Board has taken no formal action on this case for more than a year, that may change soon. The Board will meet January 25 to discuss, among other things, whether to move forward with the ANPRM.

★ Note—As mentioned above, time constraints prevented the DOD/industry working group from reaching complete agreement in two areas. The first is whether a transfer of a function between segments (horizontal transfer) and/or a functional transfer from a segment to a home office (vertical transfer) constitutes a change in cost accounting practice, i.e., a change in the method or technique for allocating costs to cost objectives. A transfer of functions between segments may not give rise to a cost accounting practice change depending on the facts. Therefore, task group members agreed during their January 18 meeting to draft additional illustrations clarifying the treatment of segment-to-segment functional transfers. The group failed to achieve consensus, however, on the effect of vertical functional transfers.

Some DOD representatives remain convinced that a change occurs for the segment (but not for the home office) when the segment transfers performance of a function (e.g., payroll) to the home office and the costs of that function are sent back to the segment through a home office allocation. In these circumstances, the contractor's method of cost allocation is seen as changing from one of *specific identification* of the cost to the segment to an *indirect allocation*. Industry representatives disagree, arguing that transferring the performance of a function, such as payroll, to a home office is the functional equivalent of contracting out that activity to a service provider. No one contends that contracting out gives rise to a cost accounting practice change and the result should be no different in the case of a segment to home office transfer.

The second open area involves exemptions from the cost impact process for certain types of cost accounting practice changes. The current DOD proposal contains a limited exemption for changes associated with pool split-outs and combinations and functional transfers. Contractor organizations advocate extending the exemption to (a) all types of management changes, provided there is a reasonable expectation that more efficient and economical operations will result, and (b) changes in the assignment of costs to a cost accounting period that reduce assigned cost in future periods. Government representatives have raised two types of objections with respect to the management changes category. Philosophically, some Government representatives believe that any exemption for such changes should appear in the FAR and not in the CAS. Second, representatives from DCAA have suggested that it will be difficult to demonstrate cost savings in situations where management changes have not resulted in reductions in personnel and/or facilities. Task group members are attempting to draft language to accommodate DCAA's desire for proof of tangible cost reductions.

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DOD Resists IG's Calls For Stricter Oversight And Limits On IR&D Cost Shares For Other Transactions

Top-level officials within the Department of Defense strongly disagree with recommendations by the agency's Inspector General that offerors' cost shares under "other transactions" agreements should be reduced to reflect independent research and development costs reimbursable under Government contracts. DOD policymakers likewise oppose reducing OT recipients' cost shares to account for federal research tax credits. Finally, DOD officials do not share the IG's expansive view of the Defense Contract Audit Agency's role in the negotiation and performance of OTs.

Former Director of Defense Procurement Eleanor R. Spector and Director of Research and Engineering Hans Mark went on record opposing these and other recommendations and conclusions in the recently released DOD IG report, *Costs Charged to Other Transactions*. The IG report—the first to evaluate contractor costs charged to OTs since Congress authorized the use of such agreements about 10 years ago—follows an earlier, equally critical report on DOD's administration of OTs. See 40 GC ¶ 447.

"Other transactions" are instruments other than contracts, grants, and cooperative agree-

ments that are used to support or acquire research or prototype projects. From October 1, 1989 to October 16, 1998, DOD issued 302 OTs for research or prototype development with a total Government and contractor value of $7 billion. Congress initially authorized OTs to support contractors' commercialization and technology transfer efforts in a period of dramatic downsizing within the defense industry. The use of OTs later was expanded to reduce barriers preventing commercial firms from participating in DOD research and to broaden the technology and industrial base.

To further those goals, OTs generally are not subject to stringent procurement statutes and regulations, such as the Federal Acquisition Regulation Part 31 cost principles, the Cost Accounting Standards, and access-to-records provisions. This intentional reduction in standard Government oversight creates a built-in tension with the IG's mission that is evident in the report.

IG Findings and Recommendations—Working with DCAA, the IG reviewed five research OTs that had a contractor cost-share of $304.3 million. The report charges that contractors were allowed to reduce their actual cost shares and risk under those agreements because DOD improperly accepted prior IR&D expenditures, current Government-funded research, and fully depreciated assets as part of contractors' cost shares. Because DOD officials were not always aware of the actual costs of OTs, the agency over-reported the benefits of research OTs to Congress by about $83.4 million, according to the IG.

The report does not fault contractors for including current IR&D costs in their OT cost shares; to the contrary, the IG acknowledges that this practice was permitted under agreements executed by the Defense Advanced Research Projects Agency. (Although not mentioned in the report, FAR 31.205-18(e) recognizes the allowability of IR&D costs incurred by contractors under OTs.) Nevertheless, the IG considers this practice "inappropriate" because it does not advance research efforts, does not meet the intent of cost sharing under 10 USC § 2371, and artificially reduces contractors' financial risks. The report applies similar reasoning in urging that contractors' actual cost shares be reduced whenever they are entitled to a research tax credit under the federal Internal Revenue Code.

The IG's findings on inappropriate cost accounting raise related audit and access-to-records issues. Unlike contracts and grants, OTs are awarded without uniform audit and records inspection provisions. A variety of access-to-records provisions appeared in seven OTs examined by the IG, many of which permitted the use of independent public accounting firms to evaluate costs. Not surprisingly, the IG opposes such provisions. The report recommends that DOD issue guidance on an access-to-records provision for OTs that would permit access to the agreements officer based on the terms, conditions, materiality, and risks involved in the transaction. In addition, the IG says that DOD should issue guidance on DCAA's roles and responsibilities for OTs.

DOD Response—The Under Secretary of Defense, Acquisition, Technology and Logistics, is considering issuing a Directive that would mandate the use of DOD's existing "'Other Transactions' Guide for Prototype Projects." In commenting on the IG report, former Director of Defense Procurement Spector said she planned to include in that guide a restriction on the use of R&D funded as a *direct* cost of a contract, grant, or cooperative agreement from being used as a contractor cost share. But she categorically rejected the suggestion that recipient cost shares be reduced if the Government reimburses some portion as current IR&D costs. "We have always treated IR&D costs as private contractor expenditures when determining technical data rights, and it would be inconsistent to treat them as federal funds for determining cost share for 'other transactions'," she explained.

Spector also disagreed that an OT recipient's cost share should be reduced if the recipient is entitled to a federal research tax credit. DOD has never considered the implications of federal taxes in pricing its contracts, Spector observed, in part because the agency does not want to interfere with tax incentives granted by Congress merely because a company does business with the Government.

As for DCAA's role in administering OTs, Spector said a planned OT guide will subject to DCAA audit those agreements providing for in-

terim or final reimbursement based on actual incurred costs—provided that a company business segment already is subject to DCAA audit cognizance. However, she stressed, some flexibility must be maintained for the use of independent auditors (e.g., public accounting firms) when Government auditors do not otherwise have audit cognizance.

Gansler Weighs In—Spector's detailed comments on the IG's recommendations were made in late October 1999, in her former capacity as Director of Defense Procurement. However, Spector's comments are consistent with more recent statements by her current boss, Under Secretary of Defense for Acquisition, Technology and Logistics Jacques S. Gansler. In a written statement issued in response to a media inquiry, Gansler said the IG wants DOD "to issue rules that make OTs more like standard government contracts, thus removing the ability to create commercial-like business arrangements." While Gansler pledged to respond to all the IG's findings, he expressed a clear preference for "encouraging" the "unprecedented flexibility and creativity" that OTs permit.

Copies of the IG audit report, (No. D-2000-065, Dec. 27, 1999) are available from the IG's web site at *http://www.dodig.osd.mil/audits/reports*.

Legislation

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Mandatory Source Status Of Federal Prison Industries, Recovery Of Overpayments To Contractors Among Holdover Issues Awaiting Congress

Lawmakers returning to Washington this week to begin the second session of the 106th Congress will face some unfinished Government contracts-related business. Among the significant issues which may be addressed by Congress this term are two pending bills relating to Federal Prison Industries Inc.'s status as a required source and a bill requiring federal agencies to reclaim overpayments made to contractors due to clerical or computer errors. A summary of Government contracts-related legislation as of the end of the 106th Congress' first term follows.

H.R. 2558 and 2551—Two bills offered this past July would remove the preferential status currently enjoyed by FPI whereby federal agencies are required to order certain goods—and potentially, services (see 41 GC ¶ 202)—from FPI as opposed to a private firm. One bill, H.R. 2558, would significantly expand the market opportunities available to FPI, open it to competition from private firms, and allow FPI-made goods to be sold commercially. The bill, sponsored by Representative Bill McCollum (R-Fla.), also would require that prison inmates be paid at minimum wage levels, a requirement long sought by labor groups who have argued that FPI has an unfair competitive advantage over commercial firms since it pays its workers at below-market rates.

H.R. 2551 also aims to eliminate FPI's status as a mandatory source on Government contracts. That bill, originally intended as stand-alone legislation, likely will be offered as an amendment to H.R. 2558 at markup. A markup session scheduled for October was postponed. When Congress recessed last November, H.R. 2558 still had not undergone markup and prospects for passage now look dim, especially since the bill's champion, McCollum, plans to seek this fall the Senate seat being vacated by retiring Republican Senator Connie Mack.

H.R. 1827—Recovery of overpayments made to contractors because of clerical or computer errors is the goal of a bill offered by House of Representatives Government Reform Committee Chair Dan Burton (R-Ind). After an amendment to the bill excluded Medicare contractors from the bill's reach, H.R. 1827 was passed by the Government Reform Committee on November 10 and reported to the House floor November 17. No Senate companion bill has been introduced.

H.R. 2392—Questions regarding oversight of the Small Business Innovation Research Program cloud passage of legislation to extend the program for another seven years. The program