. Increased procurement lead time.

#### Stress on Foreign Military Sale Arrangements with Foreign Governments

Many of the same products, such as helicopters and fighter jets, manufactured by contractors in the US and sold to the US Government are also sold to foreign governments through foreign military sales. Such sales are desirable to support the US balance of trade. Generally, foreign military sales require industrial participation in the acquiring country's economy, which often benefits the US Government supply chain as well. However, if exemption (b)(14) is eliminated,

opportunities for industrial participation will be reduced, which, consequently, would likely result in fewer foreign military sales by US contractors and diminished global supply chain development for US Government needs.

#### Other Considerations

Given the global economy, the effects of international reciprocity and international law and trade agreements must be considered before universally imposing CAS on foreign concerns. With the complexities of international law and trade agreements, which will certainly not remain unchanged over time, we question whether the CASB is prepared to ensure its regulations do not conflict with or violate these laws and regulations. We also must question the reaction foreign governments will undoubtedly have to an extra-territorial application of CAS that would likely discourage their industrial base from competing for US Government contracts.

#### Conclusion


In light of the arguments presented herein, we strongly recommend exemption (b)(14) be retained in its current form. Eliminating the exemption offers minimal, if any, benefit but makes the significant negative consequences and their costs a certainty. These costs include at least the following:

- Increased administrative burden and costs of compliance for the Government, prime contractors and subcontractors;
- Reduced pool of otherwise qualified foreign suppliers, resulting in weaker competition and increased acquisition costs;
- Mission execution risks as pre-award disclosure requirements will cause delays in the contracting process;
- Increased risk to prime contractors and subcontractors relative to CAS administration and related liabilities of noncompliance; and
- Diminished opportunities to satisfy industrial participation requirements for foreign military sales.

We believe the Government should continue to rely on the existing protections for those contracts and subcontracts that are currently exempt under (b)(14) where prices and or billings are determined based upon estimated or actual costs. These are more than adequate. The principal protections are afforded by the Truth in Negotiations Act, the False Claims Act, and the Contract Cost Principles of FAR Part 31, and the associated contract provisions, including audit rights. This group of protections provides assurance that where necessary there will be visibility into costs proposed or claimed, the accounting methods such as indirect rates that are included, and that the costs proposed or claimed are allowable.

Thank you for the opportunity to respond to this Request for Information. If you have questions, or need additional information, please contact NDIA Procurement Division Director Ruth Franklin at (703)247-2598 or at [rfranklin@ndia.org](mailto:rfranklin@ndia.org).

Sincerely,



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Vice President, Government Policy