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STATEMENT OF
ELMER B. STAATS, CHAIRMAN, COST ACCOUNTING STANDARDS BOARD
BEFORE THE
LEGISLATIVE SUBCOMMITTEE OF THE
APPROPRIATIONS COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES
ON
COST ACCOUNTING STANDARDS BOARD
BUDGET ESTIMATES FOR FISCAL YEAR 1977



MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I am appearing before you today in my capacity as Chairman of the Cost Accounting Standards Board to discuss the budget estimates for Board operations during Fiscal Year 1977.

On March 25, 1975, I appointed four Board members to serve for the next four years. I reappointed Mr. Herman W. Bevis and Mr. Robert K. Mautz to second terms. Mr. Bevis was Senior Partner of Price Waterhouse & Company, Certified Public Accountants; Mr. Mautz is currently a Partner in the firm of Ernst & Ernst, Certified Public Accountants. The Honorable Terence E. McClary, the Assistant Secretary of Defense (Comptroller), was appointed to succeed Mr. Robert C. Moot; and Mr. John W. Walker, Vice President and Controller of Texas Instruments, Incorporated, was appointed to succeed Mr. Charles A. Dana.

Mr. Arthur Schoenhaut is the Executive Secretary of the Board. He serves as director of a professional staff, presently numbering 24, and a total staff of 37.

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Our budget estimate for Fiscal Year 1977 is \$1,700,000. This amount is \$65,000 more than was appropriated for Fiscal Year 1976. This small increase is required to permit us to absorb the continuing effect of Federal pay increases.

Before describing the details of our budget estimate, I would like first to review briefly for you the Board's activities to date.

The Board has promulgated eleven Cost Accounting Standards and implementing regulations. All of these Standards are required to be included in negotiated defense contracts covered by Public Law 91-379.

The eleven Cost Accounting Standards promulgated by the Board to date are:

- No. 401 Consistency in Estimating, Accumulating, and Reporting Costs
- No. 402 Consistency in Allocating Costs Incurred for the Same Purpose
- No. 403 Allocation of Home Office Expenses to Segments
- No. 404 Capitalization of Tangible Assets
- No. 405 Accounting for Unallowable Costs
- No. 406 Cost Accounting Period
- No. 407 Use of Standard Costs for Direct Material and Direct Labor
- No. 408 Accounting for Costs of Compensated Personal Absence
- No. 409 Depreciation of Tangible Capital Assets
- No. 411 Accounting for Acquisition Costs of Material
- No. 412 Composition and Measurement of Pension Costs

The Board has also twice solicited comments from the general public on a proposal for Standard No. 410, dealing with allocation of business unit general and administrative expenses to cost objectives, and a proposal for Standard No. 413, concerned with adjustment of historical depreciation costs for inflation. Comments submitted to the Board on these proposals are being analyzed prior to Board consideration of whether to go forward with promulgation of Cost Accounting Standards on the two subjects.

In addition, the Board has designed a Disclosure Statement of cost accounting practices which contractors must submit to the Government as a condition of contracting. These Disclosure Statements require major defense contractors to describe the principal practices they will follow for applicable negotiated defense contracts. Initially, each contractor who received negotiated prime defense awards in excess of \$30 million in Fiscal Year 1971 was required to submit a Disclosure Statement.

The Board has subsequently amended its regulations on the Disclosure Statement, which now require firms which received \$10 million of negotiated, defense awards subject to the Board's jurisdiction in Fiscal Year 1972 and in subsequent years to file Disclosure Statements as a condition of contracting. Also, beginning in Fiscal Year 1976, firms are required to count the value of subcontracts subject to the Board's regulations in determining whether they have met the \$10 million level of awards.

As of December 31, 1975, the Board had received copies of 1,328 Disclosure Statements from 165 companies required to make disclosure to the Government of cost accounting practices. The Board has established a computerized data bank into which are placed the responses contained in every Disclosure Statement received. We have the capacity to provide aggregate data with respect to any question or combination of questions covered by the Disclosure Statement. This data bank is of considerable assistance to the Board in its research into possible Standards. Much of this information has been published in the Board's 1974 and 1975 Progress Reports to the Congress.

The Board has undertaken a priority study of the cost of capital used in defense contracting, looking to the possibility of a Cost Accounting Standard on this subject for issuance in 1976. The Board is also working on a number of other subjects, many of which we believe will culminate in Cost Accounting Standards. I have attached as Appendix A to this statement a brief description of fifteen subjects on which the Board has authorized research and development looking toward the potential promulgation of Standards.

The task of issuing sound, fair Cost Accounting Standards is exceedingly complex. To assist the Board in achieving its objectives, the Board has continued its policy of seeking the cooperation of all those who have an interest in its work. The Board has established active, open

consultations with representatives of all groups, including Government agencies, professional and industry associations, the academic community, and representatives of individual companies. Participation on both an individual basis and an organizational basis has been excellent. There are now more than 2,000 organizations and individuals to whom Board proposals and promulgations are regularly mailed during the course of the Board's research. These organizations and individuals generally have provided constructive reviews and comments on Board materials.

Recognizing that training in its regulations and newly issued Standards could materially assist both industry and Government, the Board actively participated in programs under which training in its materials could be provided to interested persons through the established training programs of the Civil Service Commission, the Army Logistics Management Center, the American Institute of Certified Public Accountants, and the National Contract Management Association. As valuable as this early training was, the Board has concluded during the past year that it should again actively encourage the creation of additional training opportunities for federal personnel in Board standards and regulations. This was one of the conclusions from the Board's Evaluation Conference, held last June, which I will discuss in greater detail in a moment.

In addition to participating in formal training, Board Members and staff have spoken to interested groups and participated in panels, conferences, and the like, most of which were sponsored by accounting or

legal professional associations or by industry associations. These occasions have afforded opportunities to provide interested parties with information about the Board and also to answer questions and to discuss concerns about the Board's Standards and regulations. The Board pays all travel and living expenses in accordance with the standardized travel regulations whenever the staff members attend out-of-town meetings.

The Board has also worked cooperatively with Federal agencies in the development of regulations implementing Cost Accounting Standards and pertinent Board rules and regulations. The three principal relevant agencies--the Department of Defense, the National Aeronautics and Space Administration, and the Energy Research and Development Administration--all issue implementing regulations. The General Services Administration in its publication of the Federal Procurement Regulations has also provided that the Board's Standards, rules and regulations, as a matter of policy, shall be extended to most of the negotiated contracts of the civilian executive agencies. The result of this coordination is that the regulations of all agencies are generally parallel in structure and content.

The Board also sponsored establishment of an Interagency Advisory Committee to which procurement and finance representatives of DOD, ERDA,

NASA, GSA, the Department of Health Education and Welfare and the Department of Transportation are appointed. This Committee meets from time to time to discuss problems of common interest concerning the Board's regulations and Cost Accounting Standards and to discuss ways whereby uniform action can be taken by all Executive Branch agencies on such matters. Recently the Director of the Office of Federal Procurement Policy was made Chairman of this Committee, replacing the Deputy Administrator of General Services who chaired the Committee in the past.

The Board has for three years been receiving annual reports from the Federal agencies which use Standards. The reports have provided an opportunity, which the Board welcomes, for agencies to comment on their experience in the use of Standards and Board regulations. The Board has had, however, no formalized way of obtaining similar evaluations from contractors and the accounting profession. Although the Board has from time to time invited representatives of contractors, industry associations, and accounting professional associations to meet with the Board to discuss the Board's work, those meetings usually focus on a particular proposed Standard or on an identified issue in the Board's regulations.

To provide a forum to which all interested persons could be invited to discuss with the Board their evaluations of promulgated Standards and regulations, the Board convened an Evaluation Conference last June. The Board expected that the advice and comments which it would receive would assist it in its future work as well as inform it of any widely-held

view suggesting modification of existing standards or regulations.

Nine representatives of organizations or firms accepted the invitation to appear at the Evaluation Conference, and almost 300 persons attended it. Additionally, some 13 additional organizations submitted written comments, although they did not avail themselves of the opportunity for a dialogue with Board Members.

The Board found the Evaluation Conference met our expectations for it. To judge from what we heard, experience with promulgated Standards has been largely very affirmative. Almost all of the recommendations for modifications or changes were addressed to problems arising from the implementation of the Board's regulations and Standards.

At its next meeting after the Evaluation Conference, the Board approved Staff proposals for priority projects to address the concerns most frequently mentioned at the Conference and discussed in the written submissions. These projects will look into whether the Board can in a Standard or in some other fashion promulgate a definition of materiality and make it more readily available in the administration of contracts containing Standards. Another project is to define the phrase "cost accounting practice," which is used in the law establishing the Board and in the Board's regulations. The third approved project was for staff exploration of whether the Board can assist the contracting parties in implementation of agency procurement regulations and in determining the amounts of price adjustments required by Board regulations.

The Board continues to study the possibility of establishing higher thresholds for application of its requirements to defense contracts. Currently the Board is seeking data which will help it determine whether an exemption from its requirements which would be based on the volume of a company's sales to the Federal Government would be consistent with the purposes sought to be achieved by the law establishing the Board.

Turning now to our request for appropriations, our budget estimate of \$1,700,000 for Fiscal Year 1977 will be allocated as follows:

\$1,308,000 for salaries and related benefits of the members of the Board, permanent professional staff, part-time consulting assistants, and supportive clerical staff. The increase of \$65,000 over the amount projected for Fiscal Year 1976 covers the continuing effect of Federal pay increases and the annualization of positions filled during this year.

\$100,000 for travel of Board members and staff, this being no increase over the amount projected for Fiscal Year 1976.

\$160,000 for contractual services, computer services and reimbursement to other Government agencies for administrative and personnel services; this is the same amount projected for these services in Fiscal Year 1976.

\$132,000 for costs of space and services furnished by GSA, communications, utilities, printing and reproduction, supplies, materials, and equipment, which again is the same amount projected for Fiscal Year 1976.

The amount for salaries covers 42 permanent positions. These are for the 3 Board members entitled to compensation, for the 37 present staff members and for 2 positions which remain to be filled.

Our travel estimate reflects our belief that there will be a continuing need for extensive field trips to perform research and development of possible Cost Accounting Standards. We must travel to obtain on-site information at contractors' offices and plants regarding cost accounting practices if we are to assure that Standards give due consideration to the requirements and views of contractors, as well as those of the Government.

The estimate for other services includes anticipated costs of some contract services and reimbursements to other Government agencies for use of computers and personal services in support of research and development of Cost Accounting Standards and administrative services.

This statement covers, in general, a summary of the Board's activities, in the areas in which we propose to continue our research for development of possible Cost Accounting Standards and our budget estimate for Fiscal Year 1977. I will be glad to answer any of your questions.

CURRENT STUDIES

Selection of specific areas for research and possible development of Cost Accounting Standards is based primarily on (1) relationship to the objectives of Public Law 91-379, (2) significance of observed costing problems, and (3) relationship to other work of the Board. The Board has sought and obtained advice about the importance of various problems which are involved in contract cost accounting. The research projects selected are at various stages of development and may result in one or more Standards on each subject. Preliminary proposals and research papers have been widely circulated for some subjects, and not for others.

1. Cost of Money as an Element of the Cost of Capital - This study deals with the explicit recognition of the cost of money as an element of contract cost.

2. Allocation of Manufacturing Overhead - This project covers the allocation of pools of indirect costs of manufacturing overhead.

3. Distinguishing Between Direct and Indirect Costs - This study covers the accounting concepts and principles governing consistent classification of costs as direct or indirect, and the bases for making distinctions.

4. Deferred Compensation - This research involves inquiry into the criteria for the measurement and assignment of deferred compensation costs, including profit sharing, stock options, and bonuses, but not including pension costs.

5. Accounting for Cost of Service Centers - Research on this subject involves the development of concepts for use in the accounting for the cost of service centers.

6. Accounting for Contract Terminations - This study concerns the inquiry into cost accounting principles and practices applicable to contracts which are terminated for the convenience to the Government.

7. Adjustments and Allocations of Pension Costs - This project deals with the criteria used for measuring and assigning to cost accounting periods the value of actuarial gains and losses. Criteria will be developed for both regular recurring and abnormal gains and losses. The Standard will also provide criteria for allocating pension costs from a home office to segments.

8. Accounting for Intracompany Transfers - This project is in the preliminary research stage. It covers inquiry into the accounting problems involved in the pricing of intracompany sales or transfers of goods and services.

9. Accounting for Direct Materials Not Incorporated in Contract End Items - This subject encompasses the accounting for the cost of

materials which are allocable directly to contracts and other final cost objectives but which are not incorporated in end items.

10. Accounting for Insurance Costs - This research deals with criteria for the measurement of insurance costs, including self-insurance, and the appropriate treatment of retrospective premium adjustments.

11. Allocation of Material-Related Expenses - This subject deals with the criteria for expense-pool creation and allocation-base selection pertaining to material-related expenses. The initial scope includes the functions traditionally associated with the flow of materials, such as material planning and control, purchasing, receiving and stores, internal and external transportation, distribution, etc.

12. Indirect Costs of Colleges and Universities - This study involves an inquiry into the nature and composition of indirect cost rates of colleges and universities which have Government contracts and grants.

13. Allocation of Engineering Overhead - This subject covers the allocation of pools of engineering costs.

14. Allocation of Other Operations Overhead - This subject covers the allocation of pools of costs of operations other than manufacturing and engineering costs.

15. Independent Research and Development and Bid and Proposal Costs - This subject covers the accounting for costs of performing

independent research and development and costs of preparing bids and certain proposals by contractors engaged in Government contracts.

COST ACCOUNTING STANDARDS BOARD

SALARIES AND EXPENSES

For expenses of the Cost Accounting Standards Board necessary to carry out the provisions of Section 719 of the Defense Production Act of 1950, as amended (Public Law 91-379, approved August 15, 1970), [\$1,635,000], \$1,700,000 [for "Salaries and expenses" for the period July 1, 1976, through September 30, 1976, \$410,000].

(Legislative Branch Appropriation Act, 1976.)

Justification of Estimates

Fiscal Year 1977

Section 103, title I, of the 1970 amendment (Public Law 91-379) to the Defense Production Act of 1950, established as an agent of the Congress a Cost Accounting Standards Board. This legislation provides that the Board shall consist of the Comptroller General of the United States who shall serve as Chairman and four other members appointed by the Comptroller General. The Act empowers the Board to appoint an Executive Secretary at a rate of compensation not to exceed the rate prescribed for level IV of the Federal Executive Salary Schedule.

The enabling legislation provides that three Board members appointed from private life will receive compensation at a rate of one two-hundred-sixtieth of the rate prescribed for Level IV (\$39,900 per annum) of the Federal Executive Salary Schedule for each day in which he is engaged in the actual performance of duties vested in the Board. The enabling legislation also provides that the Comptroller General (who serves as Chairman) and one member to be named from Government would continue to receive the compensation of his regular position from the agency employing him.

The principal function of the Board is to develop and promulgate Cost Accounting Standards designed to achieve greater uniformity and consistency in the cost accounting practices followed by defense contractors and subcontractors under negotiated defense procurements in excess of \$100,000. The Standards, rules, and regulations promulgated are to be followed in estimating, accumulating, and reporting costs of defense contracts.

The budget estimate for Fiscal Year 1977 is \$1,700,000. This estimate is \$65,000 more than the amount appropriated in Fiscal Year 1976.

Object Classification

	<u>1975</u> <u>Actual</u>	<u>1976</u> <u>Estimate</u>	<u>1976-T</u> <u>Estimate</u>	<u>1977</u> <u>Estimate</u>
	(In thousands of dollars)			
Personnel compensation:				
11.1 Permanent positions	\$ 976	\$1,098	\$283	\$1,158
11.3 Positions other than permanent	<u>30</u>	<u>42</u>	<u>11</u>	<u>42</u>
Total personnel compensation	1,006	1,140	293	1,200
12.1 Personnel benefits:				
Civilian employees	81	103	26	108
21.0 Travel and transportation of persons	60	100	25	100
22.0 Transportation of things	-	-	-	-
23.0 Rent, communications, and utilities	101	105	25	105
24.0 Printing and reproduction	14	15	3	15
25.0 Other services	144	160	35	160
26.0 Supplies and materials	6	7	2	7
31.0 Equipment	<u>1</u>	<u>5</u>	<u>1</u>	<u>5</u>
99.0 Total obligations	\$1,412	\$1,635	\$410	\$1,700
Unobligated balance lapsing	<u>216</u>	<u>-</u>	<u>-</u>	<u>-</u>
Budget authority	<u>\$1,628</u>	<u>\$1,635</u>	<u>\$410</u>	<u>\$1,700</u>

An explanation of our fund requirements by object classification follows:

11.1 Permanent Positions. This estimate covers the salary costs for 42 permanent positions in Fiscal Year 1977. These positions include three Board members, and Executive Secretary (at level IV), 25 other professional positions, and 13 supportive clerical positions. The increase shown for this object results from a pay increase, and the annualization of positions filled this year.

12.1 Civilian Personnel Benefits. This estimate covers the Board employer contributions to the retirement, life insurance and health benefit funds.

21.0 Travel and Transportation of Persons. This estimate covers the cost for travel of the Board and its staff to obtain on-site information of contractors' offices and for attendance at meetings and conferences regarding Board programs.

23.0 Rent, Communications, and Utilities. This estimate covers the costs of space and services furnished by the General Services Administration, equipment, telephones, postage, etc.

24.0 Printing and Reproduction. This estimate covers the cost of day-to-day printing requirements, i.e., stationery, envelopes, etc., and the cost of publishing Cost Accounting Standards, rules, and regulations promulgated by the Board.

25.0 Other Services. This estimate covers the costs for contract services and reimbursements to other Government agencies for administrative and personal services.

26.0 Supplies and Materials. This estimate covers the cost of day-to-day operating supplies and materials.

31.0 Office Furniture and Equipment. This estimate provides for the cost of typewriters, adding machines, calculators and other office machines and for office furniture, technical books and publications.