

[casb@omb.eop.gov](mailto:casb@omb.eop.gov). Please put the full body of your comments in the text of the electronic message and also as an attachment readable in either MS Word or Corel WordPerfect. Please include your name, title, organization, postal address, telephone number, and e-mail address in the text of the message. Comments may also be submitted via facsimile to (202) 395-5105. Please cite CASB Docket No. 00-03A in your comment.

**FOR FURTHER INFORMATION CONTACT:**

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**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 (e.g., promulgation of a Staff Discussion Paper.)
2. Promulgate an Advance Notice of Proposed Rulemaking (ANPRM).
3. Promulgate a Notice of Proposed Rulemaking (NPRM).
4. Promulgate a Final Rule.

This ANPRM is issued by the Board in accordance with the requirements of 41 U.S.C. 422(g)(1)(B) and (C), and, is step two of the four-step process.

**B. Background and Summary**

*Prior Promulgations*

The CAS and Federal Acquisition Regulation (FAR) have dealt with issues associated with ESOPs ever since ESOPs became popular in the late 1970s as a vehicle for providing incentive compensation to employees, as well as a means for corporations to finance their capital requirements. The popularity of ESOPs was greatly enhanced by their inclusion in the Employee Retirement Income Security Act of 1974 (ERISA) and by several beneficial changes to the Federal Income Tax Code in that same time period.

At first, the issues that arose were regarded as allowability matters that were to be treated in the FAR (or one of

its predecessors, the Defense Acquisition Regulations or Armed Services Procurement Regulations). The views of the CASB were sought primarily on an advisory basis. However, after issuance of the decision of the Armed Services Board of Contract Appeals (ASBCA) in the "Parsons case," *Ralph Parsons Co.*, ASBCA Nos. 37391, 37946, and 37947, December 20, 1990, 91-1 BCA 23648, reconsideration denied 91-2 BCA 23751, various government commenters suggested to the CASB that ESOP cost measurement and period assignment matters warranted placement on the CASB's agenda. These suggestions were amplified in light of the decision of the ASBCA in *Ball Corp.*, ASBCA No. 49118, April 3, 2000, 00-1 BCA 30864. This position has been reiterated both by the Department of Defense and by some contractors.

The Board first considered issuing an Interpretation of its existing Standards, but then decided that additional research was needed. Various approaches for dealing with ESOP accounting issues were considered by the CASB and other interested parties in the late 1990s. On September 15, 2000, the Board issued a Staff Discussion Paper (SDP) on this topic (65 FR 56008, Sept. 15, 2000).

After the Board reviewed and discussed the public comments received in response to the Staff Discussion Paper, the staff was asked to perform additional research. The staff explored three different options: (a) Modify CAS 9904.415 so that the contribution to the ESOP could be treated as deferred compensation for government contract costing purposes; (b) Develop a separate Standard based on the "contribution approach;" and, (c) Develop a separate Standard based on Generally Accepted Accounting Principles (GAAP). The Board has tentatively decided to proceed with option (a).

*Public Comments*

The Board received sixteen (16) sets of public comments in response to the Staff Discussion Paper.

These comments came from contractors, government agencies, professional associations, industry associations, and individuals.

The majority of respondents agreed on several issues related to ESOPs for government contract costing purposes:

1. Generally Accepted Accounting Principles (GAAP), in particular SOP 93-6, do not provide adequate guidance for measuring ESOP costs.
2. There should be no distinction between "pension" and "deferred

compensation" ESOPs in the measurement of ESOP costs.

3. The fair value of the stock should be established when title to the stock is transferred to the ESOP.

4. ESOP costs should be measured by the cost incurred by the contractor rather than the value of compensation received by employees.

5. The form of payment used to make distribution of ESOP benefits to employees is not relevant to the measurement of a contractor's ESOP costs.

There was, however, no strong consensus as to whether CAS 9904.412 or 9904.415 (or both) should be amended, or whether a new Standard should be adopted regarding ESOP costs.

This proposal is based upon continuing research performed by the staff of the Cost Accounting Standards Board, public comments received in response to the SDP, and deliberations of the Board. The various comments and proposals are discussed in greater detail under Section E, Public Comments. The Board would like to thank all the organizations and individuals who provided comments and information in response to the Staff Discussion Paper.

*Conclusions*

While there have been distinctions drawn in the past between "pension" and "deferred compensation" ESOPs, the Board has concluded that all ESOP costs should be treated consistently as deferred compensation.

Based on the comments received in response to the Staff Discussion Paper, the Board has also determined that specific guidance is required regarding the measurement of ESOP contributions and the assignment of ESOP costs to cost accounting periods. Specifically, the Board believes that the contractor's ESOP cost should be measured by the contribution made to the ESOP, not by the value of compensation received by the employee. In addition, the Board believes that these costs should be systematically assigned to the cost accounting periods in which ESOP awards are made to employees.

*Benefits*

CAS has never explicitly dealt with the cost of ESOPs. These costs can be significant. However, there have been numerous efforts by contracting parties to apply the provisions of existing CAS, principally CAS 9904.412 and 9904.415, to the ESOP cost determination process. These efforts have resulted in a distinction between "pension ESOPs" and "deferred compensation ESOPs" in Government contract cost accounting.