

published a proposed rule that would provide guidance on the applicability and enforcement of ERISA section 4062(e), which provides for reporting of and liability for certain substantial cessations of operations by employers that maintain single-employer plans. PBGC is extending the comment period until November 12, 2010, in order to give the public additional time to review and comment on the proposed rule.

Issued in Washington, DC, this 15th day of October 2010.

**Vincent K. Snowbarger,**

*Deputy Director for Operations, Pension Benefit Guaranty Corporation.*

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## OFFICE OF MANAGEMENT AND BUDGET

### Office of Federal Procurement Policy

#### 48 CFR Part 9903

#### **Cost Accounting Standards: Elimination of the Exemption From Cost Accounting Standards for Contracts Executed and Performed Entirely Outside the United States, Its Territories, and Possessions**

**AGENCY:** Office of Management and Budget (OMB), Office of Federal Procurement Policy, Cost Accounting Standards Board.

**ACTION:** Notice of proposed rule.

**SUMMARY:** The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards (CAS) Board (Board), invites public comments concerning a Notice of Proposed Rule (NPR) to eliminate an exemption from the Cost Accounting Standards for contracts executed and performed entirely outside the United States, its territories, and possessions.

**DATES:** Comments must be in writing and must be received by December 20, 2010.

**ADDRESSES:** All comments to this NPR must be in writing. Electronic comments may be submitted in any one of three ways:

1. *Federal eRulemaking Portal:* Comments may be directly sent via <http://www.regulations.gov>—a Federal E-Government Web site that allows the public to find, review, and submit comments on documents that agencies have published in the **Federal Register** and that are open for comment. Simply type “(b)(14) Overseas Exemption NPR” (without quotation marks) in the

Comment or Submission search box, click Go, and follow the instructions for submitting comments;

2. *E-mail:* Comments may be included in an e-mail message sent to [casb2@omb.eop.gov](mailto:casb2@omb.eop.gov). The comments may be submitted in the text of the e-mail message or as an attachment;

3. *Facsimile:* Comments may also be submitted via facsimile to (202) 395-5105; or

4. *Mail:* If you choose to submit your responses via regular mail, please mail them to: Office of Federal Procurement Policy, 725 17th Street, NW., Room 9013, Washington, DC 20503, ATTN: Raymond J.M. Wong. Due to delays caused by the screening and processing of mail, respondents are strongly encouraged to submit responses electronically.

Be sure to include your name, title, organization, postal address, telephone number, and e-mail address in the text of your public comment and reference “(b)(14) Overseas Exemption NPR” in the subject line irrespective of how you submit your comments. Comments received by the date specified above will be included as part of the official record. Comments delayed due to use of regular mail may not be considered.

Please note that all public comments received will be available in their entirety at [http://www.whitehouse.gov/omb/casb\\_index\\_public\\_comments/](http://www.whitehouse.gov/omb/casb_index_public_comments/) and <http://www.regulations.gov> after the close of the comment period. Do not include any information whose disclosure you would object to.

**FOR FURTHER INFORMATION CONTACT:** Raymond J.M. Wong, Director, Cost Accounting Standards Board (telephone: 202-395-6805; e-mail: [Raymond\\_wong@omb.eop.gov](mailto:Raymond_wong@omb.eop.gov)).

#### **SUPPLEMENTARY INFORMATION**

##### **A. Regulatory Process**

Rules, Regulations and Standards issued by the Cost Accounting Standards Board (Board) are codified at 48 CFR Chapter 99. The Office of Federal Procurement Policy (OFPP) Act, at 41 U.S.C. 422(g), requires that the Board, prior to the establishment of any new or revised Cost Accounting Standard (CAS or Standard), complete a prescribed rulemaking process. The process generally consists of the following four steps:

1. Consult with interested persons concerning the advantages, disadvantages and improvements anticipated in the pricing and administration of Government contracts as a result of the adoption of a proposed Standard.

2. Promulgate an Advance Notice of Proposed Rulemaking (ANPRM).

3. Promulgate a Notice of Proposed Rulemaking (NPRM).

4. Promulgate a Final Rule.

The Board notes that the (b)(14) overseas exemption from CAS at 48 CFR 9903.201-1(b)(14) is not subject to the four-step process required by 41 U.S.C. 422(g)(1) because it is not a Cost Accounting Standard. The Board elects to follow those requirements in the OFPP Act, at 41 U.S.C. 422(g)(1), to 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 any new or revised rule, prior to its promulgation.

#### **B. Background and Summary**

The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (Board), is today releasing a Notice of Proposed Rule (NPR) on a proposal to eliminate the exemption from the Cost Accounting Standards (CAS) for contracts executed and performed entirely outside the United States, its territories, and possessions as codified at 48 CFR 9903.201-1(b)(14), the “(b)(14) overseas exemption.” The purpose of this NPR is to obtain input on whether the (b)(14) overseas exemption at 48 CFR 9903.201-1(b)(14) should be retained, eliminated, or revised.

##### *Statutory Requirement*

Section 823(a) of the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 (NDAA FY 2009) requires the Board to: “(1) Review the inapplicability of the cost accounting standards, in accordance with existing exemptions, to any contract and subcontract that is executed and performed outside the United States when such a contract or subcontract is performed by a contractor that, but for the fact that the contract or subcontract is being executed and performed entirely outside the United States, would be required to comply with such standards; and (2) determine whether the application of the standards to such a contract and subcontract (or any category of such contracts and subcontracts) would benefit the Government.” A report must be provided to the appropriate committees of Congress containing: (1) Any revision to the cost accounting standards proposed as a result of the review required by section 823(a) and a copy of any proposed rulemaking implementing the revision; or (2) if no revision and rulemaking are proposed, a detailed justification for such decision.

*History of the (b)(14) Overseas Exemption at 48 CFR 9903.201-1(b)(14)*

The subject of this NPR is the (b)(14) overseas exemption at 48 CFR 9903.201-1(b)(14) which exempts from CAS “contracts and subcontracts to be executed and performed entirely outside the United States, its territories, and possessions.” This exemption was first promulgated in 1973. The Armed Services Procurement Regulation (ASPR), a predecessor regulation to the Federal Acquisition Regulation (FAR), provided that the CAS clause in ASPR 7-104.83 shall not be inserted in “contracts which are executed and performed in their entirety outside the United States, its territories and possessions [(the (b)(14) overseas exemption)].” See ASPR 3-1204, as amended by Defense Procurement Circular No. 115 (dated September 24, 1973). The basis for the (b)(14) overseas exemption is connected to the scope of the law that originally created the Board.

The original Board was established by Section 2168 of the Defense Production Act (DPA). Section 2163, Territorial application of Act, of the DPA provided that sections 2061 through 2171 (which included the authority for the Board) “shall be applicable to the United States, its Territories and possessions, and the District of Columbia.” The (b)(14) overseas exemption reflects this same limitation of applicability on contracts executed and performed overseas. In 1980, the Board ceased to exist under the DPA. Congress reestablished the Board in 1988 under section 22 of the OFPP Act, 41 U.S.C. 422. Unlike the DPA, the OFPP Act is not limited in applicability to the United States. Additional historical background is provided at 70 FR 53977 (September 13, 2005).

In 1991, the re-established Board reviewed the rules and regulations applicable to the administration of CAS. FAR 30.201-1(14), the exemption from CAS for contracts and subcontracts executed and performed entirely outside the United States, its territories and possessions, was part of that review. The Board retained the exemption and incorporated it into its current re-codified rules and regulations at 48 CFR 9903.201-1(b)(14), the “(b)(14) overseas exemption,” on April 17, 1992 (57 FR 14148.) No specific explanation was provided for retaining the exemption.

On September 13, 2005, the Board published a Staff Discussion Paper (SDP) discussing the (b)(14) overseas exemption and sought comments on its continued appropriateness (70 FR 53977). The three public comments

received in response to the SDP offered arguments for retaining the exemption; none of the comments supported any revision to, or an elimination of, the (b)(14) overseas exemption. After reviewing and discussing the public comments, the Board decided to retain the exemption. (73 FR 8259, February 13, 2008.) While the Board did not agree with all of the views expressed, it did agree with the conclusion not to delete or revise the (b)(14) overseas exemption.

*Conclusions*

After considering the comments from the public and Government agencies (discussed in section C. Public Comments to the Notice of Request for Information), the Board has proposed to eliminate the (b)(14) overseas exemption at 48 CFR 9903.201-1(b)(14) for the following reasons:

(1) The statutory basis that was used to justify the (b)(14) overseas exemption when it was first promulgated no longer exists. The (b)(14) overseas exemption was initially established because the Defense Production Act (DPA), the statute that originally created the Board, was limited in applicability to the United States, its territories and possessions, and the District of Columbia. Unlike the DPA, the current statute from which the Board derives its authority, the OFPP Act, does not restrict the applicability of CAS to the United States.

(2) There is no accounting basis for the (b)(14) overseas exemption. The place of contract execution and performance—the trigger for the (b)(14) overseas exemption—is not germane to the fundamental principles and methods used to account for the costs of contract performance. The exemption does not help to achieve consistency and uniformity in the cost accounting practices used by Government contractors in the measurement, assignment and allocation of costs to Government contracts, the primary objective of the CAS.

(3) Based on the data submitted in response to its request for information, the Board projects the volume of affected contractors and subcontractors to be relatively small. Some respondents expressed concern that elimination of the (b)(14) overseas exemption could negatively affect contracting, such as through decreased competition, increased prices, difficulty of enforcement overseas, and potential retaliation by foreign governments, but did not offer evidence to support these assertions. The Board has concluded that these concerns are too speculative to address. Additionally, the Board has concluded that some of the same

principles, that would be applicable due to the imposition of CAS because of the elimination of the (b)(14) overseas exemption, are already applicable under the cost principles found in Part 31 of the Federal Acquisition Regulation.

**C. Public Comments to the Notice of Request for Information**

On April 23, 2009, as required by section 823(b) of the NDAA FY 2009, the Board published a Notice of Request for Information (74 FR 18491). It solicited public comments and information with respect to the Board’s review of whether the (b)(14) overseas exemption at 48 CFR 9903.201-1(b)(14) should be retained, eliminated, or revised. The Notice posed a series of questions, the purpose of which was to elicit information and comments for the Board’s consideration. The Board also solicited comments directly from three Federal Government organizations with a significant volume of contracts performed outside the United States—the Department of Defense (DOD), the Department of State (DOS), and the United States Agency for International Development (USAID). The Board received seven public comments as well as comments from these three Government organizations. The comments, which were considered by the Board in its deliberations, provide a variety of views. The full text of the public comments to the Notice of Request for Information is available at: [http://www.whitehouse.gov/omb/casb\\_index\\_public\\_comments/](http://www.whitehouse.gov/omb/casb_index_public_comments/) and <http://www.regulations.gov>. They are summarized and addressed in this section, grouped by the questions posed by the Board in its Notice of Request for Information, and by common themes when the comments were not responsive to the questions posed.

*1. What is your experience with the [(b)(14)] 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 [(b)(14)] overseas exemption?

*Comments:* Some of the responses from Federal agencies reflected their experiences with the (b)(14) overseas exemption. DOS indicated that there are few major contracts both executed and performed overseas that are subject to CAS. USAID had only two recent actions involving the (b)(14) overseas exemption. DOD reported very little activity with the (b)(14) overseas exemption at the prime contractor level, and that much of the activity is at the

subcontractor level where the data is not readily available. See the Board's responses to question 2 for additional details.

Individual contractors did not respond to the Notice of Request for Information, and comments from other respondents, including trade and industry associations, did not address this question directly. A public interest group respondent took issue with the narrow set of questions posed by the Board as it felt the questions were posed to contractors and contracting officers that were unlikely to support increased CAS coverage. It noted that the questions appeared to be aimed solely at contractors and contracting offices of the Federal government. A consulting firm noted that, for foreign companies and foreign owned subsidiaries of U.S. companies, the (b)(14) overseas exemption appears to be useful; the firm stated that the (b)(14) overseas exemption made it easier to obtain bids from companies willing to bid on US Government subcontracts, but acknowledged that, in absence of the applicability of CAS, the cost measurement and allocation rules under FAR Part 31 would apply.

*Responses:* The Board notes that this question was directed to procuring entities (*i.e.*, Government, contractor and subcontractor) and affected contractors and subcontractors because the Board was seeking information on how the (b)(14) overseas exemption directly and specifically impacted the affected entities. While some questions were addressed to entities directly affected by the (b)(14) overseas exemption, the public was not precluded from providing comments on the substance of those questions. Other questions were not so narrowly targeted. The Board takes note of the Government's experiences with the (b)(14) overseas exemption. The Board agrees that, in the absence of the applicability of CAS, FAR Part 31, including its cost measurement, assignment, and allocation rules, would still apply. The Board sees no benefit to a CAS exemption when FAR Part 31 applies. The Board does not agree that the CAS (b)(14) overseas exemption relieves the "burden" on foreign companies from complying with the CAS rules on the measurement, assignment, and allocation of cost to Federal contracts, since the cost measurement, assignment, and allocations rules in FAR Part 31 would generally apply in the absence of CAS.

2. *How often (number of actions, dollar amounts, by fiscal year) has the [(b)(14)] overseas exemption been claimed?*

*Comments:* DOS did not provide the number of actions or dollars of obligations subject to the (b)(14) overseas exemption, but stated that eliminating the exemption would have minimal impact on State, as DOS had few major contracts that are both executed and performed overseas that are subject to CAS. USAID indicated only two recent actions: \$23.5 million and \$1.4 billion for 2006 and 2007, respectively. (The \$1.4 billion is 34% of FY 2007 obligations for USAID.) DOD reported very little activity with the (b)(14) overseas exemption at the prime contractor level. The Navy reported that no (b)(14) overseas exemptions have been granted. The Air Force (AF) reported seventeen (b)(14) overseas exemptions with prime contractors in the past three years representing only a small percentage of its obligations. The AF expects the number of (b)(14) overseas exemptions to increase in the future because of its contingency contracting efforts, but cannot predict the amount as a percentage of total obligations, which may remain very small. DOD reported that the Army appeared to have the largest number and dollar volume of contracts claiming the (b)(14) overseas exemption, but did not compile any data. DOD's preliminary finding is that most of the activity with the (b)(14) overseas exemptions is at the subcontractor level where data is not readily available. DOD reported that its contract administrator, the Defense Contract Management Agency (DCMA), is not staffed currently to administer CAS overseas. DOD stated that the Military Services were compiling data and would forward the data on specific experiences and the number of exemptions granted based on the (b)(14) overseas exemption. During the preparation of the NPR, the Board staff contacted DOD on the status of the additional information. DOD responded that it had no additional information to provide and could not develop the information to support the use of the (b)(14) overseas exemption.

*Responses:* Based on the comments with usage data received from the three Federal Government agencies with the highest volume of contracts in foreign countries, it appears that the (b)(14) overseas exemption has been rarely used at the prime contractor level. No respondents provided usage data at the subcontractor level. Consequently, eliminating the (b)(14) overseas exemption based on available data would not appear to be detrimental to

the performance of Government contracts.

3. *If the [(b)(14)] overseas exemption is eliminated, what problems will that cause you?*

a. As a procuring entity (*e.g.*, procurement office, higher tier contractor) awarding contracts/subcontracts?

*Comments:* Responses were mixed. Both DOS and USAID indicated that the elimination of the (b)(14) overseas exemption would have minimal to no impact on their operations. By contrast, DOD anticipates that some host governments may object to the imposition of CAS on the accounting practices of foreign concerns as an infringement of their sovereignty. There is also concern that some foreign entities may elect not to perform work for the U.S. Government, causing a reduction in the number of entities willing to perform work overseas for an unknown period of time. DOD anticipates an increase in the requests for CAS waivers from entities that are now using the (b)(14) overseas exemption, which could slow the contract award process. There may also be an increase in proposed prices from entities previously exempted by the (b)(14) overseas exemption for the costs associated with changing accounting systems, and to account for the additional risks due to the potential cost impacts for CAS non-compliances. The Defense Contract Audit Agency (DCAA) believes that the elimination of the (b)(14) overseas exemption will have little or no impact on U.S. firms. It believes that those firms most affected by the elimination of the (b)(14) overseas exemption will be foreign concerns that are subcontractors to U.S. prime contractors. DCAA commented that the cost of administering CAS requirements to certain foreign subcontractors that are currently CAS exempt under the (b)(14) overseas exemption might outweigh the benefit to be derived from making CAS applicable to them.

Two industry association respondents echoed the comments made by DOD. One industry group respondent noted that the Government benefits from sales to foreign governments, many of which require some form of foreign company participation. "Currently, foreign companies are covered by the [(b)(14) overseas] exemption in CAS for contracts executed and performed entirely outside the U.S. Were the [(b)(14) overseas] exemption eliminated, the opportunities provided through these industrial participation programs would be significantly reduced, which

would reduce beneficial foreign military sales." The situation would be the same, even if industrial participation programs were not involved, where the U.S. Government and local foreign government share common foreign vendors. The respondent noted that "[g]iven the global economy, the effects of international reciprocity should be considered in avoiding unintended consequences. If the U.S. applies CAS to foreign contractors, other countries may extend their rules to U.S. contractors, effectively eliminating U.S. contractors from competing globally for foreign military sales." Another industry group respondent predicts reduced competition by foreign concerns if CAS is extended to foreign contractors; the imposition of CAS would discourage foreign participation as contractors and subcontractors, especially where the industrial base is commercial. This industry group respondent believes that USAID would be adversely impacted by the elimination of the (b)(14) overseas exemption. Local foreign vendors may elect to cease doing business with the U.S. Government rather than incur the costs of complying with CAS. This industry group respondent notes the increased administrative burden and costs of compliance for both the Government and the contracting community resulting in longer procurement lead times. The lack of local foreign vendors would be especially critical in remote locations and war zones. Generally, a foreign trade association respondent, which represents several British trade groups, made similar comments.

*Responses:* The three Federal government organizations with the largest dollar volume of contracts performed outside the U.S. did not provide data demonstrating that eliminating the (b)(14) overseas exemption would be detrimental to their contracting. The Board does not agree with comments about the acquisition of commercial items from foreign companies, as acquisitions of commercial items are generally exempt under 48 CFR 9903.201-1(b)(6). The Board notes that while one respondent believes that USAID would be adversely affected by the elimination of the (b)(14) overseas exemption, USAID itself does not believe the elimination of the exemption would be problematic.

Many of the comments and concerns appear to reflect the mistaken impression that the elimination of the (b)(14) overseas exemption would impose full CAS upon foreign concerns. That may not be true in light of the availability of another CAS exemption, at 48 CFR 9903.201-1(b)(4), which has

two distinct parts: The (b)(4) foreign government exemption and the (b)(4) foreign concern exemption. The (b)(4) foreign government exemption provides for a complete exemption to CAS for "contracts and subcontracts with foreign governments or their agents or instrumentalities," while the (b)(4) foreign concern exemption provides an exemption to CAS, other than CAS 401 and 402, for any "any contract or subcontract awarded to a foreign concern." Even if no other CAS exemptions were applicable, many of the contracts with foreign concerns would continue to be subject to the cost principles in FAR Part 31 with its measurement, assignment, and allocation rules, as the FAR does not have an exemption or deviation for foreign concerns.

b. As the contractor/subcontractor claiming the applicability of the [(b)(14)] overseas exemption?

*Comments:* Three industry group respondents, including a foreign trade association respondent, expressed concerns that the ability to utilize foreign subcontractors would be curtailed. They stated that many foreign concerns will not be able to comply with CAS because of a lack of resources, the lack of knowledgeable personnel, as well as the costs of implementation. Another respondent stated that U.S. firms would be at a competitive disadvantage with foreign firms exempted from all CAS, other than CAS 401 and 402, if the foreign concern qualifies for the (b)(4) foreign concern exemption at 48 CFR 9903.201-1(b)(4).

*Responses:* See the Board's responses in question 3.a. The Board does not believe that U.S. concerns will necessarily be at a competitive disadvantage with foreign concerns exempted from all CAS, other than CAS 401 and 402, especially since most, if not all, of the contracts and subcontracts would continue to be subject to the cost principles in FAR Part 31, including its cost measurement, assignment, and allocation rules. The principles of consistency articulated by CAS 401 and 402 are incorporated into FAR Part 31.

The Board acknowledges that the (b)(4) foreign concern exemption, unlike the (b)(14) overseas exemption, is not an exemption from all of the Standards in CAS. Concerns which qualify for the (b)(4) foreign concern exemption are subject to CAS 401 and 402. Thus, they may be required to file a CAS disclosure statement. As the (b)(14) overseas exemption exempts all of CAS, there is not a requirement to file a CAS disclosure statement for entities covered by the exemption. There will be costs associated with filing and administering

disclosure statements for foreign concerns claiming the (b)(4) foreign concern exemption for the various affected parties, including the Government, contractor and subcontractor, as applicable. The costs for the contractor or subcontractor filing the disclosure statement should be minimal as the disclosure statement merely documents and reports the existing established cost accounting practices and procedures of the filing entity.

4. How does the [(b)(14)] overseas exemption help, or not help, to implement the Board'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?"

*Comments:* DCAA voiced a comment echoed by several Government respondents. "The primary objective of the Cost Accounting Standards is to achieve increased consistency and uniformity in the cost accounting practices used by Government contractors. Exempting contracts from the CAS solely based on the fact that they are executed and performed outside the United States does not achieve that primary objective." USAID is concerned that the (b)(14) overseas exemption provides a mechanism for contractors to circumvent the consistency principle of accounting. It opined that "whether the contract is CAS covered or not the contractors' established practices should result in an equitable assignment, measurement, and allocation of costs on all cost objectives regardless of the place of performance. \* \* \* that contracts, regardless of the place of performance, receive its equitable share of direct and indirect costs." The DOD Inspector General (DODIG) noted that "[c]ontractors \* \* \* may use the [(b)(14)] overseas exemption to hide potential fraudulent activities."

DOD observed that "[t]he more firms covered by the CASB rules, the more uniform and consistent the costs applied to US Government contracts will be." At the same time, DOD noted that all CAS exemptions are based on a cost benefits analysis of the costs of implementation versus the benefits of the consistent cost treatment. "As a class, there may be a good case to continue to exempt foreign firms performing overseas due to the administrative costs to both the U.S. Government and the contractor [/subcontractor] to enforce the rules, problems with host governments, and contractors[/subcontractors] who may

choose not to bid on U.S. Government work.”

In a contrary viewpoint, one non-government respondent stated that “[a]pplying full CAS to overseas contracts would not necessarily enhance measurement, assignment or allocation of costs to federal government contracts. This is because only U.S. firms would be subject to full CAS. Being less competitive may mean that foreign organization would get the work and would only have to comply with CAS 401 and 402. Applying CAS 401 and 402 may enhance the consistency in the assignment and allocation of costs to contracts. \* \* \* CAS is also not a substitute for sound financial accounting practices and internal controls. Consistency will be better served by all companies adopting the financial reporting standards.” A foreign trade association respondent offered that the FAR requires compliance with comparable standards. “[I]n many instances the organization will be covered by International Accounting Standards, which in recent years has seen a significant increase in scale and coverage.”

Finally, one industry group respondent offered that with some contracts (those that are transitory, *e.g.*, DOD contingency operations, or cooperative, *e.g.*, coproduction) the expressed objectives of CAS are irrelevant “because CAS cannot be reasonably expected to yield the intended benefits.”

*Responses:* The Board agrees that the (b)(14) overseas exemption does not help to implement consistency and uniformity in the cost accounting standards governing the measurement, assignment, and allocation of costs to contracts with the United States. The Board agrees that applying CAS 401 and 402 to foreign entities may enhance consistency and will enhance transparency with the filing of the required disclosure statements.

The Board does not agree that complying only with CAS 401 and 402 necessarily gives foreign based entities a competitive advantage over U.S. based entities which must comply with full CAS, as discussed in the Board’s responses to questions 3.a. and 3.b..

*5. What are the arguments for, and against, the requirement in the [(b)(14)] overseas exemption to require execution of the contract overseas?*

*Comments:* One industry group respondent noted that the distinguishing feature of the (b)(14) overseas exemption is the phrase “executed and performed exclusively outside the United States. \* \* \* [W]hen 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 reasonable foreseen beyond the immediate contract.”

DOD expressed the general consensus of the respondents that in an environment of global operations, electronic commerce, and contractor mobility, the place of execution of the contract has little to do with contract operation. A public interest group respondent noted “that the term ‘executed’ no longer has much meaning in the context of electronic commerce and other modern forms of communication. Gone are the days when a contract was physically executed by parties and the location of the parties at the time of ‘execution’ was easily defined. Today, contracts are executed by parties who are often remote from one another and even in different countries or continents at the time of ‘execution.’” A foreign trade association respondent agreed with those sentiments stating that the “[e]xecution of the contract overseas does not seem to be material to the contractual obligations and the application of the exemption. The nature of a contract does not change merely because it is executed overseas.” USAID observed that “in some instances, the contractors’ expend funds to transport [their] representatives outside of the United States to execute (sign) the contracts in order to adhere to this requirement.” DCAA opined “that from the pure accounting perspective, the place of contract execution and performance should not have any bearing on the fundamental principles and methods used to account for costs of contract performance.”

A public interest group respondent questioned “why should a contract that is executed and performed entirely overseas involving the U.S. Government and a U.S. company or subsidiary thereof enjoy an exemption from CAS coverage?” However, a consulting firm respondent noted that “[t]he execution of the contracts for a U.S. firms for work overseas is often done in the U.S. and therefore it is not eligible for the [(b)(14)] overseas exemption. The [place of] execution of the contract should not be sufficient enough to prevent the [(b)(14)] overseas exemption from being claimed. This places many U.S. firms at a disadvantage in competing with foreign firms for U.S. government projects.”

DOD observed that a better indicator of the need for the (b)(14) overseas exemption is the location of the company headquarters and/or the location of the normal accounting operations.

*Responses:* The Board agrees with the sentiments expressed by the majority of respondents, that the requirement for execution overseas has no bearing in the context of contract cost accounting, and consequently, believes that the (b)(14) overseas exemption should be eliminated. In a global economy with electronic commerce, the adherence to the place of execution of a contract has little relevance to the underlying contractual obligations. The Board agrees that it makes little sense for an entity subject to U.S. jurisdiction to be exempted from CAS merely because its contract is executed overseas. Fundamentally, the requirement has very little to do with contract performance.

*6. What are the arguments for, and against, the requirement in the [(b)(14)] overseas exemption to require performance of the contract overseas?*

*Comments:* A foreign trade association respondent observed that there is no argument to support the requirement for performance overseas in the (b)(14) overseas exemption. DCAA would agree with that sentiment from the pure accounting perspective. “[T]he place of contract execution and performance should not have any bearing on the fundamental principles and methods used to account for costs of contract performance.”

To the contrary, a consulting firm respondent observed that the “exemption for work overseas makes logical sense to promote competition and to allow U.S. companies to compete for such work.” The respondent argued that U.S. entities working overseas must comply with the laws and regulations of the country of contract performance. To comply with CAS also would increase the costs of contract performance overseas for U.S. entities and limit competition.

USAID opined that the (b)(14) overseas exemption “should continue to require that contracts and subcontracts be performed entirely overseas.” A foreign trade association respondent further opined that “[t]he current wording of ‘performed entirely outside’ is problematic and too restrictive,” and should be changed to “substantially performed outside.” USAID agreed with the assessment that the wording is problematic. However, it viewed the problem not as restrictive, but as lacking in clarity, stating that “[t]he language in

this exemption should clearly state that ‘performance’ includes both direct and indirect costs up to and including General and Administrative expenses when incurred within the United States, its territories, and its possessions \* \* \* [because] the Executive Management that oversees the performance or the company is located in the U.S. along with support functions and backstop positions.” DOD agreed with USAID’s assessment. DCAA offered “that the current [(b)(14)] overseas exemption at 48 CFR 9903.201–1(b)(14) would not exempt the vast majority of U.S. firms from the CAS due to the fact that some costs would be incurred within the United States, thereby failing to meet the [(b)(14)] overseas exemption criterion.”

DOD went further, stating that the performance overseas is not as important as other factors such as the ownership and control of the company, and whether the contractor’s accounting activities already encompassed CAS covered work performed elsewhere.

*Responses:* The Board agrees that the place of performance has no bearing on the fundamental principles and methods used to account for the costs of contract performance. The adherence to the principles and standards of financial and managerial accounting applied consistently is the foundation for financial reporting and managerial decisions.

The Board believes that there is competition overseas. The Board does not believe that the imposition of full CAS, or the exemption from it, is necessarily a major factor in a U.S. based entity’s decision to do business overseas with the U.S. Government. It is only one factor among many in the decision to do business outside of the U.S. Smaller entities are already exempted from CAS under 48 CFR 9903–201–1(b)(3). Full CAS is only initially imposed either upon the award of a CAS-covered contract of at least \$50 million, or upon the award of a CAS-covered contract if a contractor has received \$50 million or more in net CAS-covered contracts during its preceding cost accounting period. Modified CAS may be imposed on a covered contract of less than \$50 million awarded to a contractor that received less than \$50 million in net CAS-covered awards in the immediately preceding cost accounting period.

#### 7. Other Comments

The following additional comments were offered in response to the Notice of Request for Information:

#### a. Fraud, Waste and Abuse

*Comment:* One industry group respondent observed that “CAS compliance does not prevent wasteful practices, bribery, or fraudulent activities.” Other respondents agreed with those sentiments.

*Response:* The Board agrees that CAS compliance, by itself, does not prevent wasteful practices or fraudulent activities. However, CAS provides a framework for the measurement, assignment, and allocation of costs to government contracts in a systematically structured and consistent manner, which promotes uniformity and consistency in estimating, accumulating, and reporting costs in connection with the pricing and administration of Government contracts.

#### b. Prime Contractors’ Responsibility Related to CAS 401 and 402 for Foreign Subcontractors

*Comment:* DCAA commented that the prime contractor will need to give greater attention to foreign concerns that are performing as subcontractors to U.S. contractors and will no longer be covered by the (b)(14) overseas exemption. DCAA observed that if the (b)(14) overseas exemption is eliminated, the foreign subcontractors would be subject to the (b)(4) foreign concern exemption and must comply with CAS 401 and 402. DCAA noted “that these foreign subcontractors’ accounting practices are not always adequately defined and that the prime contractor’s oversight responsibility for ensuring its foreign subcontractors’ CAS compliance is not clearly understood and properly executed.” DCAA recommended that the prime contractor be required to evaluate the CAS compliance of its subcontractor, and to submit the CAS evaluation report on the subcontractor to its Contracting Officer (CO). DCAA also recommended that the Government be provided the right to examine the subcontractor’s records for CAS compliance when the prime contractor does not submit the CAS evaluation report on a subcontractor’s compliance with CAS to the CO. To mitigate these concerns, DCAA recommends that the Board strengthen the CAS contract clause to “\* \* \* clearly require the prime contractor to enforce CAS compliance by its foreign subcontractor.”

*Response:* The Board does not see a need to amend the CAS contract clauses because the Board believes it is already clear that the prime contractor is responsible for assessing the CAS compliance of its subcontractors. However, the Board is inviting

comments on the issue. (*See F. Public Comments to the Notice of Proposed Rulemaking*, herein.)

The FAR contract provisions and the CAS clauses already state that the prime contractor and higher tier subcontractor are responsible for their subcontractors. The CAS clauses at 48 CFR 9903.201–4 require the CAS-covered contractor and higher tier subcontractor (who shall be required to do so by the contractor) to insert the appropriate CAS clauses into all their negotiated subcontracts unless they are exempted. 48 CFR 9903.202–8(a) states the contractor or higher tier subcontractor is responsible for administering the CAS requirements in their subcontracts. These requirements are applicable whether the contracts and subcontracts are performed in the U.S. or overseas.

#### c. [(b)(14)] Overseas Exemption Inconsistent With the Application of FAR Part 31

*Comment:* A public interest group respondent argues that there must be some type of accounting system in foreign entities to ensure that billings under cost based contracts are reasonable, allowable and allocable. “If the argument is that CAS cannot be used for this purpose because foreign contractors and subcontractors will not have adequate systems in place, then how is it that these firms are eligible to receive cost-type contracts? \* \* \* [C]ontractors cannot have it both ways by claiming that a CAS exemption should apply to contracts and subcontracts executed and performed entirely outside the U.S. while still being permitted to accept cost-type contracts and applying the FAR Part 31 cost principles to these contracts. \* \* \* [Claiming the (b)(14) overseas exemption] while asserting that all costs submitted in billings to the government are reasonable, allowable, and allocable is an exercise in false logic.”

*Response:* The Board agrees with the public interest group respondent’s comments and has proposed to eliminate the (b)(14) overseas exemption.

#### D. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96–511, does not apply to this proposed rule because this rule imposes no additional paperwork burden on offerors, affected contractors and subcontractors, or members of the public which requires the approval of OMB under 44 U.S.C. 3501, *et seq.* The records required by this proposed rule are those normally maintained by contractors and subcontractors who

claim reimbursement of costs under government contracts.

**E. Executive Order 12866 and the Regulatory Flexibility Act**

Because the affected contractors and subcontractors are those who are already subject to CAS but for the (b)(14) overseas exemption, and those who are subject to only CAS 401 and 402 under the (b)(4) foreign concern exemption, the economic impact of this proposed rule on contractors and subcontractors is expected to be minor. As a result, the Board has determined that this proposed rule will not result in the promulgation of an “economically significant rule” under the provisions of Executive Order 12866, and that a regulatory impact analysis will not be required. Furthermore, this proposed rule does 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.

**F. Public Comments to the Notice of Proposed Rulemaking**

Interested persons are invited to provide input to this notice of a

proposed rule to eliminate the (b)(14) overseas exemption from CAS at 48 CFR 9903.201–1(b)(14). Respondents are encouraged to identify, comment and provide information on any issues that they believe are important to the subject. This might include comment on whether there is a need to strengthen the CAS clauses to address the prime contractor’s oversight responsibility for ensuring its subcontractors are compliant with CAS where it is applicable. All comments must be in writing, and submitted via facsimile, by e-mail, or by any other means as instructed in the **ADDRESSES** section.

To comply with the Congressional mandate in Section 823 of the NDAA FY 2009, the Board must consider the applicability of CAS to contracts and subcontracts which would be subject to CAS but for the (b)(14) overseas exemption. As always, the public is invited to submit comments on other issues regarding CAS exemptions that respondents believe the Board should consider. Those comments that are unrelated to the (b)(14) overseas exemption and its directly related issues will be separately considered by the Board. The staff continues to be especially appreciative of comments and suggestions that bring forth the

concerns of all parties for consideration in the rulemaking process.

**List of Subjects in 48 CFR 9903**

Government procurement, Cost Accounting Standards.

**Daniel I. Gordon,**

*Chair, 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:

**PART 9903—CONTRACT COVERAGE**

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

**Authority:** Public Law 100–679, 102 Stat. 4056, 41 U.S.C. 422.

2. In section 9903.201–1, remove and reserve paragraph (b)(14) to read as follows:

**9903.201–1 CAS applicability.**

\* \* \* \* \*

(b) \* \* \*

(14) [Reserved]

\* \* \* \* \*

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