INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

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Office of Federal Procurement Policy
ATTN: Laura Auletta
725 17th Street, NW, Room 9013
Washington, DC 20503

REF: Office of Federal Procurement Policy, Cost Accounting Standards Board, Case CAS-2008-01S

Dear Ms. Auletta:

We have reviewed the Staff Discussion Paper (SDP) regarding Potential Revisions to CAS 403 Thresholds – Allocation of Home Office Residual Expenses to Segments, as published in the Federal Register on February 13, 2008, and provide the following comments for the consideration of the Board.

We maintain that the operating revenue thresholds identified at 48 CFR 9904.403-40(c)(2) for determining whether a contractor is required to use the three factor formula to allocate residual home office expenses to segments should only be changed as a result of a comprehensive review of the subject, which is Alternative 2 in the SDP. It is difficult to envision that the underlying conditions cited by the Board when they established the techniques for allocating home office expenses, including the operating revenue thresholds, have changed substantively since the promulgation of CAS 403 in 1972. These conditions are identified by the Board in Preamble A to CAS 403 (see 38 FR 26680, dated December 14, 1972) and include:

- A variety of continuing problems between contractors and the Government concerning equitable allocations of home office expenses to segments involved in negotiated defense contracts.

- The lack of authoritative standards to guide contractors, procurement officers, auditors, and others, provides a great potential for disagreement and controversy over contract costs. Assurance of equity in cost determinations and contract settlement is singularly lacking.

- If residual expenses are material in amount, the Board believes selection of a single allocation technique is necessary to reduce costly controversy in an area where disputes have been commonplace.

We suggest that any adjustment to the operating revenue thresholds be made only after the Board has determined through a comprehensive review that the Standard is not meeting its intended purpose. By design, CAS 403 is meant to allocate home office expenses to segments to the maximum extent practical through the use of (i) direct allocations and (ii) homogeneous cost pools. According to Preamble A to CAS 403, the Board decided that this "Standard will operate to reduce residual expenses to a relatively minor amount and by this means also reduce controversy and inequity." For the allocation of residual expenses, the Board provides for the use of any appropriate allocation base, except where residual expenses are greater than a specified percentage of operating revenue. Again, as provided by the Board in Preamble A to CAS 403:

> However, if residual expenses exceed such specified percentages, the Board believes that its objective of reducing controversy and avoiding inequity would best be served by selecting a single allocation technique to be used. Its research in this connection has led the Board to conclude that for this purpose, a three-factor formula is superior to other allocation bases and techniques for the allocation of residual expenses.

The Board performed extensive research when promulgating the requirement of CAS 403, which would include the operating revenue threshold. Preamble A to CAS 403 references an extensive literature review on the subject, a review of decisions of contract appeals boards and courts, and a study of home office management philosophy and operations of 40 companies in a wide variety of industries. The Board stated it sent copies of the Federal Register notice directly to 196 organizations and individuals; that 86 companies were invited to provide estimates of additional or reduced costs from implementing the Standard; and that the Board considered comments and data received from 130 sources when promulgating the Standard.

We remind the Board of its previous research and study and recommend the Board consider such effort as a benchmark for measuring the objectivity of the current review. We believe that in comparison with the work done by the Board in 1972, the research and study put forth in the SDP to support Alternative 1, Use Consumer Price Index (CPI), pales in comparison. Alternative 1 proposes to increase the operating revenue threshold by 467 percent based solely on an analysis of the CPI, with adjustments. Alternative 1, if implemented, would increase the operating revenue thresholds at 48 CFR 9904.403-40(c)(2), as follows:

Current 48 C.F.R. 9904.403-40 Threshold		
Operating Revenue	Ratio	Residual Expense
$100,000,000	3.35%	$3,350,000
$200,000,000	0.95%	$1,900,000
$2,700,000,000	0.30%	$8,100,000
$3,000,000,000	0.20%	$6,000,000
Total		$19,350,000

Alternate 1 48 C.F.R. 9904.403-40 Threshold (Proposed)		
Operating Revenue	Ratio	Residual Expense
$470,000,000	3.35%	$15,745,000
$930,000,000	0.95%	$8,835,000
$12,600,000,000	0.30%	$37,800,000
$14,000,000,000	0.20%	$28,000,000
Total		$90,380,000

Again, we maintain the operating revenue thresholds identified at 48 CFR 9904.403-40(c)(2) should only be changed based on the results of a comprehensive review of the subject, which is Alternative 2 in the SDP. To do otherwise would risk exposing the contracting community to the same underlying conditions identified by the Board back in 1972, including costly controversy arising from inequitable allocations of home office expense to negotiated government contracts.

Thank you for the opportunity to comment on the proposed rule. If you have any questions, please contact Ms. Meredith Long-Morin at (703) 604-8739, or by email at Meredith.Morin@dodig.mil.

Carolyn R. Davis

Carolyn R. Davis
Acting Assistant Inspector General
Audit Policy and Oversight