National Defense Industrial Association

Promoting National Security Since 1919

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December 20, 2010

Office of Federal Procurement Policy
725 17th Street, N.W., Room 9013
Washington, DC 20503
ATTN: Raymond J.M. Wong

Ref: CASB Notice of Proposed Rule on the Overseas Exemption from CAS

Dear Mr. Wong:

Members of the National Defense Industrial Association appreciate the opportunity to respond to the CAS Board's Notice of Proposed Rule ("NPR") on the exemption from Cost Accounting Standards for contracts executed and performed entirely outside the United States, its Territories, and possessions. The NPR was published in the October 20, 2010 *Federal Register*, Volume 75, Number 202.

NDIA is a non-partisan, non-profit organization with a membership that includes over 1,750 companies and more than 87,500 individuals. NDIA has a specific interest in government policies and practices concerning the government's acquisition of goods and services, including research and development, procurement, and logistics support. Our members, who provide a wide variety of goods and services to the government, include some of the nation's largest defense contractors.

NDIA continues to strongly support retention of the current exemption. We believe that eliminating the exemption will adversely impact U.S. policy initiatives, the willingness and/or ability of foreign concerns (subcontractors in particular) to participate in U.S. Government contracts, prime contractor and subcontractor costs, and the effectiveness of the Defense Contract Management Agency and the Defense Contract Audit Agency. Although we fully support the CASB's objective to enhance the consistency and uniformity of contract costs, we remain skeptical that CAS applicability to contracts performed entirely outside the United States will yield benefits that meaningfully and measurably outweigh the additional costs.

Introduction

As the Board explained the NPR, the (b)(14) overseas exemption can be traced back to the Defense Production Act (DPA), which limited the Board's authority and applicability of its Standards and regulations to contracts within the U.S., its Territories, and possessions. The Board further noted that its authority is no longer constrained by the DPA and that the Board's current authority under the 1988 Office of Procurement Policy Act is not limited to the U.S. While true, it is worth noting that just because the Board *can* impose its regulations outside the U.S. doesn't mean that it *should*, especially when that imposition will frustrate important foreign and domestic policy initiatives, such as the

National Export Initiative, and cause reasonably foreseeable costs to exceed theoretical benefits as explained herein.

Our comments below emphasize six key areas that weigh heavily in favor of retaining the overseas exemption.

1. **Impact on Foreign Concern Subcontractors is Understated**

As we and other commentators previously asserted, the impact of eliminating the (b)(14) exemption will be most acute on foreign concern subcontractors and the prime contractors and higher-tier subcontractors that rely on the exemption in their overseas procurement processes. Although the Board acknowledged that "no respondents provided usage data at the subcontractor level," it nevertheless leapt to the conclusion that "eliminating the (b)(14) overseas exemption based on available data would not appear to be detrimental to the performance of Government contracts."

Foreign concern subcontractor usage data is not readily available because there is no requirement to capture it centrally – not because the exemption has limited use, which appears to be the Board's interpretation in the absence of data. Contractor procurement systems are not designed to collect and organize subcontract data to provide for assessments of scenarios in which new requirements are being considered, new contract clauses are flowed down, or other assorted possible but unforeseeable regulatory changes may occur.

Despite the lack of subcontractor data, DoD reported to the Board that it believes most of the activity with the (b)(14) exemption is at the subcontractor level. Similarly, DCAA commented that it believes the firms most affected by the elimination of the (b)(14) exemption will be foreign concerns that are subcontractors to U.S. prime contractors. It is unclear to us why the Board disregarded these cautionary comments.

We urge the Board to reconsider its conclusion regarding the potential detriment to Government contracts, particularly as it relates to foreign concern subcontractors performing entirely outside the U.S.. Comments by both industry and Government clearly suggest that there will be an impact to these subcontractors. Many of these foreseeable detrimental impacts were identified in our response to the Board's April 2009 RFI.

2. **Contrary to the Ashton Carter Efficiency Initiative**

While we appreciate the CASB's purist emphasis on consistency and uniformity of contract costs, we believe eliminating the (b)(14) exemption runs contrary to Under Secretary of Defense Ashton Carter's "efficiency initiative." Mr. Carter identified the elimination of "non-value-added" overhead (i.e., activities where costs outweigh benefits) as a key tenet of his initiative. In a noteworthy voice of unanimity, both industry and Government emphasized to the Board in prior comments our skepticism that the benefits of eliminating the (b)(14) exemption would outweigh the costs.

DoD aptly noted that CAS exemptions are based on a cost/benefit analysis of the costs of implementation versus the benefits of consistent cost treatment. In this regard, the Board has insufficiently addressed DoD's further point that "[a]s 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 to enforce the rules, problems with host governments, and contractors who may chose to not bid on U.S. Government work." Echoing DoD's and industry's concerns, DCAA commented that the cost of administering CAS requirements to certain foreign subcontractors that are currently

exempt under the (b)(14) overseas exemption might outweigh the benefit to be derived from making CAS applicable to them.

Because the Board has not presented a persuasive cost/benefit analysis in connection with this NPR and because industry, DoD and DCAA all question the net value of eliminating the (b)(14) exemption, we are concerned that the Board may be inadvertently creating headwinds for Mr. Carter.

3. **Additional Compliance Requirements are Understated**

The Board minimizes the additional compliance requirements of eliminating the (b)(14) exemption, noting that:

- All contractors that will be subject to CAS are already subject to FAR Part 31 requirements;
- The (b)(4) foreign government/foreign concern exemption will apply to all foreign concerns and require compliance with CAS 401/402, which are already, in essence, incorporated into FAR Part 31; and
- Formerly-exempt foreign concerns may be required to file a CASB disclosure statement, but the costs "should be minimal as the disclosure statement merely documents and reports the existing established cost accounting practices and procedures of the filing entity."

While these points have some technical merit, the Board failed to raise and address several other important considerations. First, as noted in our response to the Board's April 2009 RFI, we expect –

- Foreign concern subcontractors will have difficulty understanding and interpreting the CASB disclosure statement because it is in English only, and
- Prime contractors and the Government will have difficulty understanding foreign concern disclosures because there is no requirement that the disclosure statement be completed in English.

Second, the burden on the acquisition process of eliminating the (b)(14) exemption does not end when a foreign concern files a disclosure statement as the Board suggests. Prime contractors, higher-tier subcontractors, and the Government must *do something* with it. It must be reviewed and deemed "adequate" before a CAS-covered subcontract can be awarded, the burden of which rests on the Government in accordance with FAR 30.202-8 and CFR 9903.202-8. Subcontractors must be audited for compliance. Cost accounting practices must be monitored for changes. This will not come cheap in terms of cost and mission schedule, especially now that DoD has raised the monetary threshold of contracts relative to DCAA's pre-award audit involvement.

Third, in the inevitable event of cost accounting practice changes or noncompliances, the requirements of FAR Subpart 30.6, CAS Administration, will apply not only to foreign concern subcontractors, but also to prime contractors and higher-tier subcontractors in connection with their administration of CAS-covered overseas subcontracts. This intricate process will not be fast or cheap – for the Government or any of the prime and subcontractors involved.

Finally, as mentioned in our prior comment letter on this topic, foreign concerns, prime contractors, and higher-tier subcontractors will need to add overseas professional staff with requisite CAS experience and practical knowledge of the cumbersome FAR Subpart 30.6 requirements. We hope the Board recognizes that sufficient expertise – both in private industry and in Government – does not exist overseas and that exported U.S. expertise will be costly.

4. **Barrier to Aerospace and Defense Exports is Contrary to Administration Policy**

In March 2010, in response to the slumping U.S. economy and job market, President Obama released an Executive Order to launch the National Export Initiative. The Administration recognized that a "critical component of stimulating economic growth in the United States is ensuring that U.S. businesses can actively participate in international markets by increasing their exports of goods, services, and agricultural products."

The aerospace and defense industrial base is a foundational element of the U.S. economy and its exports contribute significantly to our international trade balance. A key enabling factor in the current and future success of these exports is industrial participation requirements. These "offset agreements" are primarily fulfilled by foreign concern subcontractors performing in the country that purchased the U.S .aerospace and defense exports. For reasons well stated in the Aerospace Industrial Association's ("AIA") comments to this NPR, eliminating the (b)(14) exemption introduces significant risks that will make subcontracting with U.S. prime contractors comparatively less attractive relative to competing offset opportunities with non-U.S. aerospace and defense companies who don't impose onerous compliance requirements and attendant risks.

This factor alone will make purchases of U.S. aerospace and defense exports less desirable to foreign governments because offsets will become increasingly more difficult for U.S. primes to achieve. Adding insult to injury, to the extent foreign concerns are willing to accept CAS coverage, the cost of offset agreements will increase due to the added compliance and enforcement burdens on both subcontractors and prime contractors, which will further jeopardize the competitiveness of U.S. exports in this highly price-competitive global market. At a time when the U.S. economy is struggling to grow and the Administration is looking for ways to break down barriers to enhance our nation's global competitiveness, the Board is inadvertently erecting new barriers.

5. **Frustrates US Policy to Support Foreign Economic Development**

A key element of US Government policy in war torn and economically underdeveloped countries is to require prime contractors to subcontract with host-country (i.e., foreign concern) companies. Imposition of CAS on these host-country firms will likely shrink the local competitive landscape, stymie host-country economic development, potentially harm project missions, and stress relations with foreign governments (as DoD noted previously). We don't see how the imposition of CAS on foreign concern subcontractors is at all consonant with this particular policy initiative.

6. **No Evidence that the (b)(14) Exemption Causes Overseas Subcontracting Challenges**

In the time between the Board's April 2009 RFI and this NPR, the topic of overseas subcontracting has received considerable high level attention. On June 29, 2010, Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction, testified before the House Subcommittee on National Security and Foreign Affairs regarding the challenges of subcontracting in Iraq. Mr. Bowen identified many subcontracting cost, price, and regulatory oversight issues, however, he did not cite the (b)(14) exemption as being a factor causing those issues. Equally important, Mr. Bowen did not recommend CAS coverage on foreign concern subcontracts among his potential solutions.

Similarly, on July 26, 2010, the Commission on Wartime Contracting ("CWC") held an extensive hearing on war zone subcontracting. In both oral and written testimony before the CWC, not one of the 14 Government and industry witnesses cited the (b)(14) exemption as contributing to the myriad subcontracting cost, pricing and compliance challenges identified during the hearings. Moreover, no

witness identified imposition of CAS coverage, disclosure statements, or any aspect of indirect cost allocations as being a recommended solution to current overseas subcontracting problems. Also noteworthy, none of the CWC's commissioners spoke of or inquired about subcontractor CAS coverage or CAS compliance during opening statements or witness testimony.

Given that this recent intense scrutiny of overseas subcontracting neither identified the (b)(14) exemption as a problem, nor identified eliminating it as a solution, we do not see the net added value in the Board fixing something that all recent testimonial evidence suggests is not broken.

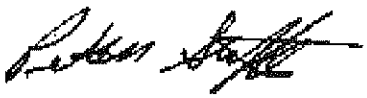
Conclusion

For the reasons above, as well as those cited in our response to the Board's April 2009 RFI and those offered by the AIA in response to this NPR, we strongly urge the Board to retain the current (b)(14) exemption. If the Board strongly believes that domestic and foreign concern *prime contractors* should no longer qualify for the (b)(14) exemption, we offer the following language as a modification to the current exemption language:

> *"Subcontracts awarded to foreign concerns where performance is expected to occur outside the United States, its Territories, and possessions."*

Thank you for the opportunity to respond to this Notice of Proposed Rule. If you have any questions, or need additional information, please contact NDIA Procurement Division Director Ruth Franklin at (703) 247-2598 or at rfranklin@ndia.org.

Sincerely,



Peter M. Steffes
Vice President, Government Policy