



OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Parts 9903 and 9904

RIN 0348-AB91

Conformance of Cost Accounting Standards to Generally Accepted Accounting Principles for CAS 407 Use of Standard Costs for Direct Material and Direct Labor

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

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (the Board), is releasing this notice of proposed rulemaking (NPRM) to elicit public comments on proposed changes to the Cost Accounting Standards (CAS) to conform CAS 407 to Generally Accepted Accounting Principles (GAAP). The Board is performing the work under case number, CASB 2025-02.

DATES: Comments must be in writing and must be received by [INSERT DATE 30 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 2025-02”. Select the link “Comment

Now” that corresponds with “CASB 2025-02”. Follow the instructions provided on the

“Comment Now” screen. Please include your name, company name (if any), and “CASB 2025-02” 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 or three days after submission to verify posting.

Privacy Act Statement: The Board proposes this 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. 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

Section 820 of the 2017 National Defense Authorization Act modified statutory responsibilities of the Board, codified at 41 U.S.C. 1501(c). These changes require the Board to conform CAS to GAAP, and minimize the burden on contractors while protecting the interests of the Government. This proposed rule is part of an ongoing series of Board actions to reduce the regulatory footprint of CAS for standards that are most suitable for potential conformance to GAAP, as identified in the Board's global roadmap published in March 2019 (84 FR 9143), because they focus primarily on cost measurement and assignment of costs to accounting periods, which is also addressed by GAAP. For additional recent discussion by the Board on the evolution of GAAP to address cost measurement and assignment of costs to accounting periods, see (90 FR 43994). This NPRM is issued by the Board in accordance with the requirements of 41 U.S.C. 1502.

II. CAS 407 – Use of Standard Costs for Direct Material and Direct Labor

A. Overview and Conclusion

Based on the Board's comparison of CAS 407 with pertinent GAAP content, other CAS Standards, and the Federal Acquisition Regulation (FAR), the Board has concluded that there is significant overlap and equivalent requirements. For the vast majority of requirements in CAS 407, comparable requirements exist in GAAP, CAS 401, CAS 418, the CASB Disclosure Statement, FAR 31.201-1 *Composition of total cost*, FAR 31.202 *Direct costs*, and FAR 31.205-26 *Material costs*. These comparable requirements protect the Government's interests and promote the uniformity and consistency that was the basis for promulgating CAS 407 more than 50 years ago, when comparable GAAP coverage did not exist. The Board has concluded that, for the vast majority of the requirements in CAS 407, the Government's interests are adequately protected by relying on disclosed GAAP practices that are consistently followed and subject to notice of changes and cost recovery pursuant to CAS 401 – Consistency in estimating, accumulating, and reporting costs. Specifically, all contractors, whether subject to full or modified CAS coverage, are subject to CAS 401 and will continue to be required to consistently follow their disclosed or actual cost accounting practices. In addition, they will continue to be bound by the 9903.201-4 CAS contract clauses requiring disclosure and consistency in cost accounting practices regardless of whether a specific standard exists. These contract clauses implement the statutory requirements for disclosure of 41 U.S.C. 1502(f)(1), and protections from payment of increased costs as a result of changes to contractors' cost accounting practices provided by 41 U.S.C. 1502(f)(2).

As explained in greater detail below, the Board proposes to retain certain limited requirements (i.e., CAS 407-30(a)(7), CAS 407-40(b), CAS 407-50(a)(4)(i) and (ii), CAS 407-50(d)(1) and (2), CAS 407-50(e), and CAS 407-60(b)). These requirements address standard costs and related variances at the production unit level that are not covered by GAAP. The Board proposes to move these requirements to CAS 418 – Allocation of direct and indirect costs.

This proposal 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 Government. Furthermore, the Board's conclusion to eliminate CAS 407 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 when no longer necessary.

The Board has not identified any instance where the elimination of CAS 407, as contemplated, would result in a change to a contractor's disclosed cost accounting practices for government contracts. With the noted exceptions, the current CAS requirements are nearly identical to GAAP. The Board expects that contractors would continue to follow their existing practices as they are both compliant with CAS and GAAP. As such, having identified no cost accounting practice changes as a result of this proposed rule any current or future changes related to standard costing of direct material or labor and the treatment of variances would be considered unilateral as defined in 9903.201-6(b)(2).

B. Evolution of CAS and GAAP Coverage on Use of Standard Costs for Direct Material and Direct Labor

CAS 407 was initially published April 1, 1974, at 39 FR 11869. The preamble for the original publication of CAS 407 stated that, "[w]ork preliminary to the development of this Cost Accounting Standard was initiated as the result of the recognition that practices concerning the use of standard costs for contract costing purposes have not been well defined in Government procurement regulations." The preamble identified that, "...this standard provides needed criteria which the Board believes will improve cost measurement and will result in more equitable assignment of contract costs." The purpose of CAS 407 is to provide criteria under which standard costs may be used for estimating, accumulating, and reporting costs of direct material

and direct labor; and to provide criteria relating to the establishment of standards, accumulation of standard costs, and accumulation and disposition of variances from standard costs.

The CAS 407 standard has remained static since its initial promulgation, with the exception of being incorporated into the FAR (57 FR 14153, April 17, 1992) and having one of the illustrations corrected for a mathematical discrepancy (57 FR 34167, August 3, 1992). By contrast, GAAP has been revised significantly with additional content and changes in requirements since the original promulgation of CAS 407 in 1974. Additionally, the sophistication of accounting systems to accurately calculate, document, and support the utilization of standard costs has drastically changed since CAS 407 was first promulgated.

C. CAS 407 Compared with GAAP

The Board performed a side-by-side comparison of CAS and GAAP requirements to identify any material differences. The Board assessed unique CAS requirements in order to determine whether they were necessary to protect the Government's interests or whether other existing requirements in CAS Standards or the FAR would adequately protect the interests of the Government.

Fundamental Requirements

The fundamental requirements of CAS 407 allow the use of standard costs for estimating, accumulating, and reporting costs of direct material and direct labor when: standard costs are entered into the books of account; standard costs and related variances are appropriately accounted for at the level of the production unit; and practices with respect to the setting and revising of standards, use of standard costs, and dispositions of variances are stated in writing and are consistently followed. GAAP states that, "standard costs are acceptable if adjusted at reasonable intervals to reflect current conditions so that at the balance-sheet date standard costs reasonably approximate such costs computed under one of the recognized bases" (ASC 330-10-30-12). While companies may elect to use a standard costing approach for operations, any variance between actual costs and standard costs would need to be absorbed to result in the

reporting of actual costs in inventory, subject to the considerations in ASC 330-10-30-3 through 330-10-30-8. ASC 912-330-50-1 requires that a contractor disclose their accounting policies with respect to costs included in inventory.

In addition to the requirements in GAAP, the Board also evaluated other CAS Standards and FAR regulations. The Board identified that the CASB Disclosure Statement requires the disclosure of setting standards, revising standards, and disposing of variances related to standard costs. FAR 31.201-1(a), *Composition of Total Cost* also requires the adjustment of standard costs for applicable variances. For each of the fundamental requirements in CAS 407, with the exception of accounting for standard costs and variances at the level of the production unit, the Board identified that a comparable requirement exists in GAAP, other CAS Standards, or FAR that would protect the Government's interests and promote uniformity and consistency.

Based on the Board's research it concluded that GAAP does not define production unit. CAS 407-30 defines *Production unit* to mean a grouping of activities which either uses homogeneous inputs of direct material and direct labor or yields homogeneous outputs such that the costs or statistics related to these homogeneous inputs or outputs are appropriate as bases for allocating variances. This was in response to comments received and documented in the preambles:

Use of the term production unit. Many commentators expressed a need for a better understanding of the meaning and significance of the term production unit. As defined in 407.30(a)(7), a production unit is a grouping of activities which either uses homogeneous inputs of direct material and direct labor or yields homogeneous outputs. Where a grouping of activities meets either one of these two criteria, it is the proper level at which to accumulate standard costs of direct material and direct labor and to accumulate variances related thereto. Since variances are allocated on the bases of costs and statistics of each production unit, homogeneity of standard costs of direct material and direct labor would assure that data thus accumulated would be appropriate as bases for allocating variances to cost objectives. The concept of homogeneity embodied in the term production unit, then, would permit contractors a degree of flexibility in setting and revising standards based on individual needs and circumstances and still provide for the proper cost assignment of variances. To further clarify the intended meaning and purpose of a production unit, the Board has added an illustration as 407.60(b).

The Board deliberated and concluded that the existing concept of the production unit in CAS 407 is required and therefore the definition at 407-30(a)(7), the fundamental requirement at 407-40(b), and the illustration at 407-60(b) should be retained.

Techniques for Application

The techniques for application of CAS 407 require the documentation of the criteria for setting and revising standards, details on calculating and allocating standard costs and the associated variances, and memorandum worksheet adjustments. GAAP directly addresses accounting policies with respect to inventory in ASC 912-330-50-1. GAAP requires that the contractor's basis of stating inventories be consistently applied and disclosed as well as disclosure of any change in valuation (ASC 330-10-35-20 and ASC 330-10-50-1). GAAP recognizes that practices vary in determining costs of inventory but ultimately requires consistency and disclosure (ASC 270-10-45-6.d and ASC 330-10-30-12). As discussed above, GAAP does not define production unit and therefore the techniques related to production units in CAS 407-50 do not have comparable GAAP requirements. On this basis, the Board concluded that CAS 407-50(a)(4)(i) and (ii), CAS 407-50(d)(1) and (2), and CAS 407-50(e) should be retained.

In addition to the requirements in GAAP, the Board also evaluated other CAS Standards and FAR regulations. The Board identified that the CASB Disclosure Statement requires disclosure of setting standards, revising standards, and disposing of variances related to standard costs. The CASB Disclosure Statement also includes the level of production unit to accumulate variances. CAS 402-50(e) states, "Any direct cost of minor dollar amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives, provided that such treatment produces results which are substantially the same as the results which would have been obtained if such cost had been treated as a direct cost." This addresses the CAS 407 techniques related to immaterial variances and is also consistent with FAR 31.202(b) which states, "For reasons of practicality,

the contractor may treat any direct cost of a minor dollar amount as an indirect cost if the accounting treatment (1) is consistently applied to all final cost objectives; and (2) produces substantially the same results as treating the cost as a direct cost.” The Board also evaluated the requirements in CAS 418 – Allocation of direct and indirect costs and identified coverage in this Standard related to standard costs.

III. Expected Impact of the Rule

The proposed rule is deregulatory in furtherance of 41 U.S.C. 1501(c), which requires the Board ensure that the Cost Accounting Standards used by contractors rely, to the maximum extent practicable, on commercial standards and accounting practices and systems. In addition, 41 U.S.C. 1501(c) requires the Board to conform CAS requirements, where practicable, to GAAP. The proposed rule would eliminate 12 of the 16 individual requirements contained in CAS 407, retaining only the minimal content the Board has identified as needed to protect the Government’s interest by moving it to another standard. This will eliminate the need for a separate CAS addressing standard costs for direct material and direct labor. The proposed rule would result in the removal of over 2,000 words of unnecessary regulatory text currently in place in this standard. Reliance on a contractor’s disclosed GAAP practices for CAS purposes significantly reduces the regulatory footprint associated with CAS and places reliance on commercial accounting practices under GAAP consistent with 41 U.S.C. 1501(c). These changes, if finalized as proposed, are expected to reduce burden for contractors, external auditors, government auditors, and oversight functions by reducing duplicative compliance requirements.

These changes individually and in conjunction with the Board’s ongoing broader CAS-GAAP conformance efforts and modernization of the CAS programmatic requirements are expected to simplify CAS administration and reduce barriers to entry for non-traditional contractors including new mid-size entities who no longer qualify as small businesses. These actions should increase competition in federal contracting, as envisioned by the Senate Armed

Services Committee in promoting CAS-GAAP conformance (S. Rept. 114-25 Section 811), “The committee is concerned that the current cost accounting standards favor incumbent defense contractors and limit competition by serving as a barrier to participation by non-traditional, small business, and commercial contractors. To level the competitive playing field to access new sources of innovation it is in the government’s interest to adopt more commercial ways of contracting, accounting, and oversight.”

The Board is interested in comments on the expected impact of this rule, including any quantified estimates on the cost reductions and savings expected to be achieved by the proposed elimination of CAS 407.

IV. Regulatory Flexibility Act

CAS Board rules do not impact small entities within the meaning of the Regulatory Flexibility Act 5 U.S.C. 601-612. Contracts and subcontracts with small business concerns are exempted from all CAS requirements.

V. Executive Orders 12866, 13563, and 14192

Executive Orders (E.O.s) 12866 and 13563 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. This is a significant regulatory action under section 3(f) of E.O. 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is anticipated to be a deregulatory action under E.O. 14192 based on the discussion in the “Expected Impact of the Rule” section.

VI. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96–511, does not apply to this proposed rule because this rule imposes no paperwork burden on offerors, affected contractors and

subcontractors, or members of the public that requires the approval of OMB under 44 U.S.C. 3501, et seq.

List of Subjects in 48 CFR Parts 9903 and 9904

Cost accounting standards, Government procurement.

Kevin R. Rhodes,

Administrator,

Office of Federal Procurement Policy, and Chair, Cost Accounting Standards Board.

For the reasons set forth in the preamble, the Office of Federal Procurement Policy proposes to amend chapter 99 of title 48 of the Code of Federal Regulations as set forth below:

PART 9903 – CONTRACT COVERAGE

1. The authority citation for part 9903 continues to read as follows:

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

Subpart 9903.301 – [Amended]

2. In § 9903.301(a), edit the following definitions to read as follows:

Actual cost. See 9904.401-30.

Production unit. See 9904-418-30.

3. In § 9903.301(a), remove the following definitions:

Labor cost at standard.

Labor-rate standard.

Labor-time standard.

Material cost at standard.

Material-price standard.

Material-quantity standard.

Standard cost.

Variance.

PART 9904 – COST ACCOUNTING STANDARDS

4. 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 9904.407 — [Removed and Reserved]

5. Remove and reserve subpart 9904.407.

Subpart 9904.418 [Amended]

6. In § 9904.418-30, add subparagraph (a)(5) to read as follows:

§ 9904.418-30 Definitions.

* * * * *

(a)(5) *Production unit* means a grouping of activities which either uses homogeneous inputs of direct material and direct labor or yields homogeneous outputs such that the costs or statistics related to these homogeneous inputs or outputs are appropriate as bases for allocating variances.

Subpart 9904.418 [Amended]

7. In § 9904.418-50, edit paragraph (a)(2)(i) to read as follows:

§ 9904.418-50 Techniques for application.

* * * * *

(i) Standard costs may be used for estimating, accumulating, and reporting costs of direct material and direct labor only when standard costs and related variances are appropriately accounted for at the level of the production unit and paragraph (h) of this subsection; or

Subpart 9904.418 [Amended]

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

§ 9904.418-50 Techniques for application.

* * * * *

(h) *Standard costing.*

(1) A labor-rate standard may be set to cover a group of direct labor workers who perform disparate functions only under either one of the following conditions:

(i) Where that group of workers all work in a single production unit yielding homogeneous outputs (in this case, the same labor-rate standard shall be applied to each worker in that group).

(ii) Where that group of workers, in the performance of their respective functions, forms an integral team (in this case, a labor-rate standard shall be set for each integral team).

(2) A contractor's established practice with respect to the disposition of variances accumulated by production unit shall be in accordance with one of the following subparagraphs:

(i) Variances are allocated to cost objectives (including ending in-process inventory) at least annually. Where a variance related to material is allocated, the allocation shall be on the basis of the material cost at standard, or, where outputs are homogeneous, on the basis of units of output. Similarly, where a variance related to labor is allocated, the allocation shall be on the basis of the labor cost at standard or labor hours at standard or, where outputs are homogeneous, on the basis of units of output; or

(ii) Variances which are immaterial may be included in appropriate indirect cost pools for allocation to applicable cost objectives.

(3) Where variances applicable to covered contracts are allocated by memorandum worksheet adjustments rather than in the books of account, the bases used for adjustment shall be in accordance with those stated in paragraph (h) of this subsection.

Subpart 9904.418 [Amended]

9. In § 9904.418-60, add paragraph (j) to read as follows:

§ 9904.418-60 Illustrations.

* * * * *

(j) Contractor J accumulates, in one account, labor cost at standard for a department in which several categories of direct labor of disparate functions, in different combinations, are used in the manufacture of various dissimilar outputs of the department. Contractor J's department is not a production unit as defined in 9904.418-30(a)(5) of this Cost Accounting Standard. Modifying its

practice so as to comply with the definition of production unit in 9904.418-30(a)(5), it could accumulate the standard costs and variances separately,

- (1) For each of the several categories of direct labor, or
- (2) For each of several subdepartments, with homogeneous output for each of the subdepartments.

[FR Doc. 2026-05512 Filed: 3/19/2026 8:45 am; Publication Date: 3/20/2026]