

This distinction is not recognized in other fields of accounting.

Historically, many controversies regarding accounting for ESOP costs have been resolved at the local level by entering into an advance agreement between the contracting parties.

Nevertheless, this is a cost accounting issue that has not been adequately dealt with within the framework of existing CAS. The Board recognizes that the diversity of current practices is not conducive to uniformity and consistency in cost measurement, assignment, or allocation of costs—the stated objectives of CAS.

The Board believes that these amendments will lead to a significant increase in uniformity and consistency in this important area of contract cost measurement. The Board also believes that the benefits of such improvements in contractor cost accounting practices should be substantial, and should greatly outweigh any added costs.

#### *Summary Description of Proposed Amendments*

The proposed amendments make clear that all ESOP cost determinations will become subject to CAS 9904.415. In addition, CAS 9904.412 is proposed to be amended to exclude the coverage of the costs of ESOPs that meet the definition of a pension plan.

The proposed amendments adopt the “contribution” approach for ESOP cost measurement. Using this approach, contractors’ contributions to ESOPs for a cost accounting period become the basis for ESOP cost determination. That part of the contribution that is assignable to the cost accounting period would be recognized as deferred compensation cost for the period. This recognition as an assignable cost is, in turn, based on the identification of ESOP awards that have been made to employees during the period that qualify as deferred compensation in accordance with the corresponding definition incorporated in the Standard. In essence, the ESOP costs assignable to a cost accounting period are that part of the annual contribution that is attributable to the awards made to employees during the period.

The proposed transition method is designed to ensure that the adoption of this proposal will not cause changes to existing arrangements that contracting parties may have developed to deal with their existing ESOP cost determinations. In particular, the intent is that contractor/government advance agreements for *existing* ESOPs should not be disturbed. The emphasis is on making sure the procedures incorporated in this proposal are

applied only to the measurement, assignment and allocation of costs of new ESOPs that are established after this proposal becomes effective, if ultimately adopted by the CASB.

#### **C. Paperwork Reduction Act**

The Paperwork Reduction Act, Public Law 96–511, does not apply to this proposal, because these amendments impose no paperwork burden on offerors, affected contractors and subcontractors, or members of the public which requires the approval of OMB under 44 U.S.C. 3501, *et seq.* The records required by this proposed rule are normally maintained by contractors that claim reimbursement of ESOP costs under government contracts.

#### **D. Executive Order 12866 and the Regulatory Flexibility Act**

Because the transition provision incorporated into this proposal ensures that arrangements for determining costs for existing ESOPs are not changed, the economic impact of these amendments, if any, on contractors is expected to be minor.

As a result, the Board has determined that this rule will not result in the promulgation of a “major rule” under the provisions of Executive Order 12866, and that a regulatory impact analysis will not be required. Furthermore, this proposal does not have a significant effect on a substantial number of small entities because small businesses are exempt from the application of the Cost Accounting Standards. Therefore, this rule does not require a regulatory flexibility analysis in accordance with the Regulatory Flexibility Act of 1980.

#### **E. Public Comments**

This proposal is based upon responses to the CASB SDP entitled “Accounting for the Cost of Employee Stock Ownership Plans” that was published in the **Federal Register** on September 15, 2000 (65 FR 56008). Altogether, 16 responses were received, classified as follows:

Industry .....	7
Professional associations and others ..	4
Industry associations .....	3
Government Agencies .....	2
Total: .....	16

The SDP asked six specific questions and the responses to these questions are discussed below. In addition to these responses, several commenters submitted additional comments on topics not covered directly by the six questions; others summarized in general terms the more significant features of their detailed responses. The comments

received and the Board’s actions are summarized below.

#### *Question 1*

Does GAAP (SOP 93–6) provide sufficient guidance for accounting for the costs of ESOPs for Government contract costing purposes? Please discuss the rationale of your answer to this question.

*Comments:* Thirteen commenters acknowledged that SOP 93–6 does not provide adequate guidance for accounting for ESOPs for Government contracting purposes. Most of these commenters recognized that GAAP is not intended to address Government contracting issues.

Nevertheless, three of these commenters, the National Defense Industrial Association (NDIA), Boeing and Darrell J. Oyer & Co., recognized that GAAP contains some useful guidance. One of these commenters, Darrell J. Oyer & Company, explains this as follows:

GAAP is not intended to address government contracting issues and does not do so in SOP 93–6. GAAP does provide some useful concepts concerning ESOPs; however, SOP 93–6 cannot blindly be applied to government contracting. Each aspect of SOP 93–6 must be considered on a case-by-case basis consistent with the principles of government contract costing. \* \* \*

Two commenters, McDermott, Will & Emery and the Project on Government Oversight (POGO), thought that GAAP may provide adequate guidance for Government contract costing purposes. McDermott, Will & Emery commented favorably on the comprehensive treatment of the topic in SOP 93–6 and then stated that if “\* \* \* the cost accounting standards for government contracts purposes were to differ materially from the requirements of SOP 93–6, contractors could be placed in an extremely awkward, illogical, and perhaps untenable position.” This commenter also pointed out that any deviation from GAAP would require companies to keep two sets of books.

POGO expressed concerns about differing treatments for pension and deferred compensation ESOPs, valuation of shares acquired by ESOPs, and interest expense incurred by leveraged ESOPs as areas of potential abuse. POGO was principally concerned with the apparent current practice in Government contract cost accounting where “\* \* \* interest expense may be passed on to contractors (and ultimately taxpayers) as a form of “employee compensation.” POGO contrasted this practice with SOP 93–6 requirements that stipulate that “\* \* \* interest expense incurred in financing leveraged