

2. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. The Committee considered the proposed letter to Industry attached to the Subcommittee report of 4 June 1976. Substantive changes to the letter were developed at the table to convey the concept to Industry that the revised material is merely proposed changes for which comments are requested for subsequent consideration by the Committee. Changes made at the table were noted by those present. The proposed letter as revised was approved for signature by the Chairman.

(23 June 1976)

1. Miscellaneous Matters. Copies of the following material resulting from prior Committee actions were provided to the Members for information.

(B) Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles - The Chairman's letter of 30 July 1976 to other Government Agencies and Industry.

(30 July 1976)

1. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. Copies of the comments received in response to the Chairman's letter of 30 July 1976 were distributed to the Members. Additional copies of the comments were provided to the Alternate DSA Policy Member for transmittal to the Section XV, Part 2 Subcommittee for review and recommendations. The Subcommittee will provide its rationale for acceptance or rejection of the comments. The DSA Policy Member will prepare the Subcommittee assignment and establish a reporting date after consultation with the Subcommittee Chairman.

Members of the Subcommittee are:

Army	- Floyd King, DRCPP
Navy	- Dennis Modesitt, NAVMAT
Air Force	- John H. Lynskey, AFSC-PMLO John Keyes, AFSC-PMLO (Alternate Member)
DSA	- George H. Strouse, DCAS-AFP, Chairman
DCAA	- John W. Paulachak
OSD	- Herbert Fisher, OASD (I&L) (Consultant) James A. E. Wood, OASD (C) (Consultant)
GSA	- Frank Van Lierde, Office of Audits (AWA) (Consultant)
ERDA	- Herbert B. Goodwin, (Consultant)

(6 October 1976)

2. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. Copies of the Subcommittee assignment of 8 October 1976, prepared by the DSA Policy Member, were distributed to the Members for information. A reporting date of 30 November 1976 is established. Copies of the CODSIA letter of 8 October 1976 were distributed to the Members. Additional copies were provided to the Alternate DSA Policy Member for transmittal to the Section XV, Part 2 Subcommittee Chairman, for consideration with the other comments previously received under this case.

(13 October 1976)

2. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. Copies of the Subcommittee report of 24 January 1977 were distributed. Attached to the report are revised Section XV, Part 2 changes resulting from the Subcommittee's review of other Government Agencies and Industry comments on the material developed under this case. The Committee agreed to consider the report at the meetings of 9/10 February.

(27 January 1977)

1. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles.

Visitor - Mr. Herbert B. Goodwin, DCAA

The Committee considered the Subcommittee report of 18 February 1976. The Air Force Legal Member informed the Members of oral comments he had received from the Air Force Trial Attorney for the Boeing case concerning the Subcommittee report and recommended that further action on this matter be delayed until receipt of written comments in this regard. The Members discussed the need for any changes to Section XV, particularly the proposed Tab D to the Subcommittee report. The Subcommittee Chairman informed the Members that the proposed coverage conforms to existing guidance in the DCAA Manual. Several alternate changes were considered. It was agreed to accept the Air Force Legal Member's recommendation to delay further consideration of the case until the written Air Force comments are submitted. The Committee will resume consideration of this case at 1100 hours on 15 April 1976.

(17 March 1976)

Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. It was agreed to reschedule this case for Committee consideration to 28/29 April 1976.

(8 April 1976)

Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. Copies of an internal Air Force memorandum of 31 March 1976 were distributed to the Members. The memorandum provides comments on the Subcommittee report submitted under this case. This memorandum will be considered with the other material already scheduled for consideration under this case at the meetings of 28/29 April 1976.

(14 April 1976)

2. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. The Committee considered the Subcommittee report of 18 February 1976 with the substitution of the alternate change to 15-205.1 (provided to the Members on 3 March 1976) for Tab A of the Subcommittee report, and the Air Force comments of 31 March 1976 on the Subcommittee report. Tab D of the Subcommittee report which proposed the establishment of a new cost principle on Public Relations cost was rejected. The addition of the words "whether or not additional capital is raised" at the end of the revised 15-205.23 was approved. The proposed changes to 15-205.1, 15-205.23, and 15-205.41, as revised by the Committee at the table (Tabs A, B and C of the Subcommittee report of 18 February 1976), were approved for submission to other Government Agencies and Industry for comment. The Subcommittee Chairman is to prepare the proposed letter to Industry. The DSA Policy Member will inform the Subcommittee Chairman of this assignment and request submission to the Committee as soon as practicable, considering all other current Subcommittee assignments.

(29 April 1976)

1. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. Copies of the Subcommittee report of 4 June 1976 were distributed to the Members. Attached to the report is a proposed letter to Industry requesting comments on the material developed under this case. The Committee agreed to consider the report at the meetings of 23/24 June 1976.

(10 June 1976)

Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. Copies of a letter of 2 October 1974 from the Assistant Administrator for Procurement, NASA, were distributed to the Members. The letter recommends that a case be established to review certain Section XV, Part 2 cost principles, in view of the decision under ASBCA Case No. 14370. The Committee referred this matter to the Section XV, Part 2 Subcommittee for review and recommendation. The Subcommittee is to submit a report by 15 February 1975.

Members of the Subcommittee are:

Army	- David F. Calder, AMC
Navy	- Dennis Modesitt, NAVMAT
Air Force	- James T. Brannan, AFSC-PPFN
DSA	- Lauren D. Lampert, DCAS-AFP
DCAA	- Herbert B. Goodwin, Chairman
OSD	- Charles E. Deardorff, OASD (I&L) (Consultant)

(16 October 1974)

Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. Copies of the Subcommittee report of 18 February 1976 were distributed to the Members. The report includes proposed changes to 15-205.1, Advertising Costs; 15-205.23, Organization Costs; 15-205.41, Taxes, together with a proposed new 15-205.50, Public Relations Costs. The changes to existing cost principles and the publication of the new cost principle on Public Relations Costs are submitted in response to a recommendation received from NASA as a result of ASBCA Case No. 14370. The case involves a precedent-setting decision by the Board with regard to a CPFF contract performed by the Boeing Company. The Committee agreed to consider the report at 1100 hours on 4 March 1976.

(25 February 1976)

2. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles.

Visitor - Mr. Herbert B. Goodwin, DCAA

The Committee considered the Subcommittee report of 18 February 1976. In a general discussion of the Subcommittee report, the relationship of the proposed changes to the Boeing and Aerojet General ASBCA cases was considered. An opinion was expressed that the revised changes would not clarify DoD policy for the cost principles being considered and that it might be appropriate to close the case without action. The Subcommittee Chairman informed the Members that the proposed changes closely relate to policies expressed in the DCAA Manual and that Members of the Subcommittee considered the proposed changes necessary for the guidance of DoD field operating personnel. The problems involved in determining whether advertising costs are allowable or not, even with the proposed changes, were discussed in some detail. The Members and the Subcommittee Chairman made a limited review of Tabs A through D attached to the Subcommittee report. It was agreed that Tab A should be revised to delete the proposed change to 15-205.1(a) and to insert a revised proposed change in 15-205.1(c). The Air Force Legal Member requested that further consideration of this case be delayed until the Air Force trial attorney for the Boeing ASBCA case had an opportunity to review the Subcommittee report and to submit his comments. The Committee agreed with this recommendation. As a result it was agreed to resume consideration of this case at 1100 hours on 17 March 1976.

(3 March 1976)

1. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. The Committee considered the Subcommittee report of 24 January 1977 and reviewed the attached proposed changes to 15-205.1, 15-205.23, 15-205.41 and 15-205.17. The proposed change to 15-205.23 was revised to insert "administrative costs of" before "short term borrowing or working capital." The change to this cost principle, as revised, together with the changes to the other attached cost principles as submitted, were APPROVED FOR PRINT in a DPC.

CASE CLOSED  
(9 February 1977)

4. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. The Chairman informed the Members that he had received a memorandum from the Director, DCAA, expressing serious concern with the changes approved under this case. The Chairman is submitting a copy of the Director, DCAA memorandum to the OAGC (Logistics) for review and comment. As a result of this memorandum, it was agreed to delay publication of the changes approved under this case until the matters raised by the Director, DCAA can be resolved.

(24 February 1977)

1. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. Copies of a memorandum of 3 May 1977 from Mr. Moed, OAGC (Logistics), were distributed. The memorandum responds to the Chairman's request for a review of the material approved under this case and the DCAA position on the changes set forth in a memorandum of 11 February 1977. After an analysis of pertinent ASBCA cases and the intent of Public Law 87-144, the memorandum concludes with the indication that the proposed changes appear to be consistent with the most recent intent of Congress as expressed in Public Law 94-419. Matters for further Committee consideration are noted. The Committee agreed to consider the memorandum at the meetings of 18/19 May.

(5 May 1977)

3. Case 74-98 - Advertising, Entertainment and Interest Expense Cost Principles. The Secretary distributed copies of the Chairman's memorandum of 25 February 1977, to OAGC (Logistics), together with a copy of the DCAA memorandum of 11 February 1977, to the Members for information and consideration with the material previously distributed. The Committee reviewed the OAGC (Logistics) and the DCAA memoranda and confirmed the previous decision to print the revised material approved under this case. A response to the DCAA memorandum of 11 February 1977, informing that agency of the Committee's final action under this case, will be prepared by the Staff.

CASE RE-CLOSED  
(18 May 1977)

*Trans. ... -  
... 3/4 @ 1100*

18 February 1976

MEMORANDUM FOR CHAIRMAN, ASPR COMMITTEE

SUBJECT: Case No. 74-98 - Advertising, Entertainment and Interest  
Expense Cost Principles

I. PROBLEM

To review the Part 2 provisions in light of the decision in ASBCA Case No. 14370 to determine if revision or clarification of the affected cost principles is warranted.

II. RECOMMENDATIONS

A. That the following cost principles be revised as indicated in the related TAB:

- 1. 15-205.1 (Advertising Costs) - TAB A
- 2. 15-205.23 (Organization Costs) - TAB B
- 3. 15-205.41(a)(ii) (Taxes) - TAB C

B. That new cost principle 15-205.50 (Public Relations Costs), as set forth in the attached TAB D, be added to Part 2.

III. DISCUSSION

A. Background

In a letter, 2 October 1974, from the NASA Assistant Administrator for Procurement to the ASPR Committee Chairman, reference was made to ASBCA Case No. 14370. It was noted that, in this case, the Board had rendered several important decisions concerning various cost principles. Because of the precedent setting nature of certain aspects of the Board's ruling, it was recommended that a case be established to study the decision to determine whether the affected cost principles should be revised or clarified. The Committee concurred in the recommendation and, on 16 October 1974, this task was assigned to this Subcommittee.

The appellant in the subject case was the Boeing Company. The appeal involved a CPFF contract which was performed by the contractor primarily during the year 1966.

The appeal involved a number of issues affecting the interpretation of certain Part 2 cost principles. These issues were grouped by the Board according to the following classifications:

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- (i) corporate, legal and accounting expense,
- (ii) public relations expense,
- (iii) business meeting expense and
- (iv) dues expense.

A discussion of each of these issues is presented in the ensuing narrative.

B. Corporate, Legal and Accounting Expense

One of the more significant questions in this area concerned expenses incident to the redemption of the contractor's convertible 4½% debenture bond issue, and the conversion of such bonds into the contractor's capital stock. Other major issues involved costs related to the contractor's 2-for-1 stock split and legal fees incurred by Boeing in conjunction with the negotiation of credit agreements with its bank.

1. Redemption and Conversion of Bond Issue

Costs incident to the redemption and conversion of the contractor's debentures primarily consisted of the federal stock issue tax, the trustee's fees for handling the transaction and legal fees incurred in defending against a suit brought by bondholders who failed to exercise their conversion privilege on a timely basis.

The Government took exception to the stock issue tax on the basis that it was proscribed by 15-205.41(a)(ii). This section provides for the allowance of the cost of taxes except when the tax is incurred "in connection with financing, refinancing or refunding operations." The trustee's fees were disallowed by the Government on the basis that they represented an integral part of the financing activity (i.e., original bond issue) involved in raising capital in 1958; and, accordingly, were unallowable pursuant to the provisions of 15-205.17 as a financing or refinancing operation. Exception to the trustee's fees was also taken on the grounds that the redemption and conversion constituted an unallowable reorganization cost within the meaning of the term as used in 15-205.23. The legal fees incurred in defending against the bondholders' suit were disallowed because they, too, were considered incident to a financing operation, or a reorganization.

The Board allowed the cost of the stock issue tax under 15-205.41(a), holding that the taxes in question were not related to a

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financing, refinancing or refunding operation. The rationale for this conclusion is set forth in the ensuing discussion.

The trustee's fees for handling the redemption and conversion were allowed by the Board on the basis that the action represented neither a financing or refinancing, nor a reorganization. The Board, in citing Webster's definition of a "financing" noted that it means raising or providing funds or capital, whereas refinancing means renewing or reorganizing the financing, or providing capital afresh. In view of the fact that the contractor's redemption and conversion exercise did not raise one cent of capital, the Board concluded that it was not in the nature of a financing, refinancing or other type of funding operation coming within the caveat of 15-205.17, 15-205.23 or 15-205.41(a)(ii).

The Board did not accept the Government's argument that the redemption and conversion constituted a reorganization. Although the Government cited authoritative accounting literature to the effect that a reorganization was a change in the financial structure of a corporation resulting in alterations in the rights and interests of security holders, the Board cited equally authoritative accounting pronouncements to the effect that there is a distinction between a "capital adjustment" and a "reorganization," with the former term meaning the modification of the corporate capital structure without raising new capital, and the latter term implying a serious corporate overhauling through legal procedure. Within such broad parameters, the Board opined that the redemption and conversion, in the instant case, could be held to be a capital adjustment, rather than a reorganization.

With respect to the legal fees incurred in defending against a bondholders' suit arising from the redemption and conversion, the Board ruled that they must be allowed since the subject matter of the litigation was neither financing nor reorganization in nature.

## 2. Two-for-One Stock Split

Costs related to the 2-for-1 stock split were questioned by the Government, pursuant to 15-205.17, on the basis that they were incurred for financing and refinancing operations. The Board did not agree that a financing or refinancing was involved because the stock split did not raise any capital; and the questioned costs were allowed. The Board was also of the opinion that the costs in question were expressly allowable pursuant to 15-205.24, as a recurring financial expense. The final consideration militating against the Government's position on this item was the fact that the Government had previously allowed costs related to the contractor's stock dividend payments in six of the years between 1952 and 1959.

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3. Negotiation of Bank Credit Agreements

The Board decision is somewhat vague as to the reasons for the Government's disallowance of contractor legal fees incurred in connection with the negotiation of its bank credit agreements. However, the implication is that these costs were considered to have been expended for financing and refinancing operations and, as such, unallowable under 15-205.17.

The Government's position was not sustained. The Board construed financing and refinancing in this situation as being restricted to raising the basic capital investment (i.e., net worth plus long term liabilities) required by a firm to become functional over the long term; as contrasted to the more immediate working capital needs of day to day operations. The Board then concluded that the negotiation of recurring bank credit agreements was designed to raise working capital and, as such, outside the purview of a financing or refinancing activity. Accordingly, the legal fees in question were considered allowable costs; primarily pursuant to the provisions of 15-205.31 (Professional and Consultant Service Costs --- Legal, Accounting, Engineering and Other).

C. Public Relations Expense

Public relations expense involved issues which, for the most part, related to costs which were classified by Boeing into three broad categories, i.e., 50th anniversary expense, news bureau expense and the cost of the outside distribution of Boeing's monthly magazine.

Boeing's 50th anniversary observance costs included those attributable to a company produced motion picture depicting how the contractor got started, its development, and the people and products contributing to such development. Also included in this category were the costs of constructing an authentic version of the first airplane designed by Boeing, and flying it to various parts of the country where the contractor's plants were located.

News bureau expenses primarily consisted of the costs of taking pictures for customer airlines, supplying film clips to TV stations and chartering aircraft from which to take photographs. Also included in this category were the fees paid to representatives of foreign public relations firms for purposes of maintaining press liaison, and distributing information about Boeing to the news media.

Boeing's monthly magazine, the cost of distribution of which was disallowed, was sent to U. S. government civilian and military personnel,

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foreign government offices, news media and schools and libraries, among others. The magazine consisted of various articles on the progress of the company and the status of scientific developments and space programs.

The Government took exception to Boeing's claimed public relations expense on the ground that they variously constituted either advertising, entertainment or donations.

The Board criticized the Government for what it perceived as its position on public relations cost, to wit: "The Government believes that all public relations activities and expense are to be found more particularly to be either advertising, entertaining or contributions and thus are specifically unallowable even though public relations under that designation are not mentioned in the regulation and the ASPR Committee has declined to address the subject as such." The Board referred to its decision in Aerojet-General Corporation, ASBCA No. 13372, wherein it held that "advertising" and "public relations" are not synonymous but, rather, constitute separate disciplines. Public relations was considered a generic term of broad application, encompassing many activities, of which advertising is one. The Board then defined its concept of advertising versus public relations in the subject case, as follows:

"From our review of the material presented we conclude that 'advertising' customarily involves the paid use of a medium such as space in a newspaper or time on radio or television to deliver a sales message. Other examples would include certain window displays, some types of handbills or circulars, exhibits, free goods and samples, and the like. Apart from the fact that 'advertising' usually involves direct payment, probably its most significant feature is that the advertiser has complete control over the form and content of what will appear, the medium in which it will appear, and when it will appear. On the other hand, 'public relations' to the extent that it involves disseminating information, does not customarily involve purchased space or time and the person releasing the information has no control over whether it will be used as prepared, changed, or where or when it will appear or whether it may be discarded."

The foregoing criteria were applied by the Board in their determination of the allowability of the costs in question. The ruling was that the cost of the company produced motion picture, fees paid to foreign public relations representatives and the cost of the outside distribution of the contractor's monthly magazine were allowable. On the other hand, the Government's position was sustained with respect to the

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cost of Boeing's construction of a replica of its first airplane and flying it to various places, and the expenses of the news bureau, exclusive of foreign public relations costs.

D. Business Meeting Expenses

The contractor incurred costs in connection with a number of business meetings and conventions involving such organizations as the Air Force Association, Association of the U. S. Army, Navy League, Society of Experimental Test Pilots, the Logistics Management Institute, Seattle Chamber of Commerce and the American Institute of Aeronautics and Astronautics (AIAA). These costs were essentially comprised of exhibit rentals and the cost of tickets for Boeing's business associates and customers to these conventions and meetings.

The Government challenged these costs on two bases. Insofar as costs related to the Army, Navy and Air Force associations are concerned, the Government took exception under the authority of the Defense Contract Audit Manual. In the Manual, the primary objective of these associations is described as fostering a favorable image of the military services. Accordingly, related meeting and convention expenses are deemed unallowable under the provisions of 15-205.43 since the costs were not incurred in dissemination of technical information or stimulation of production. Costs related to the other organizations described above were considered by the Government to be advertising in nature.

The Board rejected the Defense Contract Audit Manual as a basis for cost disallowance on the grounds that it was not part of the contract. With regard to exhibit rentals, it was held that the Government's reliance on 15-205.1, to the effect that advertising includes conventions and exhibits, was insufficient for cost disallowance. It was noted that 15-205.1 does not make the costs of exhibits and conventions unallowable, but only identifies them as among the media which may be used for advertising. It was further noted that if the convention or exhibit is not used for advertising purposes, then related costs are allowable.

With respect to the cost of participating in conventions and meetings, the Board held that such cost had to meet the criterion for allowability as set forth in 15-205.43 (dissemination of technical information, or stimulation of production). On that basis, the Board sustained the Government's disallowance of Boeing's costs incident to meetings and conventions, other than those sponsored by the AIAA and the Society of Experimental Test Pilots.

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E. Dues Expense

Costs in this category are comprised of membership dues in such organizations as the Navy League, Army Aviation Association of America, Air Force Association, Greater Seattle Inc., Municipal League of Seattle and King County, Washington State International Trade Fair, World Affairs Council of Seattle and the Effective Citizens Organization. These organizations, other than those associated with the military, are primarily devoted to such objectives as promoting the Seattle area, increasing trade in the State of Washington and furthering international understanding. The Government disallowed the membership costs in the Army, Navy and Air Force related organizations on the authority of the Defense Contract Audit Manual; similar to the position taken by the Government on the military oriented portion of Boeing's business meeting expenses, as previously discussed. The membership dues in the other types of organizations noted above were disallowed by the Government because they were considered contributions, and the organizations to whom they were paid were not trade, business, technical or professional organizations within the context of 15-205.43.

The Board found that the cost of membership dues in the non-military oriented organizations was allowable because the nature and scope of Boeing's business, as well as the obligations flowing from what it considered to be the contractor's corporate citizenship, justified the contractor's membership. The expenditures were deemed necessary to the overall operation of the contractor's business in the State of Washington. On the other hand, the Government's disallowance of dues in the military oriented associations was sustained because the history, membership, objectives and activities of these groups were not considered to qualify them as trade, business, technical or professional organizations.

F. Conclusion and Recommendation

The Subcommittee concurs with the Board's decision in this case, as well as its interpretation of pertinent provisions of Part 2, except for that part of the ruling covering the conversion and redemption of the contractor's convertible debentures. As previously indicated, the issue turned on the definition of the term "reorganization," as used in 15-205.23. In that connection, the Board distinguished between an "adjustment" ----- modification of a corporation's capital structure without revaluation and raising of new capital and a "reorganization" ----- a significant revamping of corporate capital structure by legal means. The Board held that the conversion and redemption constituted an allowable "adjustment." In the Subcommittee's view, the distinction drawn by the Board is unrealistic and its conclusion regarding the allowability of the costs of an "adjustment" is contrary to the apparent intent of 15-205.23. Each of these points is discussed below.

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The Board essentially differentiates between an "adjustment" and a "reorganization" on the basis of the latter term's implication of legal procedure. However, this distinction is specious since the end result is the same in either case ----- a revamping of the corporate capital structure, regardless of the mechanics used to achieve this result. Since the objective of the action should govern allowability, rather than the method of implementation, there appears to be no valid reason why an "adjustment" should be allowable, and a "reorganization" unallowable.

The provisions of 15-205.23 preclude the allowability of costs incident to the organization or reorganization of a contractor's corporate structure. This caveat has been in Part 2 since, at the least, July 1960; and possibly prior. Although the case history on this particular provision was not available for the Subcommittee's review, the reasons for its inclusion in the cost principles appear fairly obvious. The costs of organizing, reorganizing or, for that matter, "adjusting" a corporation are capital in nature, in that the benefit derived therefrom is long term, i.e., from the time the action is completed until dissolution of the corporation. In addition, if the DoD were to participate in the cost of establishing or enhancing a contractor's financial structure, regardless of whether the action was denominated as an organization, reorganization or adjustment, (i) such participation could be deemed discriminatory in terms of those contractors who underwrote this type of expenditure on their own and (ii) contractors might well be influenced to reorganize their capital structures when their business mix was such that the Government would absorb a large share of the cost.

In view of the foregoing, the Subcommittee recommends that 15-205.23 be revised, as indicated in the attached TAB B, to make it clear that the term "reorganization" is intended to cover the type of situation encountered in the instant case, i.e., a modification of a corporate financial structure that does not necessarily involve either formal legal procedure, or the raising of funds. The revision set forth in the attached TAB C merely cross references the mention of a "reorganization" in 15-205.41(a)(ii) (Taxes) to the proposed addition on "reorganization" in 15-205.23.

Reference is made to the discussion on page 5 concerning the criteria established by the Board for purposes of distinguishing between public relations and advertising expense. In the Subcommittee's opinion, these are valid benchmarks; and they are necessary because, as the Board points out, public relations cost is not unallowable, per se. Inasmuch as there may be some tendency to perfunctorily consider public relations to be advertising in nature and, hence, unallowable, the Subcommittee

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recommends a clarification of the distinction between the two types of expenses. This clarification is set forth in the revisions proposed in TABS A and D. These revisions reflect, in the main, the criteria used by the Board for distinguishing between advertising and public relations.



HERBERT GOODWIN  
Chairman, Part 2  
Section XV Subcommittee

Atch - TABS A - D

MEMBERS OF PART 2, SECTION XV SUBCOMMITTEE

DoD Members

R. Buckingham, Army  
D. Modesitt, Navy  
J. Keyes, Air Force  
J. Gilbert, DCAS

Other Agency Representatives

F. Van Lierde, GSA

RECOMMENDED CHANGE TO

15-205.1

15-205.1 *Advertising Costs.*

(a) (CWAS) Advertising costs mean the costs of advertising media and corollary administrative costs. [Advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.] Advertising media include magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like. [Also, see 15-205.50.]

(b) No change

(c) No change

TAB B  
Case 74-98  
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RECOMMENDED CHANGE TO

15-205.23

15-205.23 *Organization Costs.* (CWAS-NA). Expenditures in connection with (i) planning or executing the organization or reorganization in the corporate structure of a business, including mergers and acquisitions, or (ii) raising capital, are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counsellors, whether or not employees of the contractor. [The term "reorganization" includes any change in the contractor's financial structure resulting in alterations in the rights and interests of security holders *whether or not new debt or capital is raised.*]

~~...~~

RECOMMENDED CHANGE TO

15-205.41(a)(ii)

15-205.41 *Taxes.*

(a) No change

(i) No change

(ii) taxes in connection with financing, refinancing,  
~~or~~ refunding operations [or reorganizations] (see 15-205.17  
[and 15-205.23]); (CWAS-NA).

(iii) No change

(iv) No change

(v) No change

(vi) No change

(b) No change

(c) No change

(d) No change

PROPOSED CLAUSE ON PUBLIC RELATIONS COSTS

15-205.50

15-205.50 *Public Relations Costs*. (CWAS-NA). Public relations means activities in building and maintaining sound and productive relations with customers, employees, stockholders and the public at large to earn their understanding and acceptance. Public relations, to the extent that it consists of disseminating information, does not customarily involve purchased space or time and the person releasing the information has no control over whether it will be used as prepared, changed, or where or when it will appear, or whether it may be discarded. Public relations cost is allowable provided that reimbursement for the cost of the particular activity is not precluded by statute or any provision of this Part 2 (e.g., lobbying, donations, entertainment). Also, public relations effort geared to the promotion or advancing the sale of a particular product, or group of products, constitutes advertising, the cost of which is unallowable (see 15-205.1).

RECOMMENDED CHANGE TO

15-205.1

15-205.1 Advertising Costs.

(a) ~~(GWAS)~~ [Definition.] Advertising costs mean the costs of ~~advertising media~~ [media advertising] and ~~auxiliary administrative~~ [directly associated] costs. ~~Advertising media~~ [Media advertising] include[s] magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like.

(b) (CWAS) The only advertising costs allowable are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract, or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4 and 15-203 are observed.

(c) (CWAS-NA) Advertising costs other than those specified [in (b)] above are not allowable. [Unallowable advertising costs

include those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.]

RECOMMENDED CHANGE TO

15-205.23

15-205.23 Organization Costs. (CWAS-NA) Expenditures in connection with (i) planning or executing the organization or reorganization ~~in~~ [of] the corporate structure of a business, including mergers and acquisitions, or (ii) raising capital [(net worth plus long-term liabilities)], are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counsellors, whether or not employees of the contractor. [Unallowable "reorganization" costs include the cost of any change in the contractor's financial structure, excluding short-term borrowings for working capital, resulting in alterations in the rights and interests of security holders whether or not additional capital is raised.]

RECOMMENDED CHANGE TO

15-205.41(a)(ii)

15-205.41 Taxes.

(a) No change

(i) No change

(ii) taxes in connection with financing, refinancing, or  
refunding operations [or reorganizations] (see 15-205.17); [and  
15-205.23)]; (CWAS-NA)

(iii) No change

(iv) No change

(v) No change

(vi) No change

(b) No change

(c) No change

(d) No change

RECOMMENDED CHANGE TO

15-205.17

15-205.17 Interest and Other Financial Costs. (CWAS-NA) Interest on borrowings (however represented), bond discounts, costs of financing and refinancing ~~operations~~ [capital (net worth plus long-term liabilities)], legal and professional fees paid in connection with the preparation of prospectuses, costs of preparation and issuance of stock rights, and costs related thereto, are unallowable except for interest assessed by State or local taxing authorities under the conditions set forth in 15-205.41. (But see 15-205.24.)



DEFENSE SUPPLY AGENCY  
HEADQUARTERS  
CAMERON STATION  
ALEXANDRIA, VIRGINIA 22314

1106/10  
6-27/76

4 JUN 1976

IN REPLY  
REFER TO DCAS-AF

MEMORANDUM FOR CHAIRMAN, ASPR COMMITTEE

SUBJECT: Case 74-98, Advertising, Entertainment and Interest Expense  
Cost Principles

I. Problem

Draft an appropriate letter to be sent to Industry requesting comments on the approved changes made to ASPR under subject case.

II. Recommendation

That the letter, enclosed as an attachment to this report, be utilized as the transmittal letter to Industry and other Governmental agencies.

III. Discussion

A. At its regular meeting on 29 April 1976, the ASPR Committee approved revised coverage to be made to 15-205.1, Advertising Costs, 15-205.23, Organization Costs, and 15-205.41, Taxes. The Committee then requested by Inter Office Memorandum dated 3 May 1976, above subject, that the Section XV, Part 2, Subcommittee draft an appropriate letter to transmit these changes to Industry for comment.

B. The attached letter is recommended for this purpose.

C. All of the members of the Subcommittee concur in the contents of the recommended letter.

Encl

*George H. Strouse*

GEORGE H. STROUSE

Chairman

ASPR Section XV, Part 2, Subcommittee

SECTION XV, PART 2, SUBCOMMITTEE MEMBERS

DoD Representatives

Floyd King, DARCOM  
Dennis Modesitt, NAVMAT  
Martin Brincefield, HQ AFSC  
James Wood, OASD(C), Consultant  
John Paulachak, DCAA

Other Agency Representatives

Joseph Garcia, NASA  
Frank Van Lierde, GSA  
Raymond L. Carroll, ERDA

It would

The ASPR Committee <sup>the paper</sup> is currently considering revisions to ~~clarify~~ ASPR 15-205.1, Advertising Costs, 15-205.23, Organization Costs, and 15-205.41, Taxes, as set forth in Tabs A, B & C respectively, attached ~~hereto~~. The revisions have been made ~~in order~~ to clarify the intent of ~~the~~ <sup>last case & principles to maintain</sup> ~~referenced paragraphs for~~ uniform and equitable interpretation.

The revision to ASPR 15-205.1(c), Advertising Costs, <sup>would</sup> ~~consist~~ of the ~~addition of an~~ <sup>the</sup> expanded definition of ~~the type of~~ advertising costs considered unallowable based upon the definition of advertising expressed <sup>in the appropriate</sup> by the ASBCA ~~in~~ Case No. 14370 <sup>(the change)</sup> involving the Boeing Company, ASPR 15-205.23, Organization Costs, is being modified to clarify the ~~the~~ <sup>intent</sup> that ~~any~~ corporate financial structure changes <sup>resulting</sup> in alterations in the rights and interests of the security holders is ~~an~~ unallowable reorganization within the meaning of ~~that~~ <sup>very</sup> whether or not additional capital is raised. <sup>the change to</sup> ASPR 15-205.41(a)(ii) Taxes, <sup>is being revised to</sup> specifically include taxes in connection with reorganization in the unallowable taxes category to provide consistency with ASPR 15-205.23.

Your comments (25 copies), if any, are requested within 60 days from the date of this letter.

Sincerely,

RONALD M. OBACH

Colonel, USA

Chairman, ASPR Committee

Atch:  
Tabs A thru C

The ASPR Committee currently is considering revisions to the ASPR cost principles regarding Advertising Costs, Organization Costs, and Taxes, as set forth in Tabs A, B and C respectively. The proposed revisions have been developed to clarify the intent of these cost principles to insure more uniform and equitable interpretation.

The revision to ASPR 15-205.1(c), Advertising Costs, would expand the definition of advertising costs based upon the definition of advertising expressed in the appeal of the Boeing Company, ASBCA Case No. 14370. The change to ASPR 15-205.23, Organization Costs, would clarify the intent that the costs of any corporate financial structure change resulting in alterations in the rights and interests of the security holders is unallowable, whether or not additional capital is raised. The change to ASPR 15-205.41(a)(ii), Taxes, would specifically include taxes in connection with reorganization to provide consistency with ASPR 15-205.23.

Your comments (25 copies) are requested within 60 days from the date of this letter.

Sincerely,

THOMAS F. BIAKE, JR.  
Colonel, USAF  
Chairman, ASPR Committee

Attachments  
Tabs A, B & C

23 June 1976

**15-205.1 Advertising Costs.**

(a) (CWAS) Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like.

(b) (CWAS) The only advertising costs allowable are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract, or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4, and 15-203 are observed.

(c) (CWAS-NA) Advertising costs other than those specified above are not allowable. [Unallowable advertising costs include those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.]

23 June 1976

**15-205.23 Organization Costs.** (CWAS-NA) Expenditures in connection with (i) planning or executing the organization or reorganization in the corporate structure of a business, including mergers and acquisitions, or (ii) raising capital, are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counsellors, whether or not employees of the contractor. [The term "reorganization" includes any change in the contractor's financial structure resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised.]

23 June 1976.

15-205.41 *Taxes.*

(a) No change

(i) No change

(ii) taxes in connection with financing, refinancing,  
or refunding operations [or reorganizations] (see 15-205.17  
[and 15-205.23]); (CWAS-NA).

(iii) No change

(iv) No change

(v) No change

(vi) No change

(b) No change

(c) No change

(d) No change



LOGISTICS  
DEFENSE ~~XXXXXX~~ AGENCY  
HEADQUARTERS  
CAMERON STATION  
ALEXANDRIA, VIRGINIA 22314

IN REPLY  
REFER TO DLA-AF

24 January 1977

MEMORANDUM TO CHAIRMAN, ASPR COMMITTEE

SUBJECT: Case 74-98, Advertising, Entertainment and Interest  
Cost Principles

I. PROBLEM:

To evaluate Industry and other Government Agencies comments on the proposed changes to ASPR 15-205.1, Advertising Costs, ASPR 15-205.23, Organization Costs, and ASPR 15-205.41, Taxes.

II. RECOMMENDATIONS:

That the following cost principles be revised as indicated in the related Tabs:

- A. 15-205.1 (Advertising Cost) - TAB A.
- B. 15-205.23 (Organization Costs) - TAB B.
- C. 15-205.41 (Taxes) - TAB C.
- D. 15-205.17 (Interest and Other Financial Costs) - TAB D.

III. DISCUSSION:

A. Background

In a letter, 2 October 1974, from NASA Assistant Administrator for Procurement to the ASPR Committee Chairman, reference is made to ASBCA Case No. 14370 (The Boeing Company). It was noted that, in this case, the Board had rendered several important decisions concerning various cost principles. Because of the precedent setting nature of certain aspects of the Board's ruling, it was recommended that a case be established to study the decision to determine whether the affected cost principles should be revised or clarified. The Committee concurred in the recommendation and, on 16 October 1974, this task was assigned to the Subcommittee.



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SUBJECT: Case 74-98, Advertising, Entertainment and Interest  
Cost Principles

On 18 February 1976, this Subcommittee forwarded its recommendation to the ASPR Committee. At the regular meeting on 20 April 1976, the ASPR Committee revised and approved the coverage with respect to this case and transmitted the changes to Industry for comment. The comments received are summarized in the following paragraphs according to each of the issues, i.e., advertising costs, organization costs and taxes.

B. Nature of Industry Responses

Industry responses were received from the Council of Defense and Space Industry Association (CODSIA), the American Defense Preparedness Association (ADPA), the Financial Executives Institute (FEI) and the Machinery and Allied Products Institute (MAPI). The essential portions of these responses are paraphrased below:

1. Advertising Costs

a. CODSIA

(1) CODSIA believes the definition of Advertising should be clarified rather than expanded as proposed by the ASPR Committee. In this regard, CODSIA proposed the following text for ASPR 15-205.1.

" . . . 15-205.1 Advertising Costs:

(a) (CWAS) Advertising Costs mean the cost of ~~advertising~~ media media advertising and ~~essential administrative~~ directly associated costs. Advertising media Media advertising includes magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, ~~conventions, exhibits, convention exhibits~~, free goods and samples, and the like.

(b) (CWAS) ~~The only advertising costs allowable~~ Allowable advertising costs are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4 and 15-203 are observed.

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SUBJECT: Case 74-98, Advertising, Entertainment and Interest  
Cost Principles

(c) (CWAS-NA) ~~Advertising costs other than those specified above are not allowable.~~ Unallowable advertising costs include are those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products to the general public either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser's product or product line for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear."

In paragraph (a) above, CODSIA recommends that the words "media advertising" be substituted for "advertising media" in order to limit the subject of this paragraph of ASPR to advertising costs, rather than the cost of media. In addition, CODSIA recommended that the words "directly associated costs" be substituted for "corollary administrative costs" in order to incorporate the definition of CAS 405 into the ASPR and provide a more precise calculation. CODSIA also recommended that the words "convention exhibits" be substituted in place of "conventions, exhibits".

#### Subcommittee Comments

The Subcommittee agrees with CODSIA's proposal to substitute the words "media advertising" and "directly associated costs" and the proposed revision in TAB A reflects this recommendation. The Subcommittee does not agree, however, that a convention per se cannot be a form of media, and therefore we have rejected CODSIA's recommendation to substitute the words "convention exhibits".

(2) In paragraph (b) above, CODSIA recommends the words "allowable advertising costs" be substituted for the words "The only advertising costs allowable". CODSIA points out that inasmuch as there are three items of allowable advertising costs and only one item of unallowable, it is inappropriate to use the word "only" in connection with describing the allowable costs.

#### Subcommittee Comments

The Subcommittee believes that the word "only" is appropriate in that it leaves no doubt as to what types of advertising costs are allowable. If the word "only" is eliminated, paragraph (b) would then be subjected to possible misinterpretation.

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SUBJECT: Case 74-98, Advertising, Entertainment and Interest  
Cost Principles

(3) In paragraph (c) above, CODSIA recommends that the words "advertising costs other than those specified above are not allowable" be eliminated. CODSIA believes that the deletion of the first sentence of (c) conforms to the ASBCA decision that defines unallowable advertising as being only that related to sales promotion. In the second sentence the word "are" has been substituted for the word "include" because CODSIA believes the court's definition is all inclusive. CODSIA argues that using the word "include" would tend to give the reader the impression that there are other unallowable advertising costs. CODSIA also recommends the elimination of the words ". . . for purposes of enhancing his overall image to sell his products." CODSIA explains that the elimination of this phrase more clearly defines the nature of unallowable advertising cost.

#### Subcommittee Comments

The Subcommittee disagrees with CODSIA's contention that only advertising related to sales promotion is unallowable. The board used the term "sales message", which implies promotion of the overall image of the company in order to sell its products. The Subcommittee, therefore rejects all of CODSIA's recommendations for paragraph (c) because they would result in further limiting and not clarifying the definition in ASPR.

#### b. FEI

FEI argues that competition in the labor market requires that recruitment materials contain information on company products and technological advancements. The point is also made that auditors and contracting officers sometimes disallow recruitment costs arbitrarily, as in the case of advertising copy containing a picture of the contractor's products, while the military recruitment materials commonly include elaborate color displays. FEI further recommends that paragraph (c) be reworded as follows:

". . . (c) (CWAS-NA) Advertising costs other than those specified above are not allowable. Unallowable costs include certain costs related to sales promotion. Such advertising involves direct payments for the use of time (air time) or space to promote the sale of products. Sales brochures which make known the availability of a product or product line, technical literature covering specifications and applications, price books, are all a necessary expense to marketing a product or product line and are allowable, except when such material is so general as to provide no useful information to the potential buyer."

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Cost Principles

Subcommittee Comments

The Subcommittee believes the proposed coverage presented by FEI is contrary to existing policy on recruitment costs set forth in ASPR 15-205.33(b). Proposed verbage on selling costs is adequately covered in 15-205.37, Selling Costs. The proposed revision sent to Industry for comment allows sufficient latitude for the exercise of good judgement by the auditors and contracting officers when a determination of allowability of recruitment cost is needed.

c. ADPA

ADPA forwarded the comments of Fairchild Industries for the ASPR Committee's consideration. Fairchild expressed no objection to the proposed change since it basically conforms to the definition contained in the ASBCA case. Fairchild questions why the change refers to sales promotion, since any advertising which meets the definition would be unallowable unless it qualified under 15-205.1(b). Fairchild conjectures that the change may be trying to avoid a possible conflict with 15-205.37, which provides that sales promotion costs are allowable if reasonable and allocable.

Subcommittee Comments

The Subcommittee agrees with Fairchild's conjecture.

d. MAPI

MAPI forwarded the comments of the Perkin-Elmer Corporation for the ASPR Committee's consideration. Perkin-Elmer agrees that ASPR 15-205.1 should be expanded, but recommends that the ASPR Committee resolve once and for all the public relations versus advertising controversy. Perkin-Elmer, in addition, recommends that the comment relating to sales promotion expense be deleted since it conflicts with ASPR 15-205.37, Selling Costs. Perkin-Elmer proposes the following text for 15-205.1.

" . . . (a) (CWAS) Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like. [It does not include public relations activities associated with dissemination of information whereby the contractor

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Cost Principles

does not retain control of how such data will be used. Expenses associated with preparing informational brochures, capability handouts, salary costs incurred assisting public relations organizations are not considered advertising costs for purposes of this clause.]

(b) no change

(c) (CWAS-NA) Advertising Costs other than those specified above are not allowable. [~~Unallowable advertising costs include those related to sales promotion. Such~~ Unallowable advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.]

#### Subcommittee Comments

The ASBCA stated that public relations was considered a generic term of broad application, encompassing many activities, of which advertising is one. The Subcommittee, therefore does not believe that is is appropriate to address the question of the allowability of public relation expenses within the advertising cost principle. The Subcommittee also believes that costs related to brochures, capability handouts could be either advertising or public relation expense depending on the type, manner and use of them. It would, therefore, be inappropriate to recognize items of this nature.

The Subcommittee disagrees with Perkin-Elmer to delete any reference to sales promotion in paragraph (c). We believe that the costs of advertising are unallowable and are not allowable simply because they represent sales promotional expenses. In this respect, the Subcommittee believes the reference to sales promotion is appropriate in order to eliminate any possible conflict with 15-205.37.

#### 2. Organization Costs

##### a. CODSIA

(1) CODSIA states that the proposed revision is

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Cost Principles

definitely an expansion of ASPR 15-205.23 rather than a clarification and gives the impression that the Government is now changing the rules, having lost its case because of said rules. CODSIA believes that the proposed words . . . "any change in the contractor's financial structure resulting in alterations in the rights and interests of security holders" is so broad that it will encompass even administrative costs to arrange for a bank loan, inasmuch as in a liquidation of a company, the creditors would have prior rights and interests than the security holders. CODSIA believes also that cost of payment of cash dividends could also be considered unallowable under this provision since there would be less assets available to the bankholder and thus would result in "alterations of the rights and interests of the security holders."

Subcommittee Comments

The Subcommittee does not agree with CODSIA that the payment of cash dividends has realistically altered any rights of a corporation's security holders. The payment of a cash dividend is simply a distribution of company assets to security holders of record; to which the security holder was entitled. In our opinion, therefore, the proposed revision does not affect the allowability of the administrative effort required in making dividend or bond interest payments.

The Subcommittee agrees with CODSIA that the proposed wording is too broad, particularly with respect to the allowability of cost related to short-term borrowings used for working capital. The Subcommittee believes that, while short-term borrowing usually affects the interests and rights of security holders if a liquidation occurs, disallowing the day-to-day costs of financing operations would cause a severe hardship on contractors. In addition, the board in the Boeing case did recognize a difference between the allowability of financing costs for short-term borrowing and capital as follows:

" . . . In support of its claimed allowability of this expenditure (legal fees and related expenses in regard to revolving bank credit agreements) the appellant (Boeing) draws a distinction between capital as net worth plus long-term liabilities, the cost of raising which is made unallowable by the regulation (15-205.23), and working capital which this was, a distinction recognized by Kohler, above, the Government's own authority on ASPR terms. (Dictionary for Accountants, p. 72, Fourth Ed., 1970, Prentice-Hall, Inc.). We think the distinction justifies the treatment

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Cost Principles

of these fees as other costs (except interest) of short-term borrowings allowable under ASPR 15-201.2, 15-201.3, 15-204 and 15-205.31."

(Portions contained within parentheses and underlined were added for clarification by Subcommittee)

The Subcommittee is of the opinion that the revised language contained in TAB B accomplishes the purpose of disallowing the costs related to strictly capital transactions such as redemption and conversion of convertible debentures, increases in authorized stock, stock options, etc., which should not be allocated to Government contracts. It recognizes, however, the financing costs of short-term borrowings that are used as working capital for operational purposes.

As a result of the above, it is necessary that a change be made to 15-205.17 to convey the idea that costs incurred in the raising of "working capital" are outside the purview of a financing or refinancing activity and are therefore allowable. This change is set forth in TAB D.

(2) CODSIA believes that ASPR should not be changed unless there is justification that the decision in the Boeing ASBCA case was unreasonable and inequitable. The recall of a specific debenture issue and a concurrent redemption of these debentures into common stock does not raise capital and hence no reorganization took place.

#### Subcommittee Comments

The Subcommittee believes that the distinction between corporate "adjustments" and "reorganization" drawn by the board is unrealistic and its conclusion regarding the allowability of the costs of "adjustments" is contrary to the apparent intent of 15-205.23. The Subcommittee concluded, therefore, that the definition of "reorganization" needs to be defined in ASPR to preclude its interpretation along strictly legal lines as the board did in the Boeing case.

#### b. FEI

FEI believes that the disallowance of financing or refinancing costs in ASPR is contradictory to the expressed intent of DoD, the CASB and Congress to encourage investment in new facilities as expressed by the Profit 76 Study and CAS 414, Cost of Money as an Element of the Cost of Facilities Capital. FEI recommends that ASPR 15-205.23

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Cost Principles

be amended to be consistent with the objectives of DoD and the promulgation of the CAS Board giving recognition to the cost of facilities capital as follows:

"15-205.23(a) Organization Costs. (CWAS-NA).

Expenditures in connection with planning or executing the organization or reorganization in the corporate structure of a business are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, promoters and organizers, whether or not employees of the contractor."

"15-205.23(b) Organization Costs. (CWAS).

Reorganizations involving mergers or acquisitions or raising capital are allowable. Such expenditures include costs of attorneys, accountants, brokers, investment counselors and management consultants, whether or not employees of the contractor. The term "reorganization" includes any change in the contractor's financial structure resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised."

"(c) At such time as the CASB promulgates an additional standard or standards, recognizing as a cost other forms of capital or the cost of obtaining and employing other forms of capital in the performance of government contracts, such promulgations are incorporated into this regulation as of the effective date of the applicable standard(s)."

Subcommittee Comments

The Subcommittee does not believe that the disallowance of financing or refinancing costs is in conflict with either Profit 76 or CAS 414. Both Profit 76 and CAS 414 recognize that where a contractor utilizes facilities (assets) on a contract, we will recognize as a cost to that contract, the cost of money associated with the facilities. In the net result, it is a recognition of interest (imputed) as the cost of money and does not consider the cost associated with raising capital. The Subcommittee believes that a clear distinction exists between the allowability of organization or financing costs versus the cost associated with bringing certain resources to bear on a contract.

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The Subcommittee rejects paragraph (c) of the FEI proposal because it has been the practice of the ASPR Committee to consider CAS Standards on a case-by-case basis.

c. ADPA

Fairchild Industries, while questioning the original intent of ASPR 15-205.23, stated that in its opinion, the Boeing transactions were changes in the corporate capital structure, even though they did not raise additional funds.

Subcommittee Comments

The Subcommittee agrees with Fairchild.

3. Taxes ASPR 15-205.41

a. CODSIA

CODSIA posed no objection to the change since the word "reorganization" already appears in ASPR 15-205.23. As previously stated, CODSIA, however, objects to the proposed definition of reorganization in 15-205.23.

b. FEI

FEI, pursuant to its recommendations on organizational costs and financing or refinancing costs, recommends that paragraphs (ii) and (iv) should be deleted.

Subcommittee Comments

The Subcommittee disagrees for the reasons stated in our rebuttal to FEI comments on organization costs.

C. Other Government Agency Comments

The Energy Research and Development Administration (ERDA), the General Accounting Office (GAO), the General Services Administration (GSA) and the National Aeronautics and Space Administration (NASA) offered no objections and concurred with the proposed revisions.

1. Advertising Costs

a. Defense Contract Audit Agency (DCAA)

(1) DCAA recommended that the CWAS designator be removed from ASPR 15-205.1(a) since the paragraph deals merely with a

DLA-AF

SUBJECT: Case 74-98, Advertising, Entertainment and Interest  
Cost Principles

definition and the application of the principle of reasonableness under the CWAS concept does not come into play until paragraphs (b) and (c).

Subcommittee Comments

The Subcommittee agrees with DCAA and recommends that the cost designator be deleted and the word "definition" be substituted as set forth in TAB A.

(2) DCAA also expressed a reservation as to whether or not the additional ASPR coverage, reflecting the definitions set forth in the recent ASBCA case, is in accord with the intent of Congress contained in the Defense Appropriations Act of 1962 (PL87-144, Stat 36) Section 636 of PL87-144, which is also in Section 731 of 1976 Appropriations Act stated:

" . . . No part of the funds appropriated herein shall be available for paying the costs of advertising by any defense contractor, except advertising for which payment is made from profits, and such advertising shall not be considered a part of any defense contract cost. The prohibition contained in this section shall not apply with respect to advertising conducted by any such contractor, in compliance with regulations which shall be promulgated by the Secretary of Defense, solely for (1) the recruitment by that contractor of personnel required for the performance by the contractor of obligations arising under a defense contract, (2) the procurement of scarce items required by the contractor for the performance of a defense contract, or (3) the disposal of scrap or surplus materials acquired by the contractor in the performance of a defense contract."

Subcommittee Comments

The Subcommittee does not see any conflict between the current revision and the words contained in the Defense Appropriations Act of 1962.

DLA-AF

SUBJECT: Case 74-98, Advertising, Entertainment and Interest  
Cost Principles

IV. CONCLUSIONS:

A. The Subcommittee recommends incorporation of TABs A, B, C and D into ASPR.

B. All the Subcommittee members concur in the contents of this report.

*George H. Strouse*

4 Encl

GEORGE H. STROUSE  
Chairman  
Section XV, Part 2, Subcommittee

SECTION XV, PART 2, SUBCOMMITTEE MEMBERS

DoD Representatives

Floyd King, DARCOM  
Dennis Modesitt, NAVMAT  
John H. Lynskey, HQ AFSC  
John Paulachak, DCAA  
O. L. Sollom, ODASD(Audit)

Other Agency Representatives

Joseph Garcia, NASA  
Frank Van Lierde, GSA  
Raymond L. Carroll, ERDA

RECOMMENDED CHANGE TO

15-205.1

15-205.1 Advertising Costs.

(a) ~~(CWAS)~~ [Definition.] Advertising costs mean the costs of ~~advertising media~~ [media advertising] and ~~corollary administrative~~ [directly associated] costs. ~~Advertising media~~ [Media advertising] include[s] magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like.

(b) (CWAS) The only advertising costs allowable are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract, or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4 and 15-203 are observed.

(c) (CWAS-NA) Advertising costs other than those specified [in (b)] above are not allowable. [Unallowable advertising costs

include those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.]

RECOMMENDED CHANGE TO

15-205.23

15-205.23 Organization Costs. (CWAS-NA) Expenditures in connection with (i) planning or executing the organization or reorganization ~~in~~ [of] the corporate structure of a business, including mergers and acquisitions, or (ii) raising capital [(net worth plus long-term liabilities)], are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counsellors, whether or not employees of the contractor. [Unallowable "reorganization" costs include the cost of any change in the contractor's financial structure, excluding ~~at any time in the course of~~ short-term borrowings for working capital, resulting in alterations in the rights and interests of security holders whether or not additional capital is raised.]

RECOMMENDED CHANGE TO

15-205.41(a)(ii)

15-205.41 Taxes.

(a) No change

(i) No change

(ii) taxes in connection with financing, refinancing, ~~or~~  
refunding operations [or reorganizations] (see 15-205.17); [and  
15-205.23)]; (CWAS-NA)

(iii) No change

(iv) No change

(v) No change

(vi) No change

(b) No change

(c) No change

(d) No change

RECOMMENDED CHANGE TO

15-205.17

15-205.17 Interest and Other Financial Costs. (CWAS-NA) Interest on borrowings (however represented), bond discounts, costs of financing and refinancing ~~operations~~ [capital (net worth plus long-term liabilities)], legal and professional fees paid in connection with the preparation of prospectuses, costs of preparation and issuance of stock rights, and costs related thereto, are unallowable except for interest assessed by State or local taxing authorities under the conditions set forth in 15-205.41. (But see 15-205.24.)

DLA-AF

SUBJECT: Case 74-98, Advertising, Entertainment and Interest  
Cost Principles

definition and the application of the principle of reasonableness under the CWAS concept does not come into play until paragraphs (b) and (c).

Subcommittee Comments

The Subcommittee agrees with DCAA and recommends that the cost designator be deleted and the word "definition" be substituted as set forth in TAB A.

(2) DCAA also expressed a reservation as to whether or not the additional ASPR coverage, reflecting the definitions set forth in the recent ASBCA case, is in accord with the intent of Congress contained in the Defense Appropriations Act of 1962 (PL87-144, Stat 36) Section 636 of PL87-144, which is also in Section 731 of 1976 Appropriations Act stated:

" . . . No part of the funds appropriated herein shall be available for paying the costs of advertising by any defense contractor, except advertising for which payment is made from profits, and such advertising shall not be considered a part of any defense contract cost. The prohibition contained in this section shall not apply with respect to advertising conducted by any such contractor, in compliance with regulations which shall be promulgated by the Secretary of Defense, solely for (1) the recruitment by that contractor of personnel required for the performance by the contractor of obligations arising under a defense contract, (2) the procurement of scarce items required by the contractor for the performance of a defense contract, or (3) the disposal of scrap or surplus materials acquired by the contractor in the performance of a defense contract."

Subcommittee Comments

The Subcommittee does not see any conflict between the current revision and the words contained in the Defense Appropriations Act of 1962.

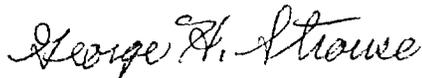
DLA-AF

SUBJECT: Case 74-98, Advertising, Entertainment and Interest  
Cost Principles

IV. CONCLUSIONS:

A. The Subcommittee recommends incorporation of TABs A, B, C and D into ASPR.

B. All the Subcommittee members concur in the contents of this report.



GEORGE H. STROUSE

Chairman

Section XV, Part 2, Subcommittee

4 Encl

SECTION XV, PART 2, SUBCOMMITTEE MEMBERS

DoD Representatives

Floyd King, DARCOM  
Dennis Modesitt, NAVMAT  
John H. Lyskey, HQ AFSC  
John Paulachak, DCAA  
O. L. Sollom, ODASD(Audit)

Other Agency Representatives

Joseph Garcia, NASA  
Frank Van Lierde, GSA  
Raymond L. Carroll, ERDA

DEPARTMENT OF THE AIR FORCE  
HEADQUARTERS AIR FORCE LOGISTICS COMMAND  
WRIGHT-PATTERSON AIR FORCE BASE, OHIO 45433



31 MAR 1976

REPLY TO: JAB/Lt. Col. E. M. Solimine, Deputy Chief Trial  
ATTN OF: Attorney/53203  
SUBJECT: ASPR Case 74-98, Advertising, Entertainment, Contribution Cost Principles

TO: Secretary of the Air Force  
General Counsel  
SAFGC (Mr. Rak)  
Pentagon  
Washington, D. C. 20330

1. We have reviewed the Subcommittee report on ASPR case 74-98, Advertising, Entertainment, Interest Expense Cost Principles. The following comments follow the issues as grouped by the ASBCA in the Boeing appeal and the Subcommittee and to the Tabs attached to the Subcommittee Report.

a. 15-205.1 (Advertising Costs); Recommended Change, Tab A: We have no objection to the adoption of the recommended change which further defines 15-205.1 Advertising Costs. The change adopts the definition in the Appeal of Boeing Company, ASBCA 14370, 73-2 BCA 10325 and we perceive no adverse Air Force interest involved.

b. 15-205.23 (Organization Costs); Recommended Change, Tab B: Under Organization Costs numerous types of costs were claimed in Boeing Company under the general heading of corporate, legal, and accounting expense; we question whether certain limits on costs of administering open lines of credit or Revolving Credit Agreements, including attorney fees relating thereto, should be established. We believe legal fees and related expenses incurred in connection with the negotiation and execution of credit line or Revolving Credit Agreements should not be made allowable, where, for instance, bank credit agreements are specifically entered into to avoid bankruptcy or to establish a creditors committee for the benefit of creditors in a bankruptcy action. Also, on the subject of bank credit agreements, the Board in Boeing joined the contractor in drawing a distinction between capital (net worth plus long term liabilities) and working capital (short term borrowings); a distinction recognized by the Kohler's Dictionary for Accountants, p. 72, Fourth Ed., 1970. The cost (interest excepted) of raising capital as opposed to working capital is made specifically unallowable under ASPR 15-205.23, Organization Costs. We believe there should be some limits to or definition of the type of bank credit agreements that a corporation can enter into before making allowable the fees and expenses related to raising "working capital."

*AFLLC - Lifeline of the Aerospace Team*

c. If the Subcommittee, indeed, desired to preclude all reorganization costs of any type, then we suggest inserting the words "or financial" between "corporate" and "structure" of first sentence of 15-205.23. Also, insert the phrase "voluntary or involuntary" between the words "any" and "change" in last sentence of recommended change to 15-205.23, Tab B: and insert the phrase "but not limited to" between the words "in" and "alterations" in last sentence. The above additional phrases should preclude allowability of all legal fees and related costs of any reorganization of any Type and Kinds (say, for instance, any reorganization monitored by a Bankruptcy Court).

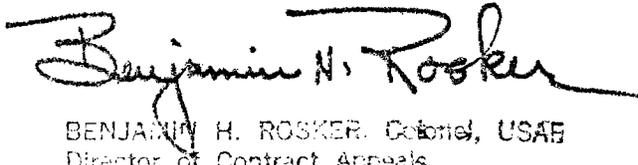
d. Tab B containing the recommended change to 15-205.23 should be amended if the Subcommittee intends to follow the ruling in the Boeing appeal by stating explicitly expenditures in "reorganization" are unallowable whether or not additional capital is raised. Thus, the latter underlined phrase should be added to the last sentence of the Recommended Change.

e. 15-205.41(a)(ii)(Taxes) Tab C: No comment is deemed necessary to the recommended change of ASPR 15-205.41(a)(ii) which is correlated to the Subcommittee's recommended change to 15-205.23.

f. New Clause, Cost Principles, 15-205.50 (Public Relations Costs) Tab D: Although the recommended proposed clause on public relation costs is consistent with the discussion of public relations in ASBCA Appeals of Aerojet-General Corporation, ASBCA 13372, 73-2 BCA 10164 and Appeal of Boeing Company, ASBCA 14370, 73-2 BCA 10325, we question the necessity for the new clause. As a generic term, "public relations" could easily have been construed to encompass many of the costs denied by the Board in Boeing. A close reading of Boeing reveals that the denials were based on two main grounds: (a) failure of proof of purpose of expenditures and (b) allocability under 15-201.4. For instance, one denial (Press tour by launch systems branch) was summarily dismissed as "propaganda efforts to influence public opinion." Actually, the many similar denials by the Board under the categories Business Meeting Expense and Dues Expense, if not otherwise prohibited by statute or other ASPR provisions could be allowed as a "Public Relations Expense." In Boeing, the Board looked to the purpose or mission of an organization (i.e., Army, Navy, and Air Force organizations) to justify allowability. This approach is highly undesirable as a guide for future cases. Nevertheless, we do not believe

the addition of a definition of Public Relation Expense could be any more helpful to industry, a DOD Auditor, or price analyst. The definition would have, in our opinion, an expansive liberalizing effect. Contractors would attempt to include costs thereunder heretofore considered to be unallowable advertising costs. Perhaps the Subcommittee should explore the need for better guidelines in determining what legitimate purposes of Business Meeting Expenses and Dues would or would not be acceptable. The Board's rationale in Boeing for allowing dues to organizations such as the Chamber of Commerce and disallowing dues to the Army/Navy/Air Force Associations is not persuasive at all. The Office of the Air Force Chief Trial Attorney has not experienced any disputes in recent memory concerning the allowance of costs in the public relations area (aside from Boeing) to compel the adoption of the recommended clause.

FOR THE COMMANDER

A handwritten signature in black ink that reads "Benjamin H. Rosker". The signature is written in a cursive style with a prominent, sweeping underline that extends across the width of the name.

BENJAMIN H. ROSKER, Colonel, USAF  
Director of Contract Appeals  
Office of the Staff Judge Advocate

Case No. 74-98

15-205.1 Advertising Costs.

(a) (CWAS) Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like.

(b) (CWAS) The only advertising costs allowable are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract, or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4 and 15-203 are observed.

(c) (CWAS-NA) Advertising costs other than those specified above are not allowable. [Unallowable advertising costs include those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.]

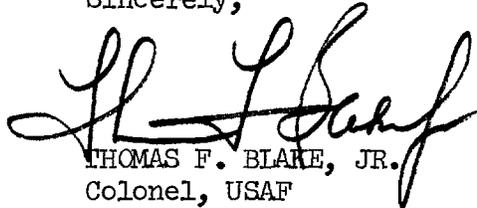
30 July 1976

The ASPR Committee currently is considering revisions to the ASPR cost principles regarding Advertising Costs, Organization Costs, and Taxes, as set forth in Tabs A, B and C respectively. The proposed revisions have been developed to clarify the intent of these cost principles to insure more uniform and equitable interpretation.

The revision to ASPR 15-205.1(c), Advertising Costs, would expand the definition of advertising costs based upon the definition of advertising expressed in the appeal of the Boeing Company, ASBCA Case No. 14370. The change to ASPR 15-205.23, Organization Costs, would clarify the intent that the costs of any corporate financial structure change resulting in alterations in the rights and interests of the security holders is unallowable, whether or not additional capital is raised. The change to ASPR 15-205.41(a)(ii), Taxes, would specifically include taxes in connection with reorganization to provide consistency with ASPR 15-205.23.

Your comments (25 copies) are requested within 60 days from the date of this letter.

Sincerely,



THOMAS F. BLAKE, JR.  
Colonel, USAF  
Chairman, ASPR Committee

Attachments  
Tabs A, B & C



OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON, D. C. 20301

74-18  
Base File

INSTALLATIONS AND LOGISTICS

30 July 1976

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THOMAS F. BLAKE, JR.  
Colonel, USAF  
Chairman, ASPR Committee

Attachments  
Tabs A, B & C



23 June 1976

**15-205.1 Advertising Costs.**

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(b) (CWAS) The only advertising costs allowable are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract, or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4, and 15-203 are observed.

(c) (CWAS-NA) Advertising costs other than those specified above are not allowable. [Unallowable advertising costs include those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.]

23 June 1976

**15-205.23 Organization Costs. (CWAS-NA) Expenditures in connection with (i) planning or executing the organization or reorganization in the corporate structure of a business, including mergers and acquisitions, or (ii) raising capital, are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counsellors, whether or not employees of the contractor. [The term "reorganization" includes any change in the contractor's financial structure resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised.]**

TAB B

# Inter-Office Memorandum

DATE: 8 Oct 76

SUBJECT: Advertising, Entertainment and Interest Expense Cost Principles, ASPR Case 74-98

FROM : DCAS-AA (Mr. Rowe/at/46411)

TO : DCAS-AF  
ATTN: Mr. Strouse

At its regular meeting on 6 Oct 76 the ASPR Committee considered the enclosed replies from Industry and Government Agencies with respect to subject matter and determined that they should be referred to the Section XV, Part 2, Subcommittee for review and submission of appropriate recommendations. A report date of 30 Nov 76 was established for receipt of your recommendations.

Encl

  
B. EISENSTEIN  
DSA Policy Member  
ASPR Committee

cc:

ASPR Committee Members  
Mr. T. Cassidy, Exec. Sec'y.

5/12  
... agenda  
25 February 1977

**MEMORANDUM FOR THE ASSISTANT GENERAL COUNSEL (LOGISTICS)**

**SUBJECT: Advertising, Entertainment and Interest Cost Principles  
(ASPR Case 74-98)**

Attached (Tab A) is a copy of the Subcommittee report on ASPR Case 74-98 which the ASPR Committee approved for publication as modified on Tab B of the report. When we asked for comments, DCAA took exception as noted on page 10 of the report. The Subcommittee and subsequently the ASPR Committee did not agree.

After approval, Mr. Neuman felt sufficiently concerned to resurface the issue (Tab B). In view of his concern, I would appreciate your comments on the compliance of the proposed cost principle with P.L. 87-144.

Signed

**THOMAS F. BLAKE, JR.**  
Colonel, USAF  
Chairman, ASPR Committee

**Attachments**  
Tabs A and B

cc: DP  
PX  
PR C.F.(74-98)  
PR Chron

Prepared by: Col. Blake/mla/25Feb77  
OASD(I&L)PR/3D776/72026



IN REPLY REFER TO  
P

## DEFENSE CONTRACT AUDIT AGENCY

CAMERON STATION  
ALEXANDRIA, VIRGINIA 22314

11 FEB 1977

Col. Thomas F. Blake, Jr., USAF  
Chairman, ASPR Committee  
Room 3D776  
Pentagon  
Washington, D.C. 20301

Dear Tom:

I am writing to you personally because of my concern regarding the direction being taken on ASPR Case 74-98, as it applies to the cost principle dealing with advertising. I believe that it would be well to couple any change to ASPR 15-205.1 with necessary decisions relating to the allowability of so-called public relations efforts.

In its report dated 24 January 1977, the Subcommittee rejected our reservations on whether the proposed revision is in accord with the legislative intent underlying the Defense Appropriations Act of 1962 Section 636 of Public Law 87-144. I do not believe the Subcommittee fully appreciated the importance of our reservations nor the precedent-making implications of the proposed revision. The revision merely incorporates an extremely narrow definition of advertising as determined by the ASBCA in connection with the appeal of the Boeing Company (ASPR Case No. 14370). In my view this is the wrong route to take; from a DoD policy point of view it would be well to thoroughly research the intent of Congress in establishing the limitations of Public Law 87-144 before proceeding.

The need for specific coverage on public relations is becoming increasingly crucial. Contracting officers and auditors must make decisions on the allowability of contractors' efforts to enhance or otherwise promote their corporate image, production capabilities, engineering know-how, and other activities designed to influence, even though indirectly, the Government and others to procure weapon system products and related services offered by the company. As you know, the same problems affect current deliberations concerning contractors' efforts to indirectly influence legislation. DoD needs to deal with the specific allowability of public relations costs within the framework of public policy and other limitations.



11 FEB 1977

P

Col. Thomas F. Blake, Jr., USAF

I suggest that a new ASPR case on public relations costs be established, bearing the foregoing in mind. In the meantime, I urge that further action on case 74-98 be postponed until the intent of Public Law 87-144 is resolved and guidance on the allowability of public relations costs is promulgated.

I would be pleased to discuss the issues further at your convenience.

Sincerely,



Frederick Neuman  
Director



DEPARTMENT OF DEFENSE  
OFFICE OF GENERAL COUNSEL  
WASHINGTON, D. C. 20301

3 May 1977

HO 5/5  
C. 100-100-100/100  
C. 100-100-100/100  
C. 100-100-100/100

MEMORANDUM FOR COLONEL BLAKE, OASD (I&L)

SUBJECT: Advertising, Entertainment and Interest Cost Principles--  
ASPR Case 74-98

You have provided to me a copy of the 24 January 1977 report of the ASPR Section 15, Part 2 Subcommittee concerning subject case and a copy of an 11 February 1977 letter to you from the Director, DCAA addressing the recommendations of that report. The subcommittee's study seems to stem from the decision of the ASBCA in the Boeing Company case (ASBCA No. 24370 73-2 BCA ¶ 10325) in which the Board examined certain overhead cost disallowances from the standpoint of whether the underlying activities constituted "advertising". The subcommittee report proposes a number of changes to ASPR 15-205.1 including a change to paragraph (c) thereof which would adopt the definition of "advertising" contained in that decision in describing unallowable advertising costs. The subcommittee's report notes a reservation by DCAA as to whether or not said proposed revision is in accord with the intent of Congress as contained in the annual DoD Appropriation Act provision (first enacted as section 636 of the 1962 DoD Appropriation Act, Public Law 87-144) limiting the use of funds appropriated therein for payment of the costs of advertising by a defense contractor.

Mr. Neuman's letter characterizes the subcommittee's report and, in turn, the ASBCA ruling as incorporating "an extremely narrow definition of advertising" and expresses the view that "this is the wrong route to take" from a DoD policy point of view. He enumerates a number of self-promotion activities engaged in by contractors and urges that the need for specific coverage on public relations costs is becoming "increasingly crucial". His letter closes by urging that further action on Case 74-98 "be postponed until the intent of P. L. 87-144 is resolved and guidance on the allowability of public relations costs is promulgated". To put it more precisely, Mr. Neuman is asking whether the exclusion of certain "public relations" costs from the ambit of unallowable advertising costs, as proposed in the ASPR Subcommittee report, is consistent with the intent of Congress manifested in the original enactment and subsequent re-enactments of the restriction against payment of contractor advertising costs.

The subcommittee's proposed revised ASPR 15-205.1(c) definition of unallowable advertising cost is essentially the verbatim text of the ASBCA's holding in Aerojet-General Corporation (ASBCA No. 13372, 73-2 BCA ¶ 10,164) as to the meaning of "advertising" as used in the present text of that ASPR section. The Aerojet-General case was an appeal from a DCAA Form 1 which disallowed a particular contract's pro rata share of that portion of Aerojet's corporate overhead costs, resulting from operation of its Public Communications Department. These costs had been disallowed on the basis that they constituted "corporate advertising and corollary administrative costs". After reviewing in great detail dictionary definitions, textbooks, and expert testimony given, the Board rejected the Government's contention that all public relations costs are "advertising" costs. Instead, the Board held as follows:

"From our review of the material presented we conclude that 'advertising' customarily involves the paid use of a medium such as space in a newspaper or time on radio or television to deliver a sales message. Other examples would include certain window displays, some types of handbills or circulars, exhibits, free goods and samples, and the like. Apart from the fact that 'advertising' usually involves direct payment, probably its most significant feature is that the advertiser has complete control over the form and content of what will appear, the medium in which it will appear, and when it will appear. On the other hand, 'public relations' to the extent that it involves disseminating information does not customarily involve purchased space or time and the person releasing the information has no control over whether it will be used as prepared, changed, or where or when it will appear or whether it may be discarded.

"Because Congress restricted only the payment of 'costs of advertising', we hold that particular restriction to be limited to 'costs of advertising'. Had it been intended to outlaw all public relations costs the Congress would, or should, have said so. Moreover, because Congress did not elect to define the word 'advertising', we may only conclude that it was used in its normally understood sense as of the time the statute was enacted. The 1957 version of Webster's New International Dictionary, Second Edition, Unabridged, from which we have already quoted the definition of 'public relations', defines advertising in these words:

'a. Any form of public announcement intended to aid directly or indirectly in the sale of a commodity, etc., in the promulgation of a doctrine or idea, in securing attendance, as at a meeting, or the like. b. Advertisements collectively. c. The act or business of preparing and circulating advertisements.'

"In view of the fact that the recurring restriction first appeared in the Defense Department Appropriation Act for fiscal 1962, which was passed by the Congress in calendar 1961, we take this definition from the dictionary copyright in 1957 to be, if not precisely what Congress understood 'advertising' to mean, at least a close approximation of it. Contrasting this definition with the earlier quoted definition of 'public relations' from the same dictionary, it is seen that our previously-expressed conclusion that 'advertising' and 'public relations' are not synonymous accords with the dictionary definition of the terms at the time Congress first enacted the statute."

The ASBCA applied its above holding in its subsequent Boeing Company decision (supra). That case involved an appeal from a DCAA Form 1 which disapproved, as allowable overhead cost, certain expenses labelled by the contractor as "Public Relations Expense." These included costs of celebration of its 50th anniversary, costs of certain operations of the contractor's news bureau, costs of outside distribution of a company magazine, and costs and for attendance and participation at conventions of the Air Force Association and similar organizations of the other two services. It was the Government's contention that all public relations activities and expense are to categorized as either advertising, entertainment or contributions and are thus specifically unallowable on these basis. The Board rejected that contention and instead made determinations as to the allowability of the individual items of cost on the basis of the ASPR 15-201.2-.4 general criteria and the pertinent ASPR principles concerning specific costs.

The committee hearings on the 1962 Department of Defense Appropriations Act and the ensuing reports sheds no significant light on the intended compass of "advertising". Neither the testimony nor the reports contain any significant references to activities characterized as "public relations" in the foregoing ASBCA decisions. Indeed the testimony and reports are directed almost exclusively to advertising in the printed media and the circumstances under which such costs should be reimbursable by

the Department of Defense. Inferentially, some conclusions can be drawn as to the Congress' intent with regard to non-print media advertising. For example, ASPR section 15-205.1, as of the time of consideration of the 1962 DoD Appropriations Act, characterized costs of participation in exhibits as allowable. The circumstance that this cost, as well as two other types of print media advertising costs also then specified in ASPR as allowable, were not included among the statutory exceptions to the ban on payment of advertising costs implies an intention of the Congress not to permit reimbursement of such costs.

It should be noted that the provisions originally enacted as section 636 of the 1962 Department of Defense Appropriations Act have been enacted almost verbatim in each subsequent Department of Defense Appropriations Act. The Aerojet and Boeing decisions which excluded certain "public relations" activities from the ambit of advertising were decided in June and October 1973 respectively. It is therefore arguable that had Congress considered the ASBCA's definition of "advertising" to be unduly restrictive, it would have made appropriate changes, to the existing text of the restriction, in the subsequent Appropriations Acts. The repetition of the original statutory provision thus raises an inference that the ASBCA's definition of "advertising" comports with the original and present intent of the legislation.

On the basis of the foregoing, the definition of "advertising" adopted in the ASPR Subcommittee proposed revision of ASPR 15-205.1(c) would not appear to be inconsistent with the intention of the Congress as expressed most recently in section 731 of the 1977 Department of Defense Appropriation Act (P. L. 94-419).

Two final observations seem appropriate. In its ruling, the ASBCA has simply said that costs of public relations may not be categorically disallowed. As may be noted from the Boeing decision, costs of individual activities conducted as part of a public relations effort may be found unallowable when examined under the general or specific cost principles of ASPR Section 15 Part 2. Secondly, the foregoing conclusion as to the scope of the statutory restrictions on payment of advertising costs obviously does not dispose of the policy question of whether, given the concerns expressed by Mr. Neuman and the concerns voiced within the

Congress as to lobbying costs, the ASPR subcommittee's recommendations--addressed solely to ASPR 15-205.1--leave a shortfall in required ASPR coverage with regard to "public relations" costs.

A handwritten signature in black ink, appearing to read 'Peniel Moed', with a large, stylized flourish on the right side.

Peniel Moed  
Office of the Assistant  
General Counsel (Logistics)

**MANPOWER, RESERVE AFFAIRS**  
**MEMORANDUM**

25 May 1977

**MEMORANDUM FOR THE DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY**

**SUBJECT: Advertising, Entertainment and Interest Cost Principles  
(ASPR Case 74-98)**

Your memorandum of 11 February 1977 requested that we delay publication of the cost principle changes approved under ASPR Case 74-98 pending the resolution of a proposed, new ASPR Case on public relations costs.

The ASPR Committee has considered your proposal and we have obtained comments from the OAGC (Logistics) on the matter.

As a result we do not believe that the ASPR changes approved under Case 74-98 are inconsistent with the intentions of Congress as expressed in the 1962 Department of Defense Appropriations Act, and subsequent legislation including the latest, section 731 of the 1977 Department of Defense Appropriation Act (P.L. 94-419). We have, therefore, released the changes approved under ASPR Case 74-98 to the ASPR Publications Editor for print in the next DFC.

Should you still believe that specific ASPR coverage on public relations costs is essential we certainly are not averse to considering any proposed ASPR changes you care to submit that would cover that area. We would expect, however, that specific ASPR changes, rather than a general policy statement, be submitted.

(signed) T. G. CASSIDY  
(for) **THOMAS F. BLAKE, JR.**  
Colonel, USAF  
Chairman, ASPR Committee

cc: DP  
PX  
PR C.F.(74-98)  
PR Chron

Prepared by: Mr. Cassidy/mla/25May77  
OASD(MRA&L)PR/3D776/74796

H.O. 3/3  
Tab A Sub

Case No. 74-98

15-205.1 Advertising Costs.

(a) (CWAS) Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like.

(b) (CWAS) The only advertising costs allowable are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract, or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4 and 15-203 are observed.

(c) (CWAS-NA) Advertising costs other than those specified above are not allowable. [Unallowable advertising costs include those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.]

## CONTRACT COST PRINCIPLES AND PROCEDURES

## 15-205 Selected Costs.

## 15-205.1 Advertising Costs.

(a) (CWAS) Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like. [It does not include public relations activities

associated with dissemination of information whereby the contractor does not retain control of how such data will be used. Expenses associated with preparing informational brochures, capability handouts, salary costs incurred assisting public relations organizations are not considered advertising costs for purposes of this clause.]

(b) (CWAS) The only advertising costs allowable are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract, or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4, and 15-203 are observed.

(c) (CWAS-NA) Advertising costs other than those specified above are not allowable. [~~Unallowable advertising costs include those related to sales promotion.~~ Such Unallowable advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.]

23 June 1976

**15-205.1 Advertising Costs.**

(a) (CWAS) Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like.

(b) (CWAS) The only advertising costs allowable are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract, or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4, and 15-203 are observed.

(c) (CWAS-NA) Advertising costs other than those specified above are not allowable. Unallowable advertising costs include those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.

23 June 1976

**15-205.23 Organization Costs. (CWAS-NA) Expenditures in connection with (i) planning or executing the organization or reorganization in the corporate structure of a business, including mergers and acquisitions, or (ii) raising capital, are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counsellors, whether or not employees of the contractor. [The term "reorganization" includes any change in the contractor's financial structure resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised.]**

23 June 1976

15-205.41 *Taxes.*

(a) No change

(i) No change

(ii) taxes in connection with financing, refinancing,  
or refunding operations [or reorganizations] (see 15-205.17  
[and 15-205.23]); (CWAS-NA).

(iii) No change

(iv) No change

(v) No change

(vi) No change

(b) No change

(c) No change

(d) No change



NATIONAL AERONAUTICS AND SPACE ADMINISTRATION  
WASHINGTON, D.C. 20546



REPLY TO  
ATTN OF: HP-2

OCT 2 1974

*14/10/10*  
*10/10/10*  
*10/10/10*  
*10/10/10*

Colonel Robert M. Obach  
Chairman, ASPR Committee  
Room 3D776  
The Pentagon  
Washington, D.C. 20301

Dear Colonel Obach:

Reference is made to ASBCA Case Number 14370, involving a number of contested cost issues under contract AF33(656)-15684 with The Boeing Company.

With regard to this case, the Board made several important decisions and interpretations concerning various cost principles, including those involving advertising, entertainment and interest expenses. Because of the precedent-setting nature of some of the Board's rulings, it is recommended that an ASPR Section XV case be established to study the Board's decisions and determine the need and desirability for revising or clarifying any of the pertinent cost principles.

Your consideration in this request is appreciated.

Sincerely,

*George J. Vecchiatti*

George J. Vecchiatti  
Assistant Administrator  
for Procurement

UNITED STATES OF AMERICA  
GENERAL SERVICES ADMINISTRATION

Federal Supply Service  
Washington, DC 20406



AUG 12 1976

Colonel Thomas F. Blake, Jr.  
Chairman, ASPR Committee  
Office of the Assistant Secretary  
of Defense (Installations & Logistics)  
Department of Defense  
Washington, DC 20301

*Tom*  
Dear Colonel Blake:

This is in response to your letter of July 30, 1976, requesting comments on proposed changes to ASPR cost principles regarding Advertising Costs, Organization Costs, and Taxes. Primarily the revisions broaden unallowability provisions relating to sales promotion and corporate financial restructuring, based upon ASBCA Case No. 14370, The Boeing Company.

We interpose no objection to these changes. However, we have not solicited comments from the members of the Interagency Procurement Policy Committee and would expect to do so prior to making parallel changes in the FPR for the purpose of uniformity.

Sincerely,

PHILIP G. READ  
Director of Federal Procurement Regulations



Keep Freedom in Your Future With U.S. Savings Bonds



National Aeronautics and  
Space Administration

Washington, D.C.  
20546

74-78  
40

Reply to Attn of: HC

AUG 11 1976

Colonel Thomas F. Blake, Jr.  
Chairman, ASPR Committee  
OASD (I&L)  
Washington, DC 20301

Dear Colonel Blake:

Reference is made to your letter of July 30, 1976,  
requesting our comments on proposed changes to ASPR  
15-205.1, Advertising Costs, ASPR 15-205.23, Organiza-  
tion Costs, and ASPR 15-205.41, Taxes.

This is to advise that NASA concurs with the proposed  
revisions contemplated by your July 30 letter.

Sincerely,

S. J. Evans  
Assistant Administrator for Procurement

# PERKIN-ELMER

OPTICAL GROUP  
THE PERKIN-ELMER CORPORATION  
NORWALK, CONNECTICUT 06856  
TELEPHONE: (203) 762-1000  
CABLE: PECO-NORWALK  
FC-0996-76

August 25, 1976

Mr. Charles I. Derr  
Machinery and Allied Products  
Institute  
1200 Eighteenth Street, N.W.  
Washington, DC 20036

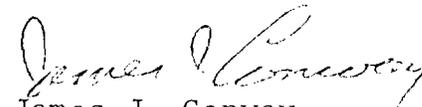
Dear Mr. Derr:

Subject: Comments relating to proposed change  
to ASPR 15-205.1(c) "Advertising Costs."  
Case 74-98

I agree that ASPR 15-205.1 should be expanded in light of recent ASBCA cases. However, since a revision is being contemplated, I strongly recommend that we once and for all put to bed the never ending discussion of public relations expenses versus advertising. My suggestions for modification of the proposed clause are attached.

One additional point. The comment relating to sales promotion expense should definitely be deleted since it conflicts with ASPR 15-205.37 "Selling Costs."

Sincerely,

  
James J. Conway  
Controller  
Optical Group

JJC:hvb  
attachment

cc: ASPR Committee ✓



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY  
CAMERON STATION  
ALEXANDRIA, VIRGINIA 22314

2 SEP 1976

PGD

MEMORANDUM FOR CHAIRMAN, ASPR COMMITTEE

SUBJECT: Revision of ASPR 15-205.1(c), Advertising Costs;  
ASPR 15-205.23, Organization Costs; ASPR 15-205.41(a)(ii),  
Taxes

The following comments are offered with regard to the subject revisions:

ASPR 15-205.1(a) - While this revision does not propose any changes to paragraph (a) we would suggest for clarification that the (CWAS) designation for this paragraph be removed. This (a) paragraph is merely a definition and description of the term "advertising costs." The application of the principle of reasonableness under the CWAS concept (15-201.3) comes into play relative to the allowable costs in paragraph (b) and the unallowable costs in paragraph (c).

ASPR 15-205.1(c) - The language of this revision presents no problems for cost accounting interpretation when performing audits of contractors' advertising costs. However, we do have reservations as to whether or not this additional ASPR coverage, reflecting the definitions set forth in recent BCA decisions, is in accord with the intent of Congress contained in the Defense Appropriations Act of 1962 (PL 87-144, Stat 36).

FOR THE DIRECTOR:

  
C. O. STARRETT, JR.  
Assistant Director  
Policy and Plans



74-18  
182

AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.

1725 DE SALES STREET, N.W. WASHINGTON, D. C. 20036 TEL. 347-2315

August 6, 1976

Thomas F. Blake, Jr.  
Colonel, USAF  
Chairman, ASPR Committee  
Installations and Logistics  
Office of the Assistant Secretary  
of Defense  
Washington, D. C. 20301

Dear Colonel Blake:

Mr. Harr has given me your 30 July 1976 letter advising that the ASPR Committee is considering revisions to the cost principles regarding Advertising Costs, Organization Costs, and Taxes.

We appreciate the opportunity to comment on these revisions under consideration, and expect to have our comments within the date indicated.

Sincerely,



Philip J. Blattau  
Aerospace Procurement Service  
Staff

PJB:cve



UNITED STATES  
ENERGY RESEARCH AND DEVELOPMENT ADMINISTRATION  
WASHINGTON, D.C. 20545

SEP 28 1976

Colonel Thomas F. Blake, Jr., USAF  
Chairman, ASPR Committee  
Office of the Assistant Secretary of Defense  
Installations and Logistics  
Washington, DC 20301

Dear Colonel Blake:

We have reviewed the proposed changes to ASPR 15-205.1, 15-205.23 and 15-205.41 (ASPR Case 74-98). We agree with the changes and recommend their implementation.

Sincerely,

Berton J. Roth  
Office of the Assistant  
Director for Policy  
Division of Procurement





# AMERICAN DEFENSE PREPAREDNESS ASSOCIATION

DEDICATED TO PEACE WITH SECURITY THROUGH DEFENSE PREPAREDNESS

UNION TRUST BUILDING, 15TH AND H STREETS, N. W., WASHINGTON, D. C. 20005  
202-347-7250

Founded 1919

27 September 1976

Col. T. F. Blake  
Chairman ASPR Committee  
Office Assistant Secretary of Defense  
The Pentagon  
Washington, D.C. 20301

Dear Colonel Blake:

Reference your letter of 30 July 1976 concerning ASPR Cost Principles and ASPR 15-205.1(c).

The one significant reply we received is attached hereto.

As stated by F. M. Beall of Fairchild, I hope the reply is of some help.

Sincerely,

Robert D. Worthen  
Colonel, U.S. Army (Ret.)  
Assistant Director, Advisory Service

RDW:b1

Encl.



Fairchild Industries Germantown, Maryland 20767 (301) 428-6000

August 18, 1976

Col. Robert D. Worthen  
Asst. Director, Advisory Service  
American Defense Preparedness Assoc.  
15th & H Streets, N.W.  
Washington, D. C. 20005

Dear Colonel Worthen:

Mr. Uhl has requested that I reply to your letter of 3 August 1976 regarding changes to ASPR 15-205.1, 15-205.23 and 15-205.41. I have the following comments:

15-205.1

I have no objection to the proposed change, which includes the definition contained in the ASBCA case. I don't understand why the change refers to sales promotion, since any advertising which meets the definition would be unallowable unless it qualified under 15-205.1(b). They may be trying to avoid a possible conflict with 15-205.37, which says sales promotion costs are allowable if reasonable and allocable.

15-205.23 and 15-205.41

This is another example of a proposed change in the ASPR because an ASBCA decision went against the government. The ASPR Committee may be correct that the original intent of the ASPR was to disallow capital structure changes of the type Boeing made. I don't know. It was, however, in my opinion, a change in the corporate capital structure, even though it did not raise additional funds.

I hope the foregoing may be of some help.

Sincerely,

F. M. Beall, Director  
Financial Systems & Procedures

FMB:bp

74-99



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

OFFICE OF GENERAL COUNSEL

B-154724

September 24, 1976

Colonel Thomas F. Blake, Jr.  
Chairman, ASPR Committee  
Office of the Assistant Secretary of  
Defense  
Department of Defense

Dear Colonel Blake:

By letter dated July 30, 1976 with attachments, you forwarded for our comment proposed revisions to ASPR cost principles regarding advertising costs, organization costs and taxes. You indicate that the proposed revisions have been developed to clarify the intent of these cost principles to insure more uniform and equitable interpretation.

We are informed that the revision to ASPR 15-205.1(c), Advertising Costs, would expand the definition of advertising costs based upon the definition of advertising expressed in the appeal of the Boeing Company, ASBCA Case No. 14370. It is your view that the change to ASPR 15-205.23, Organization Costs, would clarify the intent that the costs of any corporate financial structure change resulting in alterations in the rights and interests of the security holders is unallowable, whether or not additional capital is raised. Finally you indicate that the change to ASPR 15-205.41(a)(ii), Taxes, would specifically include taxes in connection with reorganization to provide consistency with ASPR 15-205.23.

We concur with the revisions as proposed.

Sincerely yours,

*for*   
Paul G. Dembling  
General Counsel



## FINANCIAL EXECUTIVES INSTITUTE

633 THIRD AVENUE, NEW YORK, N. Y. 10017 • 212 953-0500

24 September 1976

Col. Thomas F. Blake, Jr.  
Chairman, ASPR Committee  
OASD (I & L)  
The Pentagon, 3D-776  
Washington, D. C. 20301

Dear Col. Blake:

The Financial Executives Institute appreciates the opportunity to comment on proposed changes to ASPR sections 15-205.1, .23, and .41. These are all areas of disallowed costs that have been particularly frustrating to contractors because of the unreasonable interpretation that has frequently been imposed. The sources of difficulty are different for advertising than they are for organization costs.

### Sec. 15-205.1(c) (Tab A)

The proposed change makes it clear that specific types of advertising are unallowable. However, when recruiting for individuals qualified in certain advanced technologies, it may be necessary to call favorable attention to the potential employers to stimulate the interest of potential employees. Contracting officer and auditor reviews of such advertisements in retrospect frequently result in an interpretation that undue attention is given to the company's products and a determination of total unallowability.

We believe that the real source of difficulty that contractors have experienced with auditors and with contracting officers is the unreasonable rigid interpretation that has sometimes been placed on the form and content of recruitment advertising which is normally allowable.

Obviously all employers, including the government compete in the labor market in their recruiting processes. The effectiveness of communication in attracting applicants and the ability to sell them during employment interviews is the measure of success. Successful recruiting employs many techniques and media without having proven techniques for measuring success. The door should therefore be left open for innovation.

Col. Thomas F. Blake, Jr.  
24 September 1976  
Page 2

Too often auditors and contracting officers are given to exercising subjective judgments on form, content and volume of advertising material used for recruiting. These judgments result in arbitrary disallowances which are not supportable by a reasonable interpretation of the regulations. As an example, color advertising has been disallowed although the government uses it regularly for military recruiting. As another example, recruitment copy containing picture of products to be worked on have been disallowed because the emphasis was judged to be weighted on the product rather than employment. These are both judgmental prohibitions that limit the contractors ability to compete effectively in the recruiting process. Our comments noted in the second paragraph under Sec. 15-205.1(c) Tab A apply equally to recruitment advertising.

DOD must recognize that without continuously putting its name in front of potential buyers, no contractor could continue to be a supplier. Prime contractors would lose some of their technology. Subcontractors would become unknowns or would disappear. While we think the government position on advertising has been hard line and unrealistic, we recognize it will not be modified over night.

We believe the problem could be remedied if the regulations specifically authorized for recruitment advertising all techniques and media commonly used either by the government or by other commercial employers. Such a guideline would, we think, eliminate or reduce the possibility of disallowances based on the subjective judgment of one or two people. Such a change would remove some of the disadvantages contractors have in recruiting employees to work on government contracts.

Consideration should also be given to some reasonable pro-ration of the cost of the advertising when a difference of opinion exists between the contractor and the administrative contracting officer.

We would therefore recommend that sub-paragraph (c) be reworded to read:

Col. Thomas F. Blake, Jr.  
24 September 1976  
Page 3

"(c) (CWAS-NA). Advertising costs other than those specified above are not allowable. Unallowable costs include certain costs related to sales promotion. Such advertising involves direct payments for the use of time (air time) or space to promote the sale of products. Sales brochures which make known the availability of a product or product line, technical literature covering specifications and applications, price books, are all a necessary expense to marketing a product or product line and are allowable, except when such material is so general as to provide no useful information to the potential buyer."

Sec. 15-205.23 Organization Costs (CWASNA). (Tab B)

The proposed change incorporates the term and definition for "reorganization" and includes such activities in the unallowable category. Costs associated with financing and re-financing are included in this section.

Here the regulations seem to be at odds with DOD policy and with the recent promulgations of the Cost Accounting Standards Board. Through the Profit '76 Study, the Secretary of Defense is examining contractor profits and ways in which they could be made more comparable to the profits realized from commercial activities. One of the reasons that profits remain low is that costs remain high. Contractors are not generating enough cash from government business to invest in new, more efficient facilities. The investment cost for new processes and more advanced technology is not warranted by the returns contractors receive. This situation has been documented prior to the Profit '76 Study in other studies conducted by DOD, the General Accounting Office and by several industry groups.

The Cost Accounting Standards Board has recognized that contractors must receive consideration in cost for the capital invested in facilities to perform government contracts. Standard 414, Cost of Money as an Element of the Cost of Facilities Capital was published June 2, 1976. The effective date has not been established.

Col. Thomas F. Blake, Jr.  
24 September 1976  
Page 4

The inclusion as disallowed costs in ASPR, of costs related to financing or refinancing is completely contradictory to expressed intent of DOD, the CASB and Congress. The provisions of Sec. 205.23 should be amended to be consistent with the objectives of DOD and the promulgation of the CAS Board giving recognition to the cost of facilities capital

In view of the circumstances, we believe that Sec. 15-205.23, Organization Costs, should be rewritten as follows:

"15-205.23(a) Organization Costs. (CWAS-NA).

Expenditures in connection with planning or executing the organization or reorganization in the corporate structure of a business are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, promoters and organizers, whether or not employees of the contractor."

"15-205.23(b) Organization Costs. (CWAS).

Reorganizations involving mergers or acquisitions or raising capital are allowable. Such expenditures include costs of attorneys, accountants, brokers, investment counselors and management consultants, whether or not employees of the contractor. The term "reorganization" includes any change in the contractor's financial structure resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised."

The CASB is working on a standard for recognizing the cost of other capital. To avoid unnecessary future iterations and modifications of this regulation, we suggest it would be appropriate to add another sub-paragraph under 15-205.23(c) worded as follows:

"(c) At such time as the CASB promulgates an additional standard or standards, recognizing as a cost other forms of capital or the cost of obtaining and employing other forms of capital in the performance of government contracts, such promulgations are incorporated into this regulation as of the effective date of the applicable standard(s)."

Col. Thomas F. Blake, Jr.  
24 September 1976  
Page 5

Sec. 15.205.41 Taxes (Tab C).

Consistent with the changes proposed for Sec. 15.205.23 we think:

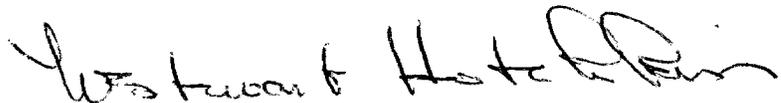
- Subparagraph (ii) should be deleted.
- Subparagraph (iii) should be renumbered (ii)
- Subparagraph (iv) should be deleted
- Subparagraph (v) should be renumbered subparagraph (iii)

Sec. 15.205.17 Interest and Other Financial Costs.

This section was included in the proposed change by reference only (see Tab C). Since it deals with some of the costs of capital and financing operations, it should be deleted. It would become nonapplicable with the effectivity of CASB Standard 414.

If the government is to benefit from costs incurred for raising capital, financing or refinancing, then it should share in the costs associated with these activities as well as pay its allocable share for the cost of facilities capital.

Very truly yours,



W. Stewart Hotchkiss  
Senior Advisor, Committee on  
Government Business  
Financial Executives Institute

25 copies enclosed.  
Copies to each Member of the Government Business Committee

WSH:cb

# COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS (CODSIA)

2001 Eye Street, N.W.  
Washington, D.C. 20006

◆  
(202) 457-4985

October 8, 1976

Colonel Thomas F. Blake, USAF  
Chairman, ASPR Committee  
OASD (I&L)  
The Pentagon, Room 3D 776  
Washington, D.C. 20301

Dear Colonel Blake:

Thank you for the opportunity of commenting on proposed revisions to ASPR 15-205.1(c) Advertising Costs; 15-205.23 Organization Costs; and 15-205.41(a)(ii) Taxes.

The opinions and recommendations of the undersigned associations of the Council of Defense and Space Industry Associations (CODSIA) regarding each of the proposed revisions are provided in the paragraphs which follow.

## ASPR 15-205.1(c) Advertising Costs:

Your 30 July 1976 letter which transmitted the proposed revision states that the purpose is to expand the definition of advertising costs based upon the definition of advertising expressed in the appeal of the Boeing Company ASBCA Case No. 14370.

The thrust of the Boeing decision: First, it indirectly established that this regulation covers only media and corollary administrative costs related to advertising offers to buy resources and advertising offers to sell resources. This point reveals a flaw in existing ASPR 15-205.1(a) in which the phrase "cost of advertising media" is used instead of the more precise phrase "cost of media advertising". This point is important because the ASPR is concerned only with advertising costs, not with media costs.

Secondly, the ASBCA decision developed a definition of "sales promotion advertising", which is the only advertising that it considers unallowable under ASPR 15-205.1(c).

Therefore, the purpose of revising ASPR 15-205.1(c) should not be to expand the definition, but rather to clarify the definition. To accomplish this purpose, the generalized statement currently in ASPR 15-205.1(c) should be revised. Changes also need to be made in 15-205.1(a) and (b) to support the revision in (c). We propose the following complete text of ASPR 15-205.1, with the description of the changes contained in the comments outlined under each section.

15.205.1 Advertising Costs:

- (a) (CWAS) Advertising costs mean the cost of ~~advertising media media~~ advertising and corollary administrative directly associated costs. ~~Advertising media~~ Media advertising includes magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, ~~conventions, exhibits,~~ convention exhibits, free goods and samples, and the like.

Comment: 1. The words "media advertising" have been substituted for "advertising media" in order to limit the subject of this paragraph of ASPR to advertising costs. 2. The words "directly associated" have been substituted for "corollary administrative" costs since Cost Accounting Standard 405 Accounting for Unallowable Costs uses the term "directly associated" for the purposes of costing unallowable costs under that Standard. 3. The changes regarding the words "conventions, exhibits" are to clarify that it is the exhibit that is the media and conventions per se are not media.

- (b) (CWAS) ~~The only advertising costs allowable~~ Allowable advertising costs are those which are solely for (i) recruitment of personnel required for the performance by the contractor of obligations arising under the contract, when considered in conjunction with all other recruitment costs, as set forth in 15-205.33, (ii) the procurement of scarce items for the performance of the contract or (iii) the disposal of scrap or surplus materials acquired in the performance of the contract. Costs of this nature, if incurred for more than one defense contract or for both defense work and other work of the contractor, are allowable to the extent that the principles in 15-201.3, 15-201.4, and 15-203 are observed.

Comment: The words "Allowable advertising costs" have been substituted for "The only advertising costs allowable". Inasmuch as there are three items of allowable advertising costs and only one item of unallowable, it is inappropriate to use the word "only" in connection with describing the allowable costs.

- (c) (CWAS-NA) ~~Advertising costs other than those specified above are not allowable.~~ Unallowable advertising costs include are those related to sales promotion. Such advertising involves direct payment for the use of time or space to promote the sale of products to the general public either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser's product or product line for purposes of enhancing his overall image to sell his products. In both instances, the advertiser has control over the form and content of what will appear, the medium in which it will appear, and when it will appear.

Comment: The entire first sentence has been deleted to conform to the ASBCA decision that defines unallowable advertising as being only that related to sales promotion. Thus the sentence would tend to be misleading

if it remained in ASPR. In the second sentence the word "are" has been substituted for the word "include" because the court definition is all inclusive. Using the word "include" would tend to give the reader the impression that there are other unallowable advertising costs. The changes in the third sentence are made to define more clearly the nature of unallowable advertising cost.

ASPR 15-205.23 Organization Costs:

Your letter states that the change to this paragraph is to clarify the intent that the costs of any corporate financial structure change resulting in alterations of the rights and interests of the security holders is unallowable, whether or not additional capital is raised.

The proposed revision is not a clarification of the ASPR clause but an expansion of the definition to add many of the normal administrative duties relating to the maintenance of the corporate structure to the list of unallowable costs. The proposed wording "any change in the contractor's financial structure resulting in alterations in the rights and interests of security holders" is so broad that it would encompass even administrative costs to arrange for a bank loan, inasmuch as in a liquidation of a company, the creditors would have prior rights and interests than the security holders. The cost of payment of cash dividends could also be considered unallowable under this provision since there would be less assets available to the bankholders and thus would result in "alterations of the rights and interests of the security holders".

As brought out in the Boeing Company ASBCA case, the financial definition of a reorganization is quite clear. The Board agreed with the description of W.A. Patton in the Accountants Handbook, Third Edition, at P. 1014, "In Law and Finance a reorganization generally implies a serious overhauling through legal procedure..." The Board concluded that although the Boeing transactions might loosely be described as "reorganizations" they should more properly be described as "rearrangements".

The administrative adjustments and the maintenance of the capital structure covered by the Boeing case are not new. These activities have all existed to some degree at the time ASPR 15-205.23 was promulgated. Inasmuch as the formal definition ascribed to reorganization denotes major change, if the intent of the ASPR was to include relatively minor administrative activities, the ASPR would have read "(1) Planning or executing the organization, reorganization, or rearrangement in the corporate structure of a business..." The fact that it did not so read is clear evidence that ASPR 15-205.23 is correct as it currently reads, without the proposed change.

This appears to be a situation where the Government, having lost its case because of the rules, seems to now want to change the rules. The proposed ASPR 15-205.23 is definitely a change in the regulation, and not a clarification of the intent of the regulation. Such a change should not be

proposed unless there is justification for finding that the decision in the Boeing Company ASBCA case was unreasonable and inequitable. In the Boeing case there was a recall of a specific debenture issue and a concurrent redemption of these debentures into common stock at predetermined rates of exchange. The converting of 4-1/2% debentures to common stock did not raise capital. Since there was no raising of capital by this transaction, the Board ruled that this was not a case of reorganization and hence the costs of administering these transactions were considered allowable under ASPR 15-205.24 (Other Business Expenses).

The Government used the definition supplied in Erik Kohler's dictionary for accountants as support for its position that the conversion and redemption of the debentures was a reorganization within the meaning of ASPR 15-205.23. This definition of reorganization includes "a major change in the financial structure of a corporation...resulting in alterations in the rights and interests of security holders."

There is nothing inherently incorrect in modifying a regulation subsequent to a ruling based on the present language of a regulation for the purpose of clarifying the intent. However, change for the sake of overruling a Board decision is not sufficient reason for making a change. While the Government should not be expected to pay for a corporation's actions in connection with the raising of capital by way of issuing new stock or debentures, it should be equally clear that management decisions which do not raise capital should not be characterized as an act of reorganization for which costs associated therewith are unallowable. For example, consider a management decision which terminates the activity of a division because it is unprofitable. This type of change does not raise capital but it certainly is a change that would impact the financial structure of a corporation and affect the security holders.

There is some logic associated with considering an act that raises capital a reorganization under ASPR 15-205.23. However, the mere act of redeeming outstanding obligations by the issuance of stock is not a reorganization. It appears unreasonable to allow an expense such as the cost of registry and transfer charges resulting from changes in ownership of securities which is considered other business expense under ASPR 15-205.24 and not allow the conversion of an existing obligation into an issuance of stock.

The proposed change should not be made.

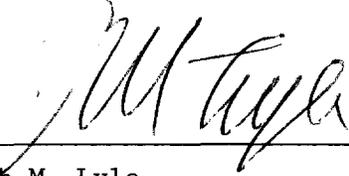
ASPR 15-205.41 Taxes:

There is no objection to the change proposed by ASPR 15-205.41. The word reorganization already appears in ASPR 15-205.23. Therefore, any tax associated with a true reorganization as interpreted by the Board should be considered unallowable.

Colonel Blake  
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We would be pleased to further discuss our comments if you so desire.

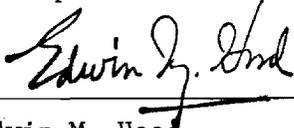
Very truly yours,



Joseph M. Lyle  
President  
National Security Industrial Assn.



Karl G. Harr, Jr.  
President  
Aerospace Industries Assn.



Edwin M. Hood  
President  
Shipbuilders Council of America

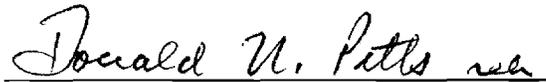


for

J. A. Caffiaux  
Staff Vice-President  
Electronic Industries Assn.



James G. Ellis  
Manager, Defense Liaison  
Motor Vehicle Manufacturers Assn.



Donald N. Pitts  
Western Electronic Manufacturers Assn.