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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: Final rule.

SUMMARY: The Office of Management and Budget (OMB), Cost Accounting Standards Board (the Board), is publishing a final rule rescinding Cost Accounting Standard (CAS) 407 to conform it with Generally Accepted Accounting Principles (GAAP). One definition is transferred to a different location within chapter 99 of title 48, Code of Federal Regulations. This final rule follows issuance of a Notice of Proposed Rulemaking (NPRM) (91 FR 13562).

DATES: Effective date: [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

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SUPPLEMENTARY INFORMATION:

I. Background

On March 20, 2026, the Board published a NPRM to solicit views on the Board's provisional conclusions regarding conformance of CAS 407 to GAAP. See the NPRM for background on the purpose of CAS 407. The NPRM noted that the vast majority of CAS 407 could be rescinded. The Board determined that despite the difference in general focus between CAS and GAAP, there has been significant convergence over the years as GAAP has evolved to address cost measurement and assignment of costs to accounting periods. GAAP now contains codified content in these areas very similar to the requirements contained in CAS 407. In addition, the creation of the Financial Accounting Standards Board (FASB) and the Accounting Standards Codification (ASC) as the recognized financial accounting and reporting standards for GAAP fosters increased uniformity and consistency. The FASB is recognized today by the U.S. Securities and Exchange Commission as the designated accounting standard setter for public companies. FASB standards are also recognized as authoritative by many other organizations, including State Boards of Accountancy and the American Institute of Certified Public Accountants (AICPA). The Board concluded that these developments have created opportunities to amend or rescind overlapping CAS requirements where GAAP standards under ASC may be applied as a reasonable substitute for CAS to support contract cost and pricing.

The Board concluded that nearly all of the content in CAS 407 has become unnecessary because the Government interests addressed by that content are adequately protected through reliance on GAAP, and existing requirements in other CAS standards. Due to the minimal amount of content identified for retention, the Board concluded that moving the retained requirements to another standard rather than maintaining CAS 407 with minimal content would best achieve the goal of streamlining CAS. This final rule reflects input from the public, as well as research conducted by the Board. This action complies with applicable requirements of 41 U.S.C. 1502 and furthers the Board’s performance of its duties under 41 U.S.C. 1501(c), which requires, among other things, that the Board: (1) ensure that the cost accounting standards used by Federal contractors rely, to the maximum extent practicable, on commercial standards and accounting practices and systems; and (2) conform CAS, where practicable, to GAAP.

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

A. Overview and Conclusion

As noted in the NPRM, the Board’s comparison of CAS 407 with pertinent GAAP content, other CAS Standards, and the Federal Acquisition Regulation (FAR) revealed significant overlaps and equivalent requirements. 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, with the exception of 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)), 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. 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 contractor's cost accounting practices provided by 41 U.S.C. 1502(f)(2). The limited requirements that are being retained address standard costs and related variances at the production unit level which are not currently covered by GAAP. The Board has concluded to move these requirements to CAS 418 – Allocation of direct and indirect costs.

This action is 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, rescinding CAS 407 aligns 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 rescind CAS coverage no longer necessary.

As noted in the NPRM the Board did not identify any instance where the rescinding of CAS 407 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 final 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). As discussed further in the "Summary of Public Comments" section below, respondents did not identify any instances or issues requiring further consideration by the Board regarding this determination.

B. Summary of Public Comments

The Board received three sets of public comments to the NPRM; two from industry associations and one from a consulting firm. All commentors agreed with the provisional decision to rescind CAS 407 and were supportive of the Board's progress with CAS to GAAP conformance. Specific comments and discussion are detailed below.

Comment: One commentor believes the Board has not gone far in enough in conformance because it proposes to retain certain limited requirements around the concept of the production unit. However, the other two commentors concur with the Board's conclusion that GAAP does not address the concept of the production unit and agree with the Board's decision to retain these requirements in CAS 418.

Response: The Board considered all current GAAP requirements and concluded that full adoption of GAAP does not provide adequate protection of the Government's interest. Retaining the requirements for accounting at the production unit level is necessary to ensure homogeneity while still providing contractors flexibility in setting and revising direct material and/or direct labor standards based on individual needs and circumstances. The Board, therefore, has not adopted the suggestion to rescind 407 in its entirety.

Comment: One commentor expressed concern that the Board appears to be expanding the "disclosure and consistency in cost accounting practices" to all GAAP accounting practices. The example given by the commentor was a contractor changing its inventory practices from first-in-first-out (FIFO) to last-in-first-out (LIFO).

Response: As noted in the NPRM, the Board is streamlining CAS 407 where reliance on existing standards and GAAP provides adequate protection of the Government's interests. A change from FIFO to LIFO would need to be disclosed by the contractor as this is a requirement for the Disclosure Statement (CASB DS-1) section 2.2.2. Furthermore, 41 U.S.C. 1502(f)(1) covers the disclosure in writing of all cost accounting practices, including methods of distinguishing direct costs from indirect costs and the basis used for allocating indirect costs. The Board is not expanding the disclosure requirement, but simply highlighting that these disclosures are already required under 41 U.S.C. 1502(f)(1).

Comment: One commentor suggested that the elimination of CAS 407 could result in a change to a contractor's disclosed cost accounting practice since GAAP allows for additional methodologies not prescribed under CAS 407 and believes that these changes should be deemed "required" or "desirable" under CAS 9903.201-6.

Response: While GAAP may allow for additional methodologies, all currently compliant CAS 407 practices are also currently compliant with GAAP and therefore, 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). The Board, therefore, rejects the suggestion that any change should be deemed required or desirable.

III. Expected Impact of the Rule

This final 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 eliminate or conform CAS requirements, where practicable, to GAAP. This final rule eliminates 12 of the 16 individual requirements contained in CAS 407, retaining only the minimal content the Board identified as needed to protect the Government's interest by moving it to another standard. This eliminates the need for a separate CAS standard addressing standard costs for direct material and direct labor. This final rule will result in the removal of almost 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, as finalized, 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 to 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.

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 E.O. 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. OMB's Office of Information and Regulatory Affairs (OIRA) has determined that this is a significant regulatory action under section 3(f) of E.O. 12866, Regulatory Planning and Review, dated September 30, 1993, and OIRA has reviewed this rule under E.O. 12866. This rule is 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 final 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 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 Management and Budget is amending 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: Public Law 111-350, 124 Stat. 3677, 41 U.S.C. 1502.

Subpart 9903.3–CAS Rules and Regulations

2. In § 9903.301(a):

a. Revise the definition for "Actual cost";

b. Remove the definitions for "Labor cost at standard", "Labor-rate standard", "Labor-time standard", "Material cost at standard", "Material-price standard" and "Material-quantity standard";

c. Revise the definition for "Production unit"; and

d. Remove the definitions for "Standard cost" and "Variance".

The revisions read as follows:

9903.301 Definitions.

(a) * * *

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Actual cost. See 9904.401-30.

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Production unit. See 9904-418-30.

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PART 9904--COST ACCOUNTING STANDARDS

3. 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]

4. Remove and reserve subpart 9904.407.

Subpart 9904.418 Allocation of direct and indirect costs.

5. In § 9904.418-30, add paragraph (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.

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6. In § 9904.418-50:

a. Revise paragraph (a)(2)(i); and

b. Add paragraph (h).

The revision and addition read as follows:

§ 9904.418-50 Techniques for application.

(a) * * *

(2) * * *

(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 section; or

* * * * *

(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 the conditions in either paragraph (h)(1)(i) or (ii) of this section:

(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 paragraph (h)(2)(i) or (ii) of this section:

(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 this paragraph (h).

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

§ 9904.418-60 Illustrations.

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(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.

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