



OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Part 9904

Conformance of the Cost Accounting Standards to Generally Accepted Accounting Principles for CAS 404 Capitalization of Tangible Assets and CAS 411 Accounting for Acquisition Costs of Material

AGENCY: Cost Accounting Standards Board, Office of Federal Procurement Policy, Office of Management and Budget.

ACTION: Advanced notice of proposed rulemaking.

SUMMARY: The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (CAS Board or the Board), is releasing this advanced notice of proposed rulemaking (ANPRM) to elicit public comments on proposed changes to the Cost Accounting Standards (CAS) on conformance to Generally Accepted Accounting Principles (GAAP) related to CAS 404, *Capitalization of Tangible Assets*, and CAS 411, *Accounting for Acquisition Costs of Material*, to GAAP. This ANPRM follows issuance of a Staff Discussion Paper 85 FR 58399 (September 18, 2020).

DATES: Comments must be in writing and must be received by [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]

ADDRESSES: Submit comments to the *Federal eRulemaking Portal*:

<https://www.regulations.gov>. by searching for “CASB 2020-1”. Select the link “Comment Now” that corresponds with “CASB 2020-1”. Follow the instructions provided on the “Comment Now” screen. Please include your name, company name (if any), and “CASB 2020-1” on your attached document. If your comment cannot be submitted using <https://www.regulations.gov>, call or email the points of contact in the **FOR FURTHER INFORMATION CONTACT** section of this document for alternate instructions. Comments received generally will be posted without change

to <https://www.regulations.gov>, including any personal and/or business confidential information provided. Public comments may be submitted as an individual, as an organization, or anonymously (see frequently asked questions at <https://www.regulations.gov/faq>). To confirm receipt of your comment(s), please check <https://www.regulations.gov>, approximately two-to-three days after submission to verify posting.

Privacy Act Statement: The CAS Board proposes the rule to elicit public views pursuant to 41 U.S.C. 1502. Submission of comments is voluntary. The information will be used to inform sound decision-making. Please note that all comments received in response to this document will generally be posted or released in their entirety, including any personal and business confidential information provided. Do not include any information you would not like to be made publicly available. Additionally, the OMB System of Records Notice, OMB Public Input System of Records, OMB/INPUT/01, 88 FR 20913 (available at www.federalregister.gov/documents/2023/04/07/2023-07452/privacy-act-of-1974-system-of-records), includes a list of routine uses associated with the collection of this information.

FOR FURTHER INFORMATION CONTACT: John L. McClung, Manager, Cost Accounting Standards Board (telephone: 202-881-9758; email: john.l.mcclung2@omb.eop.gov).

SUPPLEMENTARY INFORMATION:

I. Background

The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (CAS Board), is releasing this Advanced Notice of Proposed Rulemaking (ANPRM) on the conformance of *CAS 404, Capitalization of Tangible Assets, and CAS 411, CAS Accounting for Acquisition Costs of Material*, to the Generally Accepted Accounting Principles (GAAP). In accordance with 41 U.S.C. 1502(c), the Board is required to consult with interested persons concerning the advantages, disadvantages, and improvements anticipated in the pricing and administration of Government contracts as a result of the adoption of a proposed Standard prior to the promulgation of any new or revised CAS.

On September 18, 2020, the Board published a Staff Discussion Paper (85 FR 58399) to solicit views with respect to the Board's initial assessment of CAS 404 and CAS 411 to conform them, where practicable, to GAAP. Respondents were invited to comment, among other things, on the differences identified between CAS and GAAP, the frequency and magnitude of issues identified with CAS non-compliances, and recommendations on any changes to the Standards to conform them to GAAP.

This ANPRM reflects input from the public, as discussed below, as well as research accomplished by the Board in the respective subject areas. The Board used the side-by-side comparison of CAS and GAAP requirements set forth in the Staff Discussion Paper to identify any material differences. Unique CAS requirements were assessed for their necessity in protecting the interests of the Government or if the existing requirements in other CAS standards or requirements in other relevant rules may protect the interests of the Government.

II. CAS 404

A. Overview

CAS 404 requires contractors, for the purposes of cost measurement, to establish and adhere to policies with respect to capitalization of the acquisition costs of tangible assets. CAS 404 establishes criteria which the contractor's policies and procedures should satisfy. CAS 404 was initially published February 27, 1973 at 38 FR 5318. The preamble for the original publication of CAS 404 acknowledged that:

Work preliminary to the development of this Standard was initiated as the result of recognition that the general subject of fixed asset accounting has been the source of continuing problems between contractors and the Government concerning equitable determinations of the costs attributable to performance of specific contracts.

The Board ultimately decided after careful consideration of public comments that this standard would establish the beginning point for fixed assets and focus solely on the “determination of the acquisition costs to be capitalized as opposed to those which are charged against revenues of the current period [as depreciation]”.

CAS 404 was modified in 1996 by the addition of CAS 404-50(d) to address issues relating to the treatment of gains or losses attributable to tangible capital assets subsequent to mergers or business combinations by government contractors. This added language requires tangible capital assets of an acquired company to be capitalized by the buyer at the seller’s net book value, if the assets generated cost on government contracts in the most recent cost accounting period prior to the business combination; otherwise, the assets, which did not generate cost on government contracts, may be assigned a portion of the purchase price of the acquired entity not to exceed their fair value.

With the exception of the requirements added in 1996 by CAS 404-50(d)(1), the principal need for the promulgation of the initial CAS 404 no longer exists. GAAP has been revised significantly with additional content since the original promulgation of CAS 404 in 1974.

Furthermore, as explained in greater detail in the response to public comments in subsection b., below, a comparison of CAS 404 with pertinent GAAP content revealed significant overlap and nearly completely equivalent requirements with the noted exception of CAS 404-50(d). For all other requirements in CAS 404, a comparable requirement exists in GAAP, FAR or other CAS Standard that would protect the Government’s interests and promote uniformity and consistency. The alignment is so close as to make CAS 404 nearly duplicative of GAAP in all cases except CAS 404-50(d)(1). Where such comparable requirements exist between CAS and GAAP, the CAS 404 requirement can be eliminated.

In addition to the CAS 404-50(d) requirements for assets acquired through a business combination, there are two other potential differences between CAS and GAAP that require

further consideration: (i) the CAS requirements for a minimum capitalization threshold, and (ii) written statements of accounting policies and practices. As described below in subsection b., the Board has provisionally concluded that reliance on GAAP would materially achieve uniformity and consistency necessary for Government contracting related to these two differences.

In summary, the Board has provisionally concluded that CAS 404, with the exception of CAS 404-50(d)(1), has become unnecessary to protect the Government's interests which may be achieved through reliance on GAAP and other CAS Standards. Therefore, the Board is considering a proposed rule that would eliminate CAS 404 and retain the requirements CAS 404-50(d)(1) by relocating them to 9904.418-50 and seeks comment on such action in this ANPRM. This action would be consistent with the Board's guiding principles for conforming CAS to GAAP because it would eliminate CAS content to minimize the burden on contractors while protecting the interests of the Federal Government. Furthermore, the Board's conclusion on CAS 404 would align with the guiding principles to rely on coverage in GAAP when it would materially achieve uniformity and consistency in cost accounting without bias or prejudice to either party, rely on other CAS Standards which may protect the Government's interests, and eliminate CAS coverage no longer necessary.

B. Summary of Public Comments

The Board received four sets of public comments to the SDP. These comments came from industry associations and companies. The Board appreciates the efforts of all parties that submitted comments and found the depth and breadth of the comments to be informative.

Responses to specific comments for CAS 404 are as follows:

1. Minimum capitalization threshold. The Board observed in the SDP that CAS prescribes a specific ceiling for a monetary capitalization threshold (currently not to exceed \$5,000), and GAAP does not.

Comment: Four respondents provided comments to this potential difference identified by the Board. All four stated that the conceptual framework of GAAP would provide reasonable limitations for selecting capitalization thresholds and consistently following them. Two respondents also observed additional FAR requirements and market forces that would curb unreasonably high thresholds and protect the government's interests.

Response: Although GAAP does not provide for a specific minimum capitalization threshold, the Board has provisionally determined that the competitive constraints, disclosure statement requirements, and retention of CAS 401, which requires contractors subject to CAS to consistently follow their disclosed practices, should adequately protect the government's interest in the absence of the current prescriptive capitalization threshold. The risk of variations in the capitalization threshold, given the constraints discussed further below, would generally only result in immaterial differences in the assignment of cost between cost accounting periods.

2. Written statements of accounting policies and practices. The second potential difference the Board noted is the requirement to have a written policy for capitalization. GAAP does not explicitly require a written statement for capitalization policy; however, typically, written documentation would exist because it would be required as evidence of internal controls during audits of Sarbanes-Oxley compliance and of financial reporting.

Comment: All respondents believed that written policies and procedures would exist absent the perspective requirement currently contained in CAS. For example, in meeting the GAAP requirements, contractors maintain conventions and guidelines for the consistent treatment of the costs of acquiring tangible capital assets. Such conventions represent reasonable limits and are maintained to satisfy the GAAP requirements for consistency and accurate accounting. In addition, contractors subject to CAS would still have to consistently follow their disclosed practices (CAS 401) and the information would also be included in a disclosure statement.

Response: Although GAAP does not explicitly require a written statement for capitalization

policies, the Board agrees with the respondents and has provisionally determined that these written statements would continue to exist in the absence of the current explicit CAS requirement. The cumulative requirements that will remain in CAS 401, which requires comparison of actual practices year over year, Disclosure Statements and current practices to comply with GAAP would adequately protect the government's interest absent the expressed requirement to maintain policies and procedures required by CAS. In addition, FAR and DFARS accounting system requirements also make written policies and procedures, such as on capitalization, necessary.

3. Assets acquired through a business combination. Another difference noted by the Board is the requirements in CAS for treatment of tangible assets acquired in a business combination. CAS 404-50(d) and (e) refer to two financial accounting treatments for business combinations: “purchase method” and “pooling of interest method.” As noted in the SDP, these methods could be found in financial accounting literature at APB Opinion 16. Subsequently, financial accounting treatment has been revised several times.

In June 2001, FASB revised its approach for accounting for business combinations in Statement Financial Accounting Standards No. 141, which superseded APB Opinion 16 and adopted a single-method approach requiring that all business combinations be accounted for by the purchase method. The purchase method requires that the cost attributed to the plant and equipment of the acquired entity be “the current replacement cost for similar capacity unless the expected future use of the assets indicates a lower value to the acquiring entity.”

July 2009, the FASB Accounting Standards Codification (ASC) became authoritative for GAAP, and ASC 805-20-30-1 requires acquirers to measure tangible capital assets at the acquisition date fair values, which would be the same as replacement value at acquisition date. Replacement value refers to the amount a similar condition and used asset would cost. The CAS Board notes, however, that FASB Topic 105 – *Generally Accepted Accounting Principles* provides APB

Opinion 16 and FASB Statement No. 141 are considered grandfathered guidance allowing for the continued application of the superseded accounting standards for business combination transactions that have an ongoing effect in an entity's financial statements. As part of the codification, GAAP has also transitioned to the term "acquisition method" rather than "purchase method" for this accounting treatment of business combinations.

Regarding the cost treatment of tangible assets acquired in a business combination accounted for under the purchase method, the Board noted that under CAS 404-50(d)(2) when the acquired company has tangible assets that did not generate depreciation or cost of money allocated to Federal contracts the assets are assigned a portion of the purchase price of the acquired company, not to exceed their fair value. However, under CAS 404-50(d)(1) when the acquired company has tangible assets that generated depreciation or cost of money allocated to Federal contracts, the assets are measured by the acquirer at the net book value. By comparison, for both circumstances, GAAP would require that the assets be measured by the acquirer at fair value. Absent the requirements of CAS 404-50(d)(1) the government would be at risk if an asset was increased in value such that the combined depreciation recognized by the both the acquired company and the acquiring company for government contracts exceeds the historic cost for which the asset was originally purchased for use.

Comment: Three respondents provided comments to this potential difference identified by the Board. All three agreed if CAS 404 was eliminated that this provision should be retained as a procurement Policy in the FAR 31.205-52, as noted by the Board in the SDP. However, all three also urged to the Board that if CAS 404 was eliminated CAS 405 should also be revised to avoid a potential unintended consequence and harm to contractors related to inclusion of unallowable costs in allocation bases.

Response: The Board believes this difference between CAS and GAAP may create an exposure of unknown materiality. The Board agrees with the commenters' observation that risk could be

mitigated by a procurement policy through modification of the FAR. However, the Board has provisionally concluded that the underlying issue relates to the measurement of costs and therefore should be addressed by the Board. For these reasons, the Board is considering a proposed rule that would retain the requirements in CAS 404-50(d)(1) and move them to a new section in 9904.418-50. The retention would also prevent the potential unintended consequence and harm to contractors related to inclusion of unallowable costs in allocation bases raised in the comments. This proposed action would be consistent with the Board's guiding principles to eliminate content from CAS where GAAP, other CAS Standards or other relevant rules may protect the interests of the Government. In addition, the Board provisionally concluded that moving the retained requirement to another Standard rather than maintaining CAS 404 with minimal content would best achieve the goal of streamlining CAS. The Board is seeking comments on such actions in this ANPRM.

III. CAS 411

A. Overview

CAS 411, initially published May 5, 1975 at 40 FR 19425, provides criteria for the accounting for acquisition costs of material used during the course of a contract. CAS 411 also includes provisions on the use of inventory costing methods. The preamble for the original publication of CAS 411 acknowledged that -

Preliminary work on the development of this Standard resulted from the absence of a requirement in agency regulations that the same costing method be used for similar categories of material within the same business unit and that the method be consistently applied.

The principal need for the promulgation of the initial CAS 411 no longer exists. GAAP has been revised significantly with additional content and changes in requirements since the original promulgation of CAS 411 in 1975. The majority of the CAS 411 standard has remained static since the initial promulgation. The standard, however, was corrected in 1992 (57 FR 34167) to make clear that it does not cover accounting for the acquisition costs of tangible capital assets nor accountability for Government-furnished materials.

Furthermore, as explained in greater detail in the response to public comments in subsection b., below, a comparison of CAS 411 with pertinent GAAP content revealed significant overlap and nearly completely equivalent requirements. The Board identified that a comparable requirement existed in GAAP, FAR or other CAS Standard that would protect the Government's interests and promote uniformity and consistency. The alignment is so close as to make CAS 411 nearly duplicative of GAAP. The Board reasoned that where such comparable requirements exist between CAS and GAAP, the CAS 411 requirement could be eliminated.

The Board identified two potential differences between CAS and GAAP that required further consideration. The CAS requires written statements of accounting policies, and uses the terms "moving" and "weighted" average in relation to inventory costing methods, while GAAP simply uses "average". As described below in subsection b, the Board has provisionally concluded that reliance on GAAP would materially achieve uniformity and consistency necessary for Government contracting related to these two differences. In addition, as it relates to written statements of accounting policies, contractors whose activities that would trigger full CAS coverage and have been subject to CAS 411 would still be required to disclose these practices as part of their required CAS Disclosure Statement.

For the reasons stated above, the Board is considering a proposed rule that would eliminate CAS 411 in its entirety. This action would be consistent with the Board's guiding principles for conforming CAS to GAAP because it would eliminate CAS content to minimize

the burden on contractors while protecting the interests of the Federal Government.

Furthermore, the Board's provisional conclusion on CAS 411 would align with the guiding principles to rely on coverage in GAAP when it would materially achieve uniformity and consistency in cost accounting without bias or prejudice to either party, rely on other CAS Standards which may protect the Government's interests, and eliminate CAS coverage no longer necessary.

B. Summary of Public Comments

The Board received four sets of public comments to the SDP. These comments came from industry associations and companies. The Board appreciates the feedback. Responses to specific comments for CAS 411 are as follows:

1. **Written statements of accounting policies and practices.** The Board noted that GAAP does not explicitly require written statements of accounting policies and practices, while CAS 411-40(a) requires written statements of accounting policies and practices for accumulating the costs of material and for allocating costs of material to cost objectives.

Comment: All commenters acknowledged GAAP does not explicitly require a written statement of accounting policies and practices, however approximately 70% of the AIA member companies surveyed and 77% of FEI commercial companies surveyed do in fact have specific written policies and procedures addressing this area. Commenters noted the Board, during the promulgation of CAS 411, had acknowledged that many companies had written policies and practices in place before the CAS 411 requirement existed. Further, companies subject to CAS 411 are also required to submit Disclosure Statements. They also noted that Enterprise Resource Planning (ERP) software systems would be another existing source for written statements of accounting practices related to how the costs of material are accumulated and allocated. ERP software systems are used by contractors to manage their day-to-day business activities related to

material management and accounting for such activity include documented business scripts that document how the system works.

Response: Although GAAP does not explicitly require a written statement for accounting policies and practices for accumulating the costs of material and for allocating costs of material to cost objectives, the Board has provisionally determined that these written statements would continue to exist in the absence of the current explicit CAS requirement. The cumulative requirements that will remain in CAS 401, Disclosure Statements and current practices to comply with GAAP would adequately protect the government's interest absent the expressed requirement to maintain policies and procedures required by CAS.

2. **Average cost method for inventory costing.** The second difference noted by the Board in the SDP related to the average cost method for measuring inventory. CAS provides for the use of the moving average cost method or the weighted average cost method. Both of these methods are explicitly defined in CAS 411-30, including how the cost would be computed under each method. CAS 411-30(a)(6) defines "moving average" as "an inventory costing method under which an average unit cost is computed after each acquisition by adding the cost of the newly acquired units to the cost of the units of inventory on hand and dividing this figure by the new total number of units." CAS 411-40(a)(7) defines "weighted average cost" as "an inventory costing method under which an average unit cost is computed periodically by dividing the sum of the cost of beginning inventory plus the cost of acquisitions by the total number of units included in these two categories." By comparison, GAAP simply provides for the use of an "average" method without defining or describing specific average methods. GAAP does make clear in ASC 330-10-30-9 that "the major objective in selecting a method [for inventory costs] should be to choose the one which, under the circumstances, most clearly reflects periodic income." The Board understood this to mean that the method selected must result in a measurement of costs matched against revenue from a sale. The matching principle between cost and revenue in GAAP is similar to the CAS concept of matching the cost to a contract—

both of which result in periodic income. As a result, although GAAP doesn't explicitly define acceptable average methods, there is some constraint to the variations a contractor could elect to use in compliance with GAAP.

Comment: Commenters noted the Board is correct in that GAAP does not define specific "average" inventory costing methods, however their research of various GAAP pronouncements and discussions with member companies' GAAP accountants failed to uncover an average method beyond weighted average and moving average methods. Additionally, 100% of the AIA and FEI member companies surveyed use either the moving average, weighted average or standard cost method for inventory costing. Furthermore, in today's world, the logic behind inventory valuation methods is built into very expensive ERP systems and is not changed haphazardly. FEI noted that a survey of member companies showed that changes are overwhelmingly driven (i.e. 82%) by either new ERP system implementations/upgrades or organization type transaction activities (e.g. M&A). None of the respondents noted they make changes to ERP systems in order to solely change inventory valuation/costing methods. Commenters also noted that they are not aware of any circumstances where the use of an average method compliant with GAAP would not be acceptable for accounting for government contracts. AIA further noted it was not aware of an average costing method compliant with GAAP beyond the moving average or weighted average methods. In addition, commenters noted that the guiding principles of GAAP align identically with the fundamental requirements of CAS 411, so even if there was another inventory average costing method for GAAP, such method would almost certainly be acceptable for accounting for government contracts. GAAP's guiding principles require the use of a consistently applied inventory method that is rational, reasonable and matches inventory costs with revenues. Identical to GAAP, CAS 411 requires that the inventory costing method chosen must be, "used in a manner which results in systematic and rational costing of issues of material to cost objectives. The same costing method shall, within the same business unit, be used for similar categories of material." (Ref: 9904.411-40(e)).

Commenters view the principles and requirements of GAAP in this area are more restrictive than CAS.

Response: The Board appreciates the efforts of the associations and their members to gather and provide this information and analysis. Based on the comments and additional research conducted by the Board, the Board has not identified any additional “average” inventory costing methods beyond weighted or moving. The Board has provisionally concluded that CAS 411 and the corresponding requirements in GAAP are not materially different. Furthermore, the Board has also provisionally concluded that GAAP, FAR and other Standards may protect the Government’s interests. Therefore, the Board is considering a proposed rule that would eliminate CAS 411 and rely on GAAP to achieve the uniformity and consistency required for Government contracting. This action would be consistent with the Board’s guiding principle to eliminate content from CAS where reliance on GAAP would materially achieve uniformity and consistency in cost accounting without bias or prejudice to either party.

IV. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96–511, does not apply to ANPRM because these actions impose no paperwork burden on offerors, affected contractors and subcontractors, or members of the public requiring the approval of OMB under 44 U.S.C. 3501, et seq.

V. Executive Orders 12866, 13563, 14094 and the Regulatory Flexibility Act

Executive Orders (E.O.s) 12866, 13563, and 14094 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). E.O. 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. The economic impact of the ANPRM is expected to be minor because the affected contractors and subcontractors are those who are already subject to CAS and would

seek to rely more heavily on GAAP, which these contractors are using in their commercial transactions. Accordingly, the ANPRM is not a significant regulatory action and, therefore, are not subject to review under section 6(b) of E.O. 12866, Regulatory Planning and Review, as amended by E.O. 14094, Modernizing Regulatory Review.

List of Subjects in 48 CFR 9904

Government Procurement, Cost Accounting Standards

Christine J. Harada,

Senior Advisor Office of Federal Procurement Policy, and Chair, Cost Accounting Standards Board, performing by delegation the duties of the Administrator for Federal Procurement Policy

For the reasons set forth in the preamble, The Federal Procurement Policy Office proposes to amend 48 CFR part 9904 as set forth below:

PART 9904 – COST ACCOUNTING STANDARDS

1. The authority citation for part 9904 continues to read as follows:

Authority: Pub. L. 100-679, 102 Stat. 4056, 41 U.S.C. 422.

Subpart 9904.404 — [Removed and Reserved]

2. Remove and reserve subpart 9904.404.

Subpart 9904.411 — [Removed and Reserved]

3. Remove and reserve subpart 9904.411.

4. In § 9904.418-50, add paragraph (i) to read as follows:

§ 9904.418-50 Techniques for application.

* * * * *

(i) The capitalized values of tangible capital assets acquired in a business combination shall be assigned to these assets as follows: All the tangible capital assets of the acquired

company that during the most recent cost accounting period prior to a business combination generated either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be capitalized by the buyer at the net book value(s) of the asset(s) as reported by the seller at the time of the transaction.

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