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**Letter to the Department of Defense, December 13, 1957,
Regarding the Revision of the Armed Services Procurement
Regulation, Section XV, Costruct Cost Principles**

American Institute of Certified Public Accountants. Committee on National Defense

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procurement regulation, Section XV, Contract cost
principles. 4 typewritten pages.



AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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December 13, 1957

Honorable W. J. McNeil
Assistant Secretary of Defense
Department of Defense
Washington 25, D. C.

Dear Mr. McNeil:

The committee on national defense of the American Institute of Certified Public Accountants has reviewed the September 10, 1957 draft of the revision of Armed Services Procurement Regulation, Section XV, Contract Cost Principles. The following comments represent the consensus of the members of the committee on various parts of the draft.

We concur in the idea of a single broad set of cost principles, providing that in their application, recognition is given to the circumstances created by each type of contract as a part of the conditions and factors which have a bearing on reasonableness, relevancy, allocability, etc.

The committee feels, however, that revisions are necessary in this proposed draft in order to make it entirely workable and sufficiently flexible to be applicable to all types of contracts in which cost is a factor in price negotiations.

The suggestions which follow cover the points on which our committee differs materially with the position taken in the draft, or where it was felt that clarification was needed.

15-204.1(b) The language used in this paragraph might be interpreted as meaning that the more controversial costs to which this section refers would be disallowed in the case of negotiated fixed-price type contracts unless covered by an agreement in the contract file. The mere fact that nothing is done in advance should not result in disallowance of such costs if the facts indicate otherwise. The committee felt that this point should be clarified.

15-204.2(a) Advertising Costs. It was believed that the rules as to advertising costs were unnecessarily restrictive.

It would seem that advertising costs should be allowed where benefits to government contracts can be shown. For example, it would seem reasonable to allow the cost of advertising for scarce materials, or for second-hand machinery when new machinery is hard to obtain.

15-204.2(f)(6) Profit Sharing Plans. The members of the committee found it difficult to see why "Profit sharing plan costs under plans of the immediate distribution type are unallowable." The ruling-out of any specific method of determining a portion of executive or employee compensation seems out of place in a definition of cost principles. The committee felt that if the total compensation is reasonable, such distributions should be allowed.

15-204.2(f)(7)b Deferred Compensation. The phrase "it is for services rendered during the contract period" might be misinterpreted so as to exclude provisions for currently accrued pension costs which are calculated in part on the basis of past services. It is suggested that a clarifying statement be added to the effect that the amortization of pension costs based on past services which is permitted for federal income tax purposes, is an allowable cost.

The committee also felt that the paragraph was not clear as to the application of the carry-forward provisions in connection with profit-sharing plans of Section 404(a)(3)(A) of the Internal Revenue Code of 1954.

A minor point - the Internal Revenue Service is twice referred to under its old name, Bureau of Internal Revenue.

15-204.2(h) Contributions and Donations. The members of the committee were unanimous in feeling that reasonable amounts of contributions and donations should be allowed. They suggested that the maximum could be the equivalent of that allowed for corporate federal income tax purposes.

15-204.2(i) Depreciation. While it was agreed that under generally accepted accounting procedures, and for tax purposes, depreciation is based on original cost, sound competitive pricing of products may require the recognition of depreciation based on current cost. The committee suggests that further consideration be given to permitting, as an allowable cost, depreciation calculated on the current cost of assets used in government contract operations. The committee realizes, however, that such a departure from cost determination for financial and tax accounting purposes may create difficult

problems in trying to apply this concept to Government contracts.

Referring to sub-paragraph (2)(i), it was assumed that "property cost basis" generally means original cost basis. Also, it was felt that what is to be done in the case where the depreciation taken on the books differs from that shown on the tax return should be clarified as to the application of this section.

It was also suggested that, in connection with sub-paragraph (iii) on Page 19, it be made clear that the approved types of depreciation calculation are not limited to those included in this reference to the Internal Revenue Code of 1954. For example, depreciation based on use or production would presumably be allowable. The committee assumes that, insofar as one of the methods listed in sub-paragraph (iii) is used, the amount cannot exceed the amount permitted for federal income tax purposes.

15-204.2(a) Interest and Other Financial Costs. The committee agrees with the disallowance of interest costs if it is made clear that the profit allowed is to be large enough to cover interest on the turnover of borrowed capital in addition to a return on equity capital, thus assuring equitable treatment of contractors employing different methods of financing.

15-204.2(v) Material Costs. The committee felt that more leeway should be allowed for the use of current material costs. Specifically, it recommended that the following statement, which appeared in an earlier draft, be restored: "When materials in inventory at the commencement date of a Government contract have a provable replacement cost significantly different from book cost, either the contractor or the Government may elect to use such replacement cost in lieu of book cost in pricing materials issued from such inventory." (Applications of Cost Principles and Standards to Supply Contracts and Research and Development Contracts with Commercial Organizations - Draft HWB 15 Mr. 1954).

15-204.2(y) Overtime, Extra Pay Shift and Multi-shift Premiums. Referring to sub-paragraph (3)(ii)(A) and (C), the committee calls attention to the fact that overtime operations do not necessarily increase unit costs since the higher labor costs are often offset, or more than offset, by lower amounts of assignable fixed overhead. It believes that, in the case of negotiated fixed-price type contracts, special authorization for the inclusion of overtime and similar premiums should be required only when unit costs will be increased.

Honorable W. J. McNeil

December 13, 1957

15-204.2(hh) Rental Costs. Sub-paragraph (3) seems to the committee to be unnecessarily restrictive. If the sale and lease-back is an "arm's length" agreement and if the rentals are reasonable and in line with those charged for similar properties, it was felt that the amount of rent paid should be an allowable cost.

The committee wishes to express its appreciation of the opportunity to review the draft. It has attempted only to make suggestions that would constitute constructive proposals leading to the goal of equitable treatment of both the Government and the contractor. If we can be of any further service to you in this matter, or if you have any questions as to our suggestions, we hope you will let us know.

Respectfully submitted,

Committee on National Defense
American Institute of
Certified Public Accountants



H. T. McAnly, Acting Chairman

HTM:Bm

cc: Honorable Perkins McGuire, Assistant Secretary of Defense
Mr. Kenneth K. Kilgore, Director, Audit Division, Office
of the Assistant Secretary of Defense