

ACTION: Notice of Discontinuation of Case.

SUMMARY: The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards (CAS) Board, is providing public notification of the decision to discontinue its review of the exemption for contracts that are executed and performed outside the United States, its territories, and possessions.

FOR FURTHER INFORMATION CONTACT:

Laura Auletta, Manager, Cost Accounting Standards Board, 725 17th Street, NW., Room 9013, Washington, DC 20503 (telephone: 202-395-3256).

SUPPLEMENTARY INFORMATION:

A. Regulatory Process

The Cost Accounting Standards Board's rules, regulations and Standards are codified at 48 CFR Chapter 99. The Office of Federal Procurement Policy Act, 41 U.S.C. 422(g)(1), requires the Board, prior to the establishment of any new or revised Cost Accounting Standard, to 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.
- This notice announces the discontinuation of a case after completing step one of the four-step process.

B. Background and Summary

On September 15, 2005, the CAS Board issued a Staff Discussion Paper inviting comments regarding whether the exemption at 48 CFR 9903.201-1(b)(14) should be revised or eliminated (70 FR 53977). The SDP discussed the history of the exemption. In summary, this discussion stated that the original CAS Board was established by Section 2168 of the Defense Production Act of 1950 (DPA). Section 2163 of the DPA, entitled "Territorial Application of Act," provided that Sections 2061 through 2170 of the Act "shall be applicable to the United States, its territories and possessions, and the District of Columbia" (United States). Therefore, because the provisions of the DPA were applicable only within the United States, the CAS Board rules,

regulations and standards were also applicable only within the United States. In 1980, the original CAS Board ceased to exist under the DPA and administration of the standards was undertaken by the Department of Defense until the CAS Board was re-established in 1988 under the Office of Federal Procurement Policy (OFPP) Act. In 1991, the new CAS Board retained the exemption when it recodified its rules and regulations at 48 CFR 9902.201-1(b)(14) on April 17, 1992 (57 FR 14148). The SDP published on September 15, 2005 invited public comments on whether the Board should revisit the exemption.

C. Public Comments

The Board received three sets of public comments in response to the staff discussion paper (available at http://www.whitehouse.gov/omb/procurement/casb/index_public_comments.html). None of the comments supported the Board revising or eliminating the exemption. In fact, all three of the comments offered arguments for why the CAS Board should retain the exemption.

One commented that while the OFPP Act, unlike the DPA, does not specifically limit CAS to contracts and subcontracts executed and performed within the United States, when Congress intends for laws to have extra-territorial effect, it would expressly state that intention. Additionally, the commenter notes that given the dynamic nature of international relations and bilateral agreements, the CAS Board would find it difficult to insure consistency of its regulations with international law and trade agreements. This commenter also questioned the material impact of the exemption, stating that, based on anecdotal evidence, contractors do not invoke the exception frequently. The value of the exemption, noted the commenter, includes putting foreign and U.S. companies on an equal footing by applying the same local accounting requirements; facilitating government procurements in the context of war readiness, other military action or disaster relief.

Another commenter discussed the impracticality of applying CAS to contracts and subcontracts performed entirely outside the United States, noting, in part, that a contractor would be expected to follow the accounting conventions (rules and regulations) of the country where the contract is being performed. Requiring contractors and those in their supply chain to follow CAS instead would likely make

participation in the U.S. Government procurement process prohibitive.

Another commenter expressed concern that eliminating the exemption would result in applying CAS to foreign contractors that would otherwise be small businesses, since the CAS small business exemption applies only to firms that have a place of business located in the United States.

While the CAS Board does not necessarily share each of the views expressed in these comments, the Board agrees with the conclusion not to delete or revise the exemption, especially with the absence of any commenter support for any such revision or elimination.

D. Conclusion

Based on the public input and Board discussions of this issue, the Board finds that the exemption should be retained without change.

Paul A. Denett,

Administrator, Office of Federal Procurement Policy.

[FR Doc. E8-2668 Filed 2-12-08; 8:45 am]

BILLING CODE 3110-01-P

OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Part 9904

Cost Accounting Standards Board; Allocation of Home Office Expenses to Segments

AGENCY: Cost Accounting Standards Board, Office of Federal Procurement Policy, OMB.

ACTION: Staff Discussion Paper (SDP).

SUMMARY: The Cost Accounting Standards Board (the Board), Office of Federal Procurement Policy, invites public comments on a staff discussion paper (SDP) addressing potential revisions to Cost Accounting Standard (CAS) 403, "Allocation of Home Office Expenses to Segments." This SDP addresses whether the current thresholds that require use of the three factor formula for allocating residual home office expenses require revision.

DATES: Comments must be in writing and must be received by April 14, 2008.

ADDRESSES: Due to delays in receipt and processing of mail, respondents are strongly encouraged to submit comments electronically to ensure timely receipt. Electronic comments may be submitted to casb2@omb.eop.gov. Please include your name, title, organization, and reference case "CAS-2008-01S."

Comments may also be submitted via facsimile to (202) 395-5105. Comments via regular mail should be addressed to the Office of Federal Procurement Policy, 725 17th Street, NW., Room 9013, Washington, DC 20503, ATTN: Laura Auletta. Please note that any comments received will be posted in their entirety, including any personal and/or business confidential information provided, at <http://www.whitehouse.gov/omb/procurement/casb.html> after the close of the comment period.

FOR FURTHER INFORMATION CONTACT:

Laura Auletta, Manager, Cost Accounting Standards Board, 725 17th Street, NW., Room 9013, Washington, DC 20503 (telephone: 202-395-3256).

SUPPLEMENTARY INFORMATION:

A. Regulatory Process

The Board's rules, regulations and standards are codified at 48 CFR Chapter 99. The Office of Federal Procurement Policy Act, 41 U.S.C. 422(g)(1), requires the Board, prior to the establishment of any new or revised Standard, to 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 (i.e., prepare and publish SDP).
2. Promulgate an Advance Notice of Proposed Rulemaking (ANPRM).
3. Promulgate a Notice of Proposed Rulemaking (NPRM).
4. Promulgate a Final Rule.

The SDP published with this notice is issued by the Board in accordance with the requirements of 41 U.S.C. 422(g)(1)(B), and is the first of the four-step process.

The Board has received two recommendations to revise the CAS 403 operating revenue thresholds used in determining if a contractor is required to apply the three factor formula to allocate residual home office expenses to segments. The research accomplished to date by the Board staff is the basis for the SDP being released today.

B. Background

Over the past few years, the Board has received two proposals to revise the CAS operating revenue thresholds for determining if a contractor is required to use the three factor formula to allocate residual home office expenses to segments.

1. *Consumer Price Index:* A proposal from the Aerospace Industries Association (AIA) recommends that the operating revenue thresholds be raised by 400 percent to reflect the changes in the consumer price index (CPI) from 1973 to 2003.

2. *Conduct Staff Study:* A proposal from the Department of Defense (DoD) recommends that the Board obtain actual statistics of various companies and conduct a staff study similar to that performed by the original Board. This proposal recommends that the study update the thresholds to reflect the impact that economic changes, industry changes, and the advent of acquisition reform have had in the years since the thresholds were established.

C. Staff Discussion Paper

I. Background

- 48 CFR 9904.403-40(c)(2) requires that home office residual expenses be allocated to segments using the three factor formula if the residual expenses exceed:
 - 3.35 percent of the first \$100 million of operating revenue;
 - .95 percent of the next \$200 million of operating revenue;
 - .30 percent of the next \$2.7 billion of operating revenue; and
 - .20 percent of all amounts over \$3 billion of operating revenue.

• The operating revenue thresholds at 48 C.F.R 9904.403-40(c)(2) were promulgated in December 1972 and have not been revised in the 35 years since.

• The Board has decided to initiate a case to determine if the current thresholds require revision. This case will analyze all aspects of this issue. For example, in addition to the inflation of the dollar, the last 35 years have also seen a change in the nature of home offices. In particular, the number of home offices have significantly increased due to the proliferation of intermediate home offices. In determining whether to revise the current thresholds, the Board will need to analyze if and to what extent such a proliferation impacts the thresholds. In addition, the Board will need to determine if and to what extent a data call is needed to obtain information necessary to reach an informed decision on this issue.

II. Staff Research

Comments on Alternatives

1. *Use Consumer Price Index (CPI):* On August 26, 2003, AIA sent a letter to the Board recommending that the operating revenue thresholds be raised by 400 percent to reflect the changes in

the CPI from 1973 to 2003. The staff believes the AIA recommendation offers the advantage of a simple and quick revision to the out-of-date thresholds. It is also an objective measure of the economic escalation that has occurred since the thresholds were initially promulgated. A significant disadvantage is that the increase in the CPI may not be a good measure of increases necessary to the three factor formula. For example, the number of home offices have significantly increased due to the proliferation of intermediate home offices. The increase in home offices may warrant a smaller increase in the three factor formula than the CPI would provide. A second disadvantage is that the Board will not be aware of the exact impact the revision will have on the number of companies covered by the three factor formula.

The CPI represents changes in prices of all goods and services purchased for consumption by urban households. User fees (such as water and sewer service) and sales and excise taxes paid by the consumer are also included. Income taxes and investment items (like stocks, bonds, and life insurance) are not included. It is an objective measure of the economic escalation that has occurred since the thresholds were initially promulgated.

A potential problem concerning the use of the CPI is that historical values are not revised when there are improvements in the index. Consequently, past errors in methodology are only corrected prospectively (i.e., the historical data is not corrected). Most of the major improvements in the CPI have tended to reduce measured inflation. As a result, the increase in the CPI since 1972 overstates inflation.

The overstatement in the CPI can be mitigated by using alternative versions that incorporate current methodology in measuring past price movements. From 1972 to 1978, the best alternative version is the CPI-U-X1, which provides an adjustment to the CPI that computes housing costs using rental equivalents (this method was adopted for the official CPI in the early 1980s). However, the CPI-U-X1 does not include other improvements to the CPI that were adopted in the early 1980s.

The CPI-U-RS, which was developed in the late 1990s, incorporates changes in methodology implemented since 1978. Thus, it can be used to analyze inflationary trends in the CPI without interference from changes in methodology. New values based on current methods are released each April.

From December 1972 through December 1977, the CPI-U-X1

increased by a factor of 1.43. From January 1978 through February 2007, the CPI-U-RS increased by a factor of 3.26. To compute the increase for the period December 1972 through February 2007, the factor for the CPI-U-X1 is multiplied by the factor for the CPI-U-RS (1.43 x 3.26) to obtain an inflation factor of 4.66.

Applying this factor to the current thresholds at 48 C.F.R 9904.403-50 yields the following revised thresholds for application of the three factor formula:

- 3.35 percent of the first \$470 million of operating revenue;
- .95 percent of the next \$930 million of operating revenue;
- .30 percent of the next \$12.6 billion of operating revenue; and
- .20 percent of all amounts over \$14.0 billion of operating revenue.

2. *Conduct Staff Study*: On September 26, 2002, DoD sent a letter to the Board recommending that, as part of the comprehensive review, the Board obtain actual statistics of various companies and conduct a staff study similar to that

performed by the original Board. DoD recommended that the study update the thresholds to reflect the impact that economic changes, industry changes, and the advent of acquisition reform have had in the years since the thresholds were established. The staff believes that the DoD recommendation offers the Board an opportunity to understand the impact that various revisions would have on the number of companies subject to the three factor formula before drafting an ANPRM. The disadvantage is that the analysis will require significant time and effort to accomplish, and it is possible that such an analysis would not yield useful data for determining the appropriate thresholds.

III. Public Input

The Board is requesting public input on whether the thresholds should be raised, the potential advantages and disadvantages of the two alternatives described above, and any additional recommended alternatives the

commenters may have. Key questions for consideration include, but are not limited to, the following:

1. Should the operating revenue thresholds be revised? Why or why not?
2. If the threshold should be revised, what should be the basis of that revision (e.g., CPI, staff study, other)?
3. What are the advantages and disadvantages of the two alternatives described above?
4. What type of data is currently available for performance of the staff study?
5. Is the administrative burden of collecting the data associated with the staff study commensurate with risk?
6. To what extent does the proliferation of intermediate home offices impact any potential revision of the operating revenue thresholds?

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[FR Doc. E8-2666 Filed 2-12-08; 8:45 am]

BILLING CODE 3110-01-P