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Special allocations under the cost accounting standards

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The Cost Accounting Standards are intended to achieve consistency and uniformity in the cost accounting practices of Government contractors.² Consistency is achieved by requiring individual contractors to follow the same practices over time.³ Uniformity is achieved by establishing standards for all CAS-covered contracts for the measurement of costs, the allocation of costs to cost objectives, and the assignment of costs to cost accounting periods.⁴

According to the CAS Board's "Statement of Objectives, Policies and Concepts," consistency "[e]ssentially ... relates to the *allocation* of costs, both direct and indirect, and to the treatment of cost with respect to individual cost objectives as well as among cost objectives in like circumstances" (emphasis added).⁵ Consistency in cost accounting practices is principally governed by CAS 401 and 402. CAS 401 requires that a contractor's practices used in estimating costs in pricing a proposal must be consistent with the practices the contractor uses in accumulating and reporting costs and, concomitantly, that the practices used in accumulating and reporting actual costs for a contract must be consistent with the practices used in estimating costs.⁶ CAS 402 requires that a contractor consistently treat all costs incurred for the same purpose, in like circumstances, as either direct costs only or indirect costs only with respect to final cost objectives.⁷

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In furtherance of these twin objectives of increased uniformity and consistency, and consistent with the basic premise of good accounting, the CAS require that the measurement, assignment, and allocation of costs to cost objectives be based on the *beneficial or causal relationship* between those costs and the cost objectives.⁸ The beneficial or causal relationship criterion is analogous to the "relative benefits received or other *equitable* relationship" (emphasis added) criteria required for a cost to be considered allocable under the Federal Acquisition Regulation cost principles.⁹

The twin objectives of consistency and equitable allocation are not always compatible. In certain circumstances, a contractor's disclosed or established allocation practices will not result in an allocation commensurate with the benefits received. In those circumstances, the CAS recognize and, depending on the Standard, either permit or require, a special allocation. Special allocations thus sacrifice the requirement for consistency to ensure that allocations are based on the beneficial or causal relationship between the costs and cost objectives.

This *Feature Article* examines the special allocations prescribed by CAS 403, 410, 418 and 420, and discusses their application, the circumstances that may warrant their use and the issues that may arise in their administration.

Special Allocations Under CAS 403, 410, 418 and 420

Four of the Cost Accounting Standards provide for a special allocation: (1) CAS 403, Allocation of home office expenses to segments;¹⁰ (2) CAS 410, Allocation of business unit general and administrative expenses to final cost objectives;¹¹ (3) CAS 418, Allocation of direct and indirect costs;¹² and (4) CAS 420, Accounting for independent research and development costs and bid and proposal costs.¹³ CAS 403, 418, and 420 *permit* the contractor and

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the contracting officer to agree to a special allocation when application of the Standard's prescribed indirect cost allocation criteria would produce inequitable results.¹⁴ CAS 410, on the other hand, *requires* the contractor to use a special allocation for G&A expense when a particular final cost objective receives significantly more or less benefit from G&A expenses than the other final cost objectives.¹⁵

Accordingly, a special allocation under CAS 410 differs from a special allocation under the other three Standards in two significant respects: (1) a CAS 410 special allocation is mandatory when the applicable conditions are met; and (2) CAS 410 does not require an agreement to use a special allocation. These two distinctions are readily apparent in the different language used in CAS 403, CAS 418 and CAS 420, as compared to CAS 410, as shown below:

- CAS 403-40(c)(3) states: "Where a particular segment receives significantly more or less benefit from residual expenses than would be reflected by the allocation of such expenses pursuant to paragraph (c)(1) or (2) of this subsection (see 9904.403-50(d)), ***the Government and the contractor may agree to a special allocation*** of residual expenses to such segment commensurate with the benefits received. The amount of a special allocation to any segment ***made pursuant to such an agreement*** shall be excluded from the pool of residual expenses to be allocated pursuant to paragraph (c)(1) or (2) of this subsection, and such segment's data shall be excluded from the base used to allocate this pool."¹⁶
- CAS 418-50(f) states: "Where a particular cost objective in relation to other cost objectives receives significantly more or less benefit from an indirect cost pool than would be reflected by the allocation of such costs using a base determined pursuant to paragraphs (d) and (e) of this subsection, ***the Government and the contractor may agree to a special allocation*** from that indirect cost pool to the particular cost objective commensurate with the benefits received. The amount of a special allocation to any such cost objective ***made pursuant to such an agreement*** shall

be excluded from the indirect cost pool and the particular cost objective's allocation base data shall be excluded from the base used to allocate the pool."¹⁷

- And, CAS 420-50(f)(2) states: "The IR&D and B&P cost pools, which are not allocated under subparagraph (f) of this subsection, shall be allocated to all final cost objectives of the business unit by means of the same base used by the business unit to allocate its general and administrative expenses in accordance with 9904.410-50; provided, however, where a particular final cost objective in relation to other cost objectives receives significantly more or less benefit from IR&D or B&P cost than would be reflected by the allocation of such costs ***the Government and the contractor may agree to a special allocation*** of IR&D or B&P costs to such final cost objective commensurate with the benefits received. The amount of a special allocation to any such final cost objective ***made pursuant to such an agreement*** shall be excluded from the IR&D and B&P cost pools to be allocated to other final cost objectives and the particular final cost objective's base data shall be excluded from the base used to allocate these pools."¹⁸

On the other hand,

- CAS 410-40(b)(2) states: "The allocation of the G&A expense pool to any particular final cost objectives which receive benefits significantly different from the benefits accruing to other final cost objectives ***shall*** be determined by special allocation (9904.410-50(j))."¹⁹
- And, CAS 410-50(j) states: "Where a particular final cost objective in relation to other final cost objectives receives significantly more or less benefit from G&A expense than would be reflected by the allocation of such costs using a base determined pursuant to paragraph (d) of this subsection, ***the business unit shall account for this particular final cost objective by a special allocation*** from the G&A expense pool to the particular cost objective commensurate with the benefits received.

The amount of a special allocation to any such final cost objective shall be excluded from the G&A expense pool required by 9904.410-40(a), and the particular final cost objective's cost input data shall be excluded from the base used to allocate this pool.”²⁰

Application of Special Allocations

All four Standards prescribe the same technique for applying a special allocation, namely: A special allocation is subtracted from the indirect cost pool, and the amount of the allocation base for the cost objective (or segment) receiving the special allocation is subtracted from the indirect cost pool allocation base. Accordingly, the indirect cost rate applicable to all of the cost objectives *other* than the cost objective receiving the special allocation is computed as follows:

$$\frac{\text{indirect cost pool} - \text{special allocation}}{\text{indirect cost pool allocation base} - \text{allocation base for cost objective receiving special allocation}}$$

The special allocation contract receives the special allocation, but does not participate in the allocation of costs from the indirect cost pool.

The following example demonstrates the mechanics of a special allocation from a G&A expense pool:

G&A expense pool	\$100,000
G&A cost input allocation base	\$1,000,000
Contract A cost input	\$50,000
Special allocation to Contract A	\$20,000

G&A rate before the special allocation:

$$\frac{\$100,000}{\$1,000,000} = 10\%$$

G&A rate after the special allocation to be applied to all of the other final cost objectives:

$$\frac{\$100,000 - \$20,000}{\$1,000,000 - \$50,000} = \frac{\$80,000}{\$950,000} = 8.42\%$$

Amount allocated to Contract A through special allocation \$20,000

The same technique would apply to a special allocation under CAS 403 except that the special allocation for a segment (rather than a final cost objective) would be subtracted from the residual expenses and

that segment's data would be subtracted from the three-factor formula allocation base.

Although a special allocation, by definition, removes a certain amount of costs from an indirect cost pool and directly charges that amount to a particular final cost objective, there is a significant difference between a *direct* allocation and a *special* allocation. The following examples illustrate the different results that would be obtained through a *direct* allocation of a particular sales commission under CAS 402.50(d) on the one hand, and through two *special* allocations of the same sales commission under CAS 410.50(j) on the other. For the purpose of each example, assume (a) a G&A expense pool of \$100,000, (b) a G&A total cost input allocation base of \$1,000,000, (c) a total cost input for the special allocation contract of \$50,000, and (d) a sales commission of \$16,000. Assume further that the G&A rate is 10 percent before any direct or special allocation of the sales commission.

A *direct* allocation of the sales commission to the special allocation contract would result in the following G&A rate, applicable to *all* of the contractor's contracts, including the special allocation contract:

$$\frac{\$100,000 - \$16,000}{\$1,000,000} = \frac{\$84,000}{\$1,000,000} = 8.40\%$$

Put another way, by using a direct allocation instead of a special allocation, the “special allocation” contract receives both a direct allocation of the sales commission and an allocation of G&A expense. By contrast, a special allocation of G&A expense to the special allocation contract would result in a somewhat higher G&A rate applicable to the contractor's other, non-special allocation contracts. The first example below assumes a special allocation (of \$18,000) that is *greater* than the \$16,000 sales commission. The second example assumes a special allocation (of \$15,000) that is *less* than the \$16,000 sales commission.

$$(1) \frac{\$100,000 - \$18,000}{\$1,000,000 - \$50,000} = \frac{\$82,000}{\$950,000} = 8.63\%$$

$$(2) \frac{\$100,000 - \$15,000}{\$1,000,000 - \$50,000} = \frac{\$85,000}{\$950,000} = 8.95\%$$

Using the above examples, the amount of G&A expense removed from the G&A expense pool—

which may be greater or less than the amount of the sales commission depending upon the proportionate benefit that contract receives from the G&A expense pool—would be directly charged to the special allocation contract, while the remaining costs in the G&A expense pool would be indirectly charged to the contractor's other final cost objectives.

Circumstances that May Warrant a Special Allocation

Several of the Standards provide illustrations or otherwise amplify the circumstances that may warrant use of a special allocation. As well, the FAR cost principles, the Defense Contract Audit Agency Contract Audit Manual, and the Department of Defense CAS Working Group papers suggest certain circumstances that may warrant a special allocation.

CAS 403

CAS 403 permits a contractor and a CO to agree to a special allocation of residual home office expenses when a particular segment receives significantly more or less benefit from residual expenses than would be reflected by the allocation of such expenses pursuant to CAS 403-40(c)(1) or (c)(2).²¹ The Standard goes on to explain that “[s]egments which may require special allocations of residual expenses ... include, but are not limited to foreign subsidiaries, [Government-Owned, Contractor-Operated facilities], domestic subsidiaries with less than a majority ownership, and joint ventures.”²²

In its prefatory comments accompanying the promulgation of CAS 403, the CAS Board gave the following rationale for excepting certain segments from the otherwise required use of a segment activity allocation base.²³ The promulgated Standard provides for special allocations of residual expense in response to concerns that the draft Standard required use of the three-factor allocation formula in circumstances where it would produce anomalous results, the Board explained. Specifically, majority ownership or situations where ownership in a subsidiary is between 20 percent and 50 percent does not mean that the residual executive home office functions provide benefits to those segments in the same proportion as to other segments that are not subsidiaries. The CAS Board

therefore agreed that the *pro rata* allocation of residual expenses to all segments through the required allocation base may be inappropriate and that fact situations warranting special allocations extended beyond those pertaining to subsidiaries.

CAS 403 provides the following guidance for implementing the Standard's special allocation procedures.²⁴

An indication that a segment received significantly less benefit in relation to other segments can arise if a segment, unlike all or most other segments, performs on its own many of the functions included in the residual expense. Another indication may be that, in relation to its size, comparatively little or no costs are allocable to a segment pursuant to [CAS 403-40(b)(1)-(b)(5)]. Evidence of comparatively little communication or interpersonal relations between a home office and a segment, in relation to its size, may also indicate that the segment receives significantly less benefit from residual expenses. Conversely, if the opposite conditions prevail at any segment, a greater allocation than would result from the application of [CAS 403-40(c)(1) or (c)(2)] may be indicated. This may be the case, for example, if a segment relies heavily on the home office for certain residual functions normally performed by other segments on their own.

As a practical matter, the nature of home office residual expenses may make it difficult to demonstrate a differing relationship between home office residual expenses and specific segments. Home office residual expenses, as the name implies, are those costs left after all of the home offices expenses that can practicably be allocated directly to the benefiting segments have been so allocated.²⁵ The Standard describes typical home office residual expenses as including the compensation of the chief executive, the chief financial officer, and any staff who are not identifiable with specific activities of segments.²⁶ However, some companies may, based on materiality, have combined residual pools. By their nature, the residual executive functions tend to be equally applicable to all segments reporting to a home office. Consequently, it may be difficult to demonstrate the existence of a materially disparate beneficial relationship between residual executive expenses and particular segments. Hence, while the suggested test is an objective one—looking to the comparative amount of CAS 403 allocations for other home office

expenses allocated to a particular segment in relation got the total of such allocations—it may be of little practical use.

Moreover, once the criteria justifying a special allocation of residual expenses are satisfied, CAS 403 requires that the special allocation be the cost of estimated or recorded efforts devoted to the segments.²⁷

Given the nature of typical residual executive functions, it is unlikely that the residual executives participate in a labor recording system. More likely than not, the executives estimate the amount of time spent supporting the various segments. Periodic intensive involvement with a particular segment by an executive whose compensation costs are included in the residual cost pool should not be cause for a special allocation. The nature of executive duties may occasionally require devoting a significant amount of time to a particular segment. By contrast, a special allocation requires that an executive routinely spend a significantly greater or lesser amount of time on a particular segment. This conclusion is consistent with the requirement that home office residual expenses allocated to segments be included in segment G&A expense pools²⁸ because the allocation base selected for the G&A expense pool is required to represent the activity of a typical cost accounting period.²⁹ On the other hand, specific situations may make the appropriateness of a special allocation clear—such as a joint venture with its own executives and defined management scope of operations independent of other segments.

CAS 410

CAS 410 requires the contractor to use a special allocation for G&A costs when a particular final cost objective receives benefits significantly different from the benefits accruing to the other final cost objectives.³⁰ The Standard provides an illustration of a special allocation from a G&A expense pool.³¹ In the illustration, the business unit's normal productive activity is the construction of base operating facilities, and a total cost input base is used to allocate G&A expense. The contractor is awarded a contract that requires, in addition to construction, the acquisition of a large group of trucks and mobile equipment. The costs of the equipment constitutes a significant part of the contract costs. That deviation from normal productive activity, the illustration concludes, justifies a special allocation.³²

A business unit's G&A expense pool includes those expenses necessary for the general management and administration of the business unit as a whole,³³ and the allocation base must represent the total activity of the business unit.³⁴ Accordingly, the G&A pool should not have a direct and definitive relationship to any final cost objectives. Nevertheless, the circumstances that controlled the selection of a cost input allocation base may also indicate why a particular final cost objective should receive a special allocation. For example, if a value-added base best represents the beneficial relationship between the G&A expense pool and final cost objectives, it is because including material and subcontract costs would distort the allocation of the G&A expense pool and because costs other than direct labor are significant.³⁵

If a particular final cost objective includes a significant amount of material or subcontract costs and all other final cost objectives do not, then a special allocation should be considered. In *Ford Aerospace & Communications Corp.*,³⁶ after examining the relationship between costs accumulated in the G&A expense pool and costs of material and subcontracts, the Armed Services Board of Contract Appeals upheld the contractor's selection of a value-added base. In circumstances such as those present in *Ford Aerospace*, where a value-added or single-element cost input base best represents the beneficial relationship between the G&A expense pool and business units' normal activity, the presence of a final cost objective with a material amount of non-allocation base costs may warrant consideration of a special allocation.

CAS 418

CAS 418 provides cost allocation criteria for all indirect cost pools, except cost allocations governed by other Standards³⁷ and the costs of special facilities that are accounted for in separate indirect cost pools.³⁸ CAS 418 permits a contractor and a CO to agree to a special allocation of indirect costs when a particular cost objective in relation to other cost objectives receives significantly more or less benefit from an indirect cost pool that would be reflected by the allocation of such costs using a base determined pursuant to CAS 418.50(d) or (e).³⁹ Neither the Standard nor its Preamble further explains the special allocation provision of CAS 418.50(f). However, the other Standards, procurement regulations, and related material may provide relevant guidance.

For example, the FAR identifies circumstances when normal indirect cost groupings or accounting practices may yield inequitable results.⁴⁰ Circumstances that may require closer examination include the existence of substantial differences between cost patterns of work under the contract and the contractor's other work; significant changes in the nature of the business, the extent of subcontract, fixed-asset improvement programs, inventories, volume of sales and production, manufacturing processes, or contractor's products; and application to offsite locations of indirect cost groupings that were developed for the contractor's primary location. Many of the circumstances requiring an evaluation of changed indirect cost groupings or allocation methods are also candidates for consideration of a special allocation if the revised indirect cost pools or allocation methods do not achieve an equitable allocation of indirect cost to all cost objectives.

CAS 420

CAS 420 permits the contractor and CO to agree to a special allocation of independent research and development and bid and proposal costs when a particular segment or final cost objective receives significantly more or less benefit from IR&D or B&P costs than would be reflected by the allocation of such costs pursuant to CAS 420.50(e)(1) or (f)(1).⁴¹ CAS 420 provides an illustration of a special allocation of IR&D and B&P project costs accumulated at a home office.⁴² In the illustration, IR&D project costs not directly identified to one or more segments are included in a cost pool that the Standard requires to be allocated using the same base as is used to allocate home office residual expenses.⁴³ The illustration is silent as to the circumstances that allowed the contractor and the CO to agree that the nature of the business activity at the segment was such that the segment did not benefit from the home office's project costs. The special allocation is accomplished by eliminating segment data from the home office IR&D/B&P allocation base.

CAS 420 does not provide an illustration for a special allocation of business unit IR&D or B&P cost pools to a particular final cost objective. The Preamble shows that product lines were considered and rejected as a basis for allocating business unit IR&D/B&P costs.⁴⁴ The Standard also provides that IR&D/B&P

costs may not be assigned to a cost accounting period other than the one in which they were incurred.⁴⁵ Taken together, these provisions indicate that it would be difficult to justify a special allocation to a particular final cost objective performed in the current cost accounting period.

However, circumstances warranting a special allocation of G&A expense may also warrant a special allocation of business unit IR&D/B&P. The CAS Board required use of the business unit's G&A expense pool allocation base to allocate IR&D/B&P costs because it found that the beneficial relationship between the IR&D/B&P cost pool and final cost objectives is similar to that between the G&A expense pool and final cost objectives.⁴⁶ Both G&A and IR&D/B&P costs are viewed as having a beneficial relationship to final cost objectives best measured by a cost input allocation base representing the productive activity of the entire business unit. Thus, if a special G&A allocation is required, a special allocation of IR&D/B&P may also be appropriate.

Issues in the Administration of Special Allocations

Is a Special Allocation a Change in Cost Accounting Practice?

Neither the illustrations in CAS 9903.302-3 of a change in cost accounting practice nor the regulatory history of the special allocation provisions suggests that the CAS Board intended a special allocation to be a change to a cost accounting practice. Moreover, in *Perry v. Martin Marietta Corp.*, the U.S. Court of Appeals for the Federal Circuit held that changes to the size and composition of indirect cost pools and allocation bases do not constitute a change to cost accounting practices, so long as the proportional allocation methodology remains the same.⁴⁷ A special allocation removes a certain amount of costs from an indirect cost pool and removes the corresponding cost objectives from the pool's allocation base, but it does not change the proportionate method used to allocate the indirect cost pool. Consequently, a special allocation is not a change in cost accounting practice.

The Armed Services Board of Contract Appeals recognized this point in its decision on remand in

Aydin Corp. (West).⁴⁸ More than any other case, *Aydin Corp. (West)* explores the apparent conflict between special allocations and the consistency requirements of CAS 402. At issue in *Aydin* was, among other things, the allocability of a particularly large foreign sales commission that accounted for 91 percent of Aydin's sales commissions for the year, while the contract for which it was paid—the "SOLAR II" contract—accounted for only 19 percent of Aydin's total cost input G&A allocation base. In the initial appeal, the ASBCA found Aydin in noncompliance with CAS 410 because the Government contract at issue in the case received significantly less benefit from the G&A expense pool than did the SOLAR II contract.⁴⁹ Accordingly, the ASBCA "agree[d] with the Government that for the SOLAR II commission to remain in the G&A expense pool would result in an inequitable distribution of SOLAR II commission to the Government contracts."⁵⁰ "In such circumstances," the ASBCA stated, "CAS 410.40(b)(2) provides that allocation shall be determined by special allocation in accordance with CAS § 410.50(j)."⁵¹

The ASBCA went on to hold that it would not violate CAS 402 for Aydin to directly allocate the SOLAR II sales commission yet continue to treat all other sales commissions as indirect expenses.⁵² Put another way, the ASBCA held that the noncompliance could be resolved by a one-time direct allocation under CAS 402 as well as by a special allocation under CAS 410.

The Federal Circuit reversed the ASBCA's holding with respect to CAS 402.⁵³ The court observed that the phrase "all such costs" in CAS 402.50(d)(2) could embrace all selling expenses, all sales commissions, or even all foreign sales commissions, but the Government could not define the phrase so narrowly as to capture only one isolated cost item—the SOLAR II sales commission—even where that cost is disproportionately large. On that basis, the court ruled that the "Board's holding—that all sales commissions could remain under Aydin's G&A expense pool, with the exception of the SOLAR II commissions—violates CAS 402."⁵⁴ The court remanded to the ASBCA to explain how the SOLAR II sales commission costs differed in purpose or circumstances from the other sales commission costs, justifying different treatment of those costs under CAS 402.⁵⁵

On remand, the ASBCA acknowledged that the SOLAR II sales commission costs differed from other sales commission costs only in size and not in purpose or circumstances. Consequently, the board withdrew its earlier suggestion that an "equitable allocation" of Aydin's 1989 G&A expenses could be achieved through a one-time direct charge of the SOLAR II sales commission under CAS 402.50(d). However, the ASBCA noted that while the Federal Circuit reversed the board's holding on CAS 402, the court did not say that a special allocation under CAS 410.40(b)(2) was similarly impermissible.⁵⁶ Accordingly, the ASBCA again directed the parties to establish an equitable special allocation under CAS 410.50(j).

In remanding to the parties, the ASBCA noted that it was *not* directing a change to Aydin's established cost accounting practices. Rather, the ASBCA held, "Aydin's G&A rate charged to the Government must be adjusted by Special Allocation as provided by CAS 410.50(j)."⁵⁷

Does a Special Allocation Require a Disclosure Statement Revision?

Because the use of a special allocation is not a change in cost accounting practice, it should not require a revision to the contractor's CAS Board Disclosure Statement. However, the Defense Contract Audit Agency Contract Audit Manual takes the position—at least for CAS 410, 418 and 420—that the special allocation must be described in the contractor's Disclosure Statement or the contractor would be in noncompliance for failing to follow its disclosed practices.⁵⁸ The DCAM does not say whether a Disclosure Statement revision is required for a special allocation under CAS 403. DCAA's position is consistent with Department of Defense CAS Working Group Item 78-21, which suggests that the Disclosure Statement be amended to identify a CAS 410.50(j) special allocation and the circumstances that required its use.⁵⁹

Given that a special allocation under CAS 410 is required when a particular final cost objective receives significantly different benefits from an indirect cost pool than do the other cost objectives, disclosing the Standard's criteria for the special allocation seems to serve no useful purpose. Moreover, the terms of Disclosure Statement are inconsistent

with a universal requirement for disclosure of criteria or circumstances warranting special allocations.⁶⁰ For example, Item 4.2.0, “G&A Expense Pools,” provides for a description of special allocations and the allocation base used, but not for the criteria. Item 4.5.0, “Application of Overhead and G&A Rates to Specified Transactions or Costs,” similarly provides for a number of “special situations,” but does not require a description of the criteria warranting a special allocation. Likewise, Item 4.6.0, “IR&D and B&P Costs,” and Item 8.3.0, “Expenses or Pools of Expenses and Methods of Allocation,” provide for a description of “other” allocations or special allocations for residual expenses and/or fixed management charges, respectively, but do not require any description of the criteria or circumstances for such allocations. Item 4.1.0, “Overhead Pools,” and Item 4.3.0, “Service Center and Expense Pool Allocations,” do not contain any special allocation disclosure requirements.

Can a Special Allocation Be Applied to More than One Contract or to a Class of Contracts?

For recurring special allocations of the type described at Disclosure Statement 4.5.0, “Application of Overhead and G&A Rates to Specified Transactions or Costs,” it is self-evident that more than one contract or other final cost objective may be subject to classes of transactions and cost elements where a special allocation rate is applied. In these types of situations, there is no reason to believe that special allocations cannot apply to classes of contracts.

A special allocation is also warranted if the allocation base selected for a particular indirect cost pool does not allocate cost to a particular cost objective commensurate with benefits received in a particular factual situation. Working Group Item 78-21 states that a need for a special allocation of G&A to a class of contracts may indicate a requirement for either G&A pool purification or that the selected allocation base does not represent total activity during a typical cost accounting period.

For example, if a total cost input base is selected as best representative of the total activity of a typical cost accounting period, a disclosed or established practice of special allocations for all contracts containing sig-

nificant amounts of Government-Furnished Property is permitted. CAS 410 and the other Standards dealing with indirect cost pools place no express limitation on the number of special allocations. The test is not how many cost objectives require special allocations but, rather, in accordance with CAS 402, whether there are alternative indirect cost allocation methods complying with prescribed criteria that will produce cost allocations commensurate with benefits received. At some point, however, the absolute amount of cost allocated via special allocations might indicate that either the composition of the indirect cost pool or its allocation base should be revised. Finally, the Working Group suggested that administrative contracting officers should exercise caution in agreeing to special allocations and recognize that, in some circumstances, special allocations may result in an unfair competitive advantage.⁶¹

When Should a Special Allocation Be Negotiated?

If a special allocation is necessary for a particular contract, then ideally it should be negotiated as part of the contract price. However, because a special allocation is not a change in cost accounting practice, it is not subject to the limitation in FAR 30.603-2(d)(3) on retroactive changes. Nothing in the FAR or CAS prohibits or limits the retroactive use of a special allocation. Indeed, the CAS Board regulations provide no criteria or guidance whatsoever regarding the *timing* of negotiation of a special allocation. Nor is there any restriction on negotiating an advance agreement after the costs have been incurred. FAR 31.109 states that advance agreements *should* be negotiated before incurrence of costs involved, but does not state that they *must* be. Furthermore, even for changes in cost accounting practice, the ASBCA has long recognized that changes in allocation may be required when the existing practices become inequitable, and that in certain circumstances retroactive changes may be necessary.⁶²

Who is the Appropriate Official to Approve the Use of a Special Allocation?

The cognizant Federal agency official—typically the administrative contracting officer—is responsible for CAS administration.⁶³ However, because a special

allocation under CAS 410, 418 or 420 results in a cost being charged to a specific contract, and is not a change in cost accounting practice, the procuring contracting officer may be a more appropriate official than the ACO to approve the use of a special allocation.⁶⁴

There are few reported decisions dealing with special allocations, and none that addresses this precise issue. However, the ASBCA's decision in *AM General LLC*⁶⁵ is instructive. That case involved a CAS 418 noncompliance, and AM General argued that the PCO agreed to a special allocation. The ASBCA concluded that beyond counsel's conclusory assertions, there was no evidence to support AM General's claim that the PCO agreed to a special allocation. The ASBCA did *not* say that only the ACO, and not the PCO, could agree to a special allocation. To the contrary, the decision appears to assume that the PCO is the appropriate person to approve a special allocation.

Conclusion

Special allocations remain a relatively little understood—and infrequently litigated—area of the Cost Accounting Standards. Perhaps for that reason, COs are often reluctant to approve the use of a special allocation, and may even challenge a contractor's use of a special allocation required under CAS 410. Consequently, although they provide an exception to the CAS consistency requirements to allow an equitable allocation of costs, special allocations are not used as often as may be appropriate.

❖ Endnotes

- 1 Karen L. Manos is a partner resident in the Washington, DC office of Gibson, Dunn & Crutcher, LLP, and co-chair of the firm's Government and Commercial Contracts practice group. Ms. Manos is the Immediate Past Chair of the American Bar Association Section of Public Contract Law. Before entering private practice in 1995, Ms. Manos was an Air Force judge advocate, and was the Government trial attorney in the ASBCA appeal of *Aydin Corp. (West)*, which is discussed in this Feature Article. This article is adapted from an article published in the October 1996 issue *COST, PRICING & ACCOUNTING REPORT*.
- 2 Office of Federal Procurement Policy Act, P.L. 100-679, § 26(f), 102 Stat. 4059 (1988). See also CAS Board "Statement of Objectives, Policies & Concepts," 57 Fed. Reg. 31036 (July 13, 1992).
- 3 57 Fed. Reg. 31036, note 2 above.
- 4 57 Fed. Reg. 31036, note 2 above.
- 5 57 Fed. Reg. 31036, note 2 above.
- 6 48 CFR § 9904.401-40.
- 7 48 CFR § 9904.402-40.
- 8 57 Fed. Reg. 31036, note 2 above.
- 9 See FAR 31.201-4.
- 10 See 48 CFR § 9904.403-40(c)(3).
- 11 See 48 CFR §§ 9904.410-40(b)(2), 9904.410-50(j).
- 12 See 48 CFR § 9904.418-50(f).
- 13 See 48 CFR § 9904.420-50(e)(2), (f)(2).
- 14 See notes 10, 12 and 13, above.
- 15 See note 11, above.
- 16 48 CFR § 9904.403-40(c)(3) (emphasis added).
- 17 48 CFR § 9904.418-50(f) (emphasis added).
- 18 48 CFR § 9904.420-50(f)(2) (emphasis added).
- 19 48 CFR § 9904.410-40(b)(2) (emphasis added).
- 20 48 CFR § 9904.410-50(j) (emphasis added).
- 21 See note 10, above.
- 22 48 CFR § 9904.403-50(d)(2).
- 23 48 CFR § 9904.403-50(d)(1).
- 24 48 CFR § 9904.403-40(a), (c).
- 25 48 CFR § 9904.403-40(c)(1).
- 26 48 CFR § 9904.403-50(d)(3).
- 27 CAS 403, Preamble A, 38 Fed. Reg. 26680 (Dec. 14, 1972), reprinted in *COST ACCOUNTING STANDARDS GUIDE (CCH)* ¶ 3906, p. 4979.
- 28 48 CFR § 9904.410-50(g).
- 29 CAS 410, Preamble A, 41 Fed. Reg. 16141 (Apr. 16, 1976), reprinted in *COST ACCOUNTING STANDARDS GUIDE (CCH)* ¶ 4182, p. 5170.
- 30 See note 11, above.
- 31 48 CFR § 9904.410-60(g).
- 32 See note 29, above.
- 33 48 CFR § 9904.410-30(a)(6).
- 34 48 CFR § 9904.410-40(b)(1).
- 35 48 CFR § 9904.410-50(d)(2).
- 36 ASBCA 23833, 83-2 BCA ¶ 16813.
- 37 48 CFR § 9904.418-40(d).
- 38 48 CFR § 9904.418-40(e).
- 39 See note 12, above.
- 40 FAR 31.203(d)(1)-(d)(3).
- 41 See note 13, above.
- 42 48 CFR § 9904.420-60(f).
- 43 48 CFR § 9904.420-50(e)(2).
- 44 CAS 420, Preamble A, 44 Fed. Reg. 55127 (Sept. 25, 1979), reprinted in *COST ACCOUNTING STANDARDS GUIDE (CCH)* ¶ 4534, p. 5445.
- 45 48 CFR § 9904.420-40(f)(1), (f)(2).
- 46 CAS 420, Preamble A, note 43, above, p. 5446.
- 47 *Perry v. Martin Marietta Corp.*, 47 F.3d 1134, 1138 (Fed. Cir. 1995).
- 48 *Aydin Corp. (West)*, ASBCA No. 42760, 96-1 BCA ¶ 28,209.
- 49 *Aydin Corp. (West)*, ASBCA No. 42760, 94-2 BCA ¶ 26,899 at 133,936.
- 50 *Id.* at 133,935.
- 51 *Id.*
- 52 *Id.* at 133,934–133,935.
- 53 *Aydin Corp. (West) v. Widnall*, 61 F.3d 1571, 1579-80 (Fed. Cir. 1995).

- 54 *Id.*
- 55 61 F.3d at 1580.
- 56 96-1 BCA ¶ 28,209 at 140,802.
- 57 96-1 BCA ¶ 28,209. In an unpublished decision, the Federal Circuit reversed on other grounds, finding that “the Board violated the narrow scope of this court’s remand order,” by going beyond providing an explanation of “how the SOLAR II sales commission costs differ in purpose or circumstance from other sales commission costs, justifying different treatment of these costs.” 121 F.3d 726, 1997 WL 413329 (Fed. Cir. 1997).
- 58 DCAM ¶¶ 8-410.1b(3), 8-418.2.j, 8-420.2d (Aug. 16, 2011).
- 59 CAS Working Group Item 78-21, “Implementation of CAS 410, Allocation of Business Unit General and Administrative (G&A) Expenses to Final Cost Objectives” (Amendment 1) (Apr. 21, 1981), Question & Answer 9, reprinted in GOVERNMENT CONTRACT COSTS & PRICING E-68.
- 60 CASB DS-1 (codified at 48 CFR § 9903.202-9), reprinted in GOVERNMENT CONTRACT COSTS & PRICING App. G.
- 61 DoD CAS Working Group Item 78-21, note 59 above, Question & Answer 8, reprinted in GOVERNMENT CONTRACT COSTS & PRICING E-67.
- 62 *See, e.g., Celesco Industries, Inc.*, ASBCA No. 20569, 77-1 BCA ¶ 12,445.
- 63 *See* FAR 30.601(a), 42.302(a)(11).
- 64 A special allocation under CAS 410 does not require the Government’s agreement, and in fact is mandatory when the conditions for using it apply. However, to the extent that a special allocation under CAS 410 results in a charge to a particular contract, it may nevertheless be prudent to obtain the PCO’s approval.
- 65 *AM General LLC*, ASBCA Nos. 53619 et al., 06-1 B.C.A. ¶ 33,190.