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Glance into Renegotiation

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A GLANCE INTO RENEGOTIATION

By THEIA A. GEBBIE

Forerunners of Renegotiation

The basis for most of the thinking on wartime profit control was the recognition that the people of this country were determined to prevent excessive profits in World War II. War profits always arouse public ire. The recollection of experiences during and after World War I convinced industry that if some businesses were allowed to make undue profits from war, all industry suffered.

Between February, 1919, and April 28, 1942, there were about 170 bills and resolutions introduced into Congress designed to reduce or eliminate profits on war production.

Following the United States' entrance into World War II on December 8, 1941, the procurement of war materials expanded rapidly. Many manufacturers were urged to undertake the manufacture of articles never produced before and subject to frequent change. Others undertook articles new to them, or increased production to amounts far beyond their previous small quantities.

The demands of war reflected through (1) revisions of specifications, (2) changes in quantities and rates of delivery, (3) shortages of materials and equipment, and (4) manpower problems. It was practically impossible to forecast costs so that reasonable profits might be estimated.

Since most early war contract prices had their origin in small quantity production, the great increases in the volume of production and the rapid improvements in methods frequently brought profits far beyond those anticipated when contracts were originally made, and left many contractors with profits which they should not and did not wish to retain.

The cost-plus-fixed-fee contracts were widely used in the beginning, but even then it was believed that any flat profit limitation tended to promote inefficiency, was a stumbling block in the procurement program, and was sadly inequitable.

Renegotiation Becomes Law

The enactment of the renegotiation law as Section 403 of the Sixth Supplemental National Defense Appropriation Act of 1942 was finally the result of certain suggestions and proposals made by the procurement services of the armed forces. This was effective as of April 28, 1942.

Later Revisions

During 1943 the renegotiation law and its administration were examined by Congress. Four Congressional committees held

public hearings and in executive sessions examined carefully many renegotiation cases, particularly the cases of those who complained about the administration of the law.

As a result of these studies, a revision of the renegotiation legislation was initiated by the Committee on Ways and Means, of the House of Representatives, in September, 1943. and further considered by the Finance Committee of the Senate. This legislation, which was incorporated in the Revenue Act of 1943, became law on February 25, 1944. The revision followed closely the concept and scope of the 1942 law and, in general, strengthened and clarified the fundamental policies.

There were certain changes, however. One of the principal revisions was the exemption measured by sales volume which was increased from $100,000 in 1942 to $500,000 in 1943. While it was known that excessive profits existed in many smaller companies, it was recognized that all contractors could not be examined and renegotiated in a reasonable period. Also, the amount of excessive profits involved in these companies was usually not sufficient to warrant the effort and cost of renegotiation.

Over-all Method Adopted

The over-all method of renegotiation was adopted. This procedure permitted the contractor's profits on his entire war business to be examined for a specific fiscal period in order to reach an agreement for eliminating excessive profits on all contracts and subcontracts as a group and for that period. In this way, contractors might offset their losses on certain contracts against profits on other contracts during the same period.

The over-all method also reduced the administrative burden and saved time for the contractors and the Government. The use of the fiscal period for renegotiation facilitated the use of the regular financial and accounting material of contractors.

War Contracts Board

The authority and discretion to administer the Renegotiation Act of 1943 was conferred upon the War Contracts Board with power of delegation. The Board is composed of six members, one each from the War Department, the Navy Department, the Treasury, the Maritime Commission or the War Shipping Administration, the Reconstruction Finance Corporation, and the War Production Board.

The Board may, in its discretion, review any determination made by any officer or agency to which its powers have been delegated, and has the authority to make a redetermination of the amount of excessive profits. However, where a determination with respect to the amount of excessive profits of a contractor or subcontractor is embodied in an agreement between the contractor or subcontractor and a duly authorized representative of the Board, such agreement is conclusive according to its terms and shall not be subject to review by the Board.

Assignment for Renegotiation

Assignments of contractors are ordinarily made to the Department or Service believed to have the predominant interest in the assigned contractor's renegotiable business. Some assignments are made, however, by considerations of geographic convenience and other reasons. For instance, it has been found advantageous to assign concerns which produce the same or similar products to the same Department or Service.

The War Contracts Board may cancel the assignment of any contractor on the ground that it clearly appears that no excessive profits were realized by the contractor. However, cancellation of an assignment does not constitute a formal clearance. If a contractor desires a clearance of its responsibilities under the Act, renegotiation must be completed and a clearance issued in the regular manner.

Determination of Renegotiable Business

In order to determine whether a contractor's profits received or accrued under renegotiable contracts and subcontracts are excessive, it is necessary first to determine the amount of renegotiable business and the profits thereon.

It is the contractor's responsibility to make the segregation of sales and the allocation of costs and expenses between renegotiable and nonrenegotiable business. However, the segregation and allocation must be satisfactory to the Department conducting the renegotiation.

The Renegotiation Act prescribes what type of contracts are subject to renegotiation. In practice, there often is difficulty in tracing and identifying all sales with exactness, especially subcontract sales where the products are far removed from the end use. Each contractor must decide what method will result in the most equitable segregation of sales.

Often there is more than one method available for segregating sales between renegotiable and nonrenegotiable business. In that event the methods available for equitably allocating the cost of sales are carefully considered before a final determination is made as to the method to use in segregating sales. In general, some such classifications for segregating sales and allocating costs and expenses are:

(1) Industry, customer or customer group.

(2) Product or group of products.

(3) End use classifications as shown on reports to the War Production Board.

(4) Division, department or plant, wherein the extent of renegotiation can be determined.

(5) Periods of the year, where the percent of business subject to renegotiation varies with the period.

Determination of Excessive Profits

After the profits pertaining to renegotiable business have been determined, there must be a determination of the amount, if any, which is excessive under the Renegotiation Act.

Under war conditions the Government is the nation's principal buyer. Its purchases are paid for by taxation and borrowing. The lower the costs of production and the prices paid directly or indirectly by the Government, the less will be the financial burden on the people of the country. Since prices are composed of costs and profits, renegotiation is in effect an over-all repricing. Where prices have been so high as to produce excessive profits, the adjustment of prices may be accomplished through an adjustment of the profits included therein.

All the facts applicable to the contractor's business for the year being renegotiated are examined and considered. The profit considered is that before Federal taxes on income. There is no formula for determining excessive profits; it is a matter of judgment. Some of the principles given consideration are:

(1) The relationship of profit to sales. It is generally recognized that sales to the Government under war contracts should not result in profits as great as those which might be earned on a similar volume of peacetime business acquired in a freely competitive market. Profits on war business are paid involuntarily out of taxes by citizens.

(2) The efficiency of the contractor with regard to the quantity and quality of production, the reduction of costs and economical use of materials, facilities, and manpower.

(3) Corresponding profits in prewar base years of the contractor and for the industry. (Generally, the years 1936-1939 are used as a base period.) The rate of profit made on peacetime business is not necessarily a basis for profits to be made on war contracts, but it is significant.

(4) The effect of volume on costs and profits. In general, the margin of profit on expanded war sales should be reduced in reasonable relationship to the expanded volume.

(5) The varying characteristics among several classes of production or between peacetime and war business; the complexity of the manufacturing technique, and the character and extent of the subcontracting.

(6) The amount and source of public and private capital employed and the net worth. This concerns the proportion of the plant or equipment or materials supplied by Government agencies or other contractors, and the amount of facilities covered by certificates of necessity. Where a large part of the capital or facilities is furnished, the contractor's contribution tends to become more of management only.

(7) The risk incident to reasonable pricing policies. The contractor who overprices has taken little responsibility for increases in cost of materials and wages, guaranties of quality and performance of the product, or any such risk.

(8) Contribution to the war effort, including inventive and developmental contribution and cooperation with the Government and other contractors in supplying technical assistance.

Elimination of Excessive Profits

When an agreement has been reached with a contractor for the elimination of excessive profits as a result of renegotiation, such agreement is evidenced by the execution of a renegotiation agreement. In most instances the contractor has been assessed Federal income and excess profits taxes on the profits to be eliminated, and a credit equal to the amount of such taxes is allowed against the refund to be made by the contractor. This refund may be made by the contractor in a single payment or in installments as the agreement may provide.

Discussion

The surface view of renegotiation pictured above deals primarily with the cooperative contractors, those who realize that the motivating idea is ethical and fair. There are some non-cooperative contractors, and there are some contractors who consider the treatment they have received under renegotiation to be unfair. In such cases a unilateral determination may be issued involving subsequent review by the War Contracts Board and the right to appeal to the Tax Court.

In the main, however, renegotiation is accepted as an expedient—an attempt to correct some of the difficulties in relation to excessive earnings from war. Until competitive conditions are again established, renegotiation is somewhat of a leveling agent and accepted by some contractors as such.

Renegotiation has not tried to determine what are fair and accurate costs. The underlying thought and approach to renegotiation concerns the elimination of excessive and inordinate profits.

PRONOUNCE IT CORRECTLY

By JENNIE M. PALEN, C.P.A.

Accounting, like all learned professions, has a technical vocabulary. All good accountants know this vocabulary and the nuances of its meanings. Astonishingly enough, however, some of the top-grade accountants do not pronounce some of these words correctly.

As an example let us take the word *amortize,* a word which every accountant uses over and over again. Dictionaries agree that the accent is on the second syllable. Yet in accounting offices and even on the floor and platform of accounting society meetings one hears it constantly pronounced with the accent on the first syllable. The related noun *amortization* is properly pronounced *a-mor″ ti-za′ tion,* with the primary accent on the fourth syllable and the secondary accent on the second syllable, but we seldom hear it that way. We hear, instead, *am″ or-ti-za′ tion,* with the secondary accent incorrectly placed on the first syllable.

Then there is the word used in describing that part of the accountant's report which details its contents. The word is *presentation* and the *e* in the first syllable is short; thus, *prez″ en-ta′ tion.* But do most of us pronounce it that way? We do not! Ninety-nine percent of us say *pree″ zen-ta′ tion!* We are not, of course, alone in this error. Many an award presented at distinguished affairs is described by the presiding officer and by the radio commentators who subsequently report the affair as a *pree″ zen-ta′ tion.* So far no dictionary has given this pronunciation the accolade of its approval.

The words *comparable* and *comparably* do yeoman service for the accounting profession. A high ranking government official recently pronounced these words *com-par′ a-ble* and *com-par′ a-bly* in an able speech which was eagerly listened to by accountants. Webster says *com′ par-a-ble* and *com′ par-a-bly.* Many accountants are guilty of mispronouncing both.

There is also the word *finance.* The accent is on the second syllable. But far, far too often do we hear it pronounced *fye′ nance.* At an important public dinner held recently a minister, one of the principal speakers, was guilty of this error. Let us not be smug about that, however. Ministers are not expected to know as much about finance as we.

Ministers also have been known to trip, along with some of us, on the word *resources,* but this word, too, is one of the tools of our profession and WE should know that the accent is on the second syllable, not on the first.