COMMITTEE ON GOVERNMENT BUSINESS

04 January 2021

Cost Accounting Standards Board
ATTN: Mr. Mathew Blum
Office of Federal Procurement Policy
725 17th Street NW
Washington, DC 20503

Submitted via email to: CASB@omb.eop.gov

Subject: Financial Executives International Committee on Government Business Comments on Cost Accounting Standards Board Advance Notice of Proposed Rulemaking Conformance of the Cost Accounting Standards to Generally Accepted Accounting Principles for Operating Revenue and Lease Accounting

Reference: CASB Case Number 2020-02

Mr. Blum:

I am pleased to offer the following comments on the Advanced Notice of Proposed Rulemaking: Conformance of the Cost Accounting Standards to Generally Accepted Accounting Principles for Operating Revenue and Lease Accounting. (*Federal Register* notice dated November 05, 2020 - 85 FR 70572) on behalf of the Financial Executives International – Committee on Government Business ("FEI-CGB"). FEI is a professional association representing the interests of more than 10,000 chief financial officers, treasurers, controllers, tax directors and other senior financial executives from major companies throughout the United States. FEI represents both the providers and users of financial information. CGB formulates policy opinions on government contracting issues for FEI in line with the views of the membership.

FEI-CGB reviewed the Advanced Notice of Proposed Rule-Making prepared in response to the National Defense Authorization Act of FY2017 (Pub. L. 114–328, 130 Stat. 2273) which amended 41 U.S.C. 1501(c)(2) to require the Board to review CAS and conform them, to the extent practicable, to GAAP. CAS was designed to achieve uniformity and consistency in determining costs on US Government contracts.

CAS focuses on the measurement, assignment and allocation of cost at the contract level. GAAP is a common set of accounting pronouncements that prescribe how financial statements are prepared, including recognition, measurement, presentation and disclosure. The purpose of GAAP is to provide a conceptual framework and acceptable accounting methods and practices for financial reporting.

Given that there is some overlap in membership between the FEI-CGB and the Aerospace Industries Association ("AIA") Cost Principles Committee ("CPC") and many of the (31) survey responses came from members of both committees, the FEI-CGB endorses the technical content of AIA's comments to the referenced Advanced Notice of Proposed Rule-Making related to CASB Case Number 2020-02. Specifically, FEI-CGB agrees with AIA's comments presented in the enclosure to the AIA letter, and thus incorporates below that enclosure in this letter.

On the surface, the initiative to streamline the US Government procurement process by shifting reliance for Government cost accounting from CAS to GAAP makes sense. Specifically, all public companies and nonprofit organizations are already required to prepare financial statements based on GAAP. Accordingly, using GAAP to govern Government contract cost accounting would eliminate the administrative effort needed to maintain an additional "set of CAS books" (i.e., the CAS specific entries) to meet CAS requirements. However, the FEI-CGB strongly believes that any significant potential benefit from the conformance of CAS to GAAP will be achieved only if (i) compliance is based solely upon GAAP requirements and (ii) compliance determinations reflect the results of reviews performed by the individual company's outside audit firms who have both the proficiency and practical experience to determine compliance with GAAP.

Leveraging existing GAAP regulations has the potential to eliminate time and expense for the US Government (i.e., the CASB, Government audit agencies, and Government contracting officers) and contractor support for CAS audits (e.g., Government requested briefings and data for reviews and testing). GAAP coverage has increased significantly over the years to the point where the CAS and GAAP concepts are much the same in many respects. The alignment of CAS with GAAP, where appropriate, would provide standardization of costing for Government contractors and help minimize allowable administrative costs charged to Government contracts. There would be fewer adjustments required to match financial statements with CAS contract requirements. This would also provide a more understandable contracting environment for companies considering doing business with the Federal Government.

If you wish to engage with the FEI-CGB on this matter, we would be amenable to meeting with you at your convenience. Please contact Ms. Marisa Peacock at the FEI office in Morristown, NJ by phone at (973) 765-1007 or email at mpeacock@financialexecutives.org for arrangements.

Thank you for your consideration in this matter.

Respectfully,

Mr. Mark A. Smith
Chairman, Financial Executives International – Committee on Government Business

Andrej Suskavcevic
President & CEO, Financial Executives International

Distribution: Laurie Schmidgall – Vice Chair, FEI-CGB
Marisa Peacock – Manager, Technical Activities, FEI

AIA Response to CASB Case Number 2020-02, Cost Accounting Standards Board Advance Notice of Proposed Rulemaking Conformance of the Cost Accounting Standards to Generally Accepted Accounting Principles for Operating Revenue and Lease Accounting

Contents

(1) Views on the Analysis of Operating Revenue and the Board's Recommendations

AIA agrees with relying on the definition of operating revenue that conforms to Generally Accepted Accounting Principles (GAAP). Public companies receive audits of their financial statements, which includes revenue recognition under GAAP. This audit of public companies provides for assurance from an independent third party that revenue recognition practices and policies under GAAP are materially correct. While some private companies do not receive an audit, the use of GAAP standards and availability of public company disclosures, provides significantly more guidance than the existing CAS requirements.

AIA also believes that the GAAP requirements for operating revenue already addresses the Board's concerns with respect to GOCO arrangements. We support this position below in addition to addressing the Board's request for public comments surrounding the impact of potential cost accounting practice changes associated with CAS-GAAP conformance.

GAAP Criteria for Principal vs. Agent Considerations Sufficiently Addresses GOCOs

AIA believes that the Board's desire to retain the CAS 403 criterion regarding only utilizing the *"fee for management contracts under which the contractor essentially acts as an agent of the Government in the erection or operation of Government-owned facilities"* is unnecessary. AIA believes this scenario is adequately addressed by relying upon the GAAP criteria for defining revenue (which requires recognizing only the fee as revenue in an agent relationship).

Specifically addressing the Board's concern with respect to the agency relationship of GOCOs, ASC Topic 606 requires an entity to determine whether it controls the goods or services being provided to the GOCO before those goods or services are transferred to the GOCO to determine if the entity is a principal or agent in the delivery of goods or services. Control is determined based on whether the entity is the primary obligor, has inventory risk, or has latitude in establishing the price for the goods and services ultimately delivered to the GOCO. The existing CAS definition of operating revenue includes the clause, *"the contractor essentially acts as an agent of the Government in the erection or operation of Government-owned facilities."* If an entity is essentially acting as an agent to earn a management fee from a GOCO, then an entity is likely to conclude that it does not control the goods or services before transfer to the GOCO, and the GAAP and current CAS definition of revenue should already be in alignment. Additionally, GAAP revenue recognition guidance under ASC Topic 606 only applies to contracts with a customer. If an entity has an investment in a GOCO and a management fee is earned as part of that investment, then other US GAAP may be applicable, such as ASC Topic 610 *Other Income* or ASC Topic 323 *Investments-Equity Method and Joint Ventures*. The recognition of management fees under these other topics may result in income recognition consistent with an agency relationship.

Based upon ASC Topic 606 having sufficient criteria for determining an agency relationship and its applicability to the GOCO scenario mentioned in CAS 403, AIA recommends that the Board fully rely upon the GAAP criteria for determining revenue. Therefore, we recommend that the Board make an additional revision to CAS 403-50(c)(1)(ii) to delete language in the following sentence as being redundant and unnecessary, *"For this purpose, the method used for determining operating revenue for financial accounting shall be used ~~except that it includes only the fee for management contracts under which the contractor essentially acts as an agent of the Government in the erection or operation of Government-owned facilities.~~"*

AIA believes it important to point out that even with the perceived alignment (with respect to GOCOs) of the GAAP requirements and the CAS definition for operating revenue, that GOCOs continue to have unique emphasis relative to ensuring allocations are causal/beneficial under CAS 403-50(d)(2). Aligning CAS with GAAP with respect to this circumstance does not preclude the contractor and the government from entering into a special allocation agreement if it is deemed appropriate.

Cost Accounting Practice Change Considerations – Conformance of Operating Revenue to ASC 606

With the assumption the subject conformance could create a cost accounting practice change, AIA contends that it is a "required change" as defined under CAS 9903.201-6(a)(2), which reads in part:

(2) Required change means a change in cost accounting practice that a contractor is required to make in order to comply with applicable Standards, modifications, or interpretations thereto...

The Board's conformance of CAS to GAAP by eliminating or changing requirements in CAS, which causes reliance on GAAP for government contract accounting is considered effectively a "modification" of CAS, and therefore, meets the definition of a required change.

AIA's opinion of course spans beyond the conformance of the CAS definition of operating revenue to GAAP, but to any conformance of CAS standards to GAAP recently proposed under Section 820 of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2017 including any future proposals. We note that proposals reviewed thus far (e.g., CAS 404, 408, 409 and 411) all have a significant amount of alignment occurring and overlapping requirements between CAS and GAAP. Therefore, we anticipate that any general dollar magnitude impacts (GDMs) associated with all potential cost accounting practice changes with respect to these proposals should not have a significant impact to either the government or contractors. However, the administrative burden of preparing and adjudicating "required change" GDMs would likely be significant and undesirable to both parties. Therefore, in order to efficiently and effectively address cost accounting practice changes where a "required change" results from CAS-GAAP conformance, we recommend that an alternative exemption from this administrative process be allowed. Specifically, we recommend that 48 CFR 9903.201-8 be modified as follows (see italics):

“9903.201-8 Compliant accounting changes due to external restructuring activities *and CAS-GAAP Conformance*.

The contract price and cost adjustment requirements of this part 9903 are not applicable to compliant cost accounting practice changes directly associated with

a. External restructuring activities that are subject to and meet the requirements of 10 U.S.C. 2325.

b. Conformance of Cost Accounting Standards to Generally Accepted Accounting Principles.

AIA believes that this modification will serve to streamline this process for both the government and contractors as the Board continues to propose conformance initiatives in accordance with Section 820 of the FY17 NDAA (or any other future initiatives).

(2) Views on the Analysis of Lease Accounting and the Board's Recommendations

AIA generally agrees with the Board's proposal to clarify that under the CAS, property that was formerly classified as operating leases and are now identified as right-of-use assets should be excluded from treatment as intangible capital assets and tangible capital assets. However, the proposed changes to various definitions within CAS may still be too ambiguous to achieve the desired goal of the Board. The Board proposes that definitions found in 9904.403-30(a)(5), 9904.404-30(a)(4), 9904.409-30(a)(3), 9904.414-30(a)(4), 9904.414-30(a)(5), 9904.417-30(a)(1) and 9904.417-30(a)(1) be amended to specifically exclude right-of-use assets from the definitions. AIA proposes the revised language to be more specific to read:

> *It includes assets classified as finance leases for financial accounting purposes and excludes those right-of-use assets that were formerly known as operating leases.*

The CAS Board also proposes the direction contained in the Appendix A to CAS 414 be revised to clarify the exclusion of right-of-use assets from the items reported on the form. AIA agrees with the need but believes that the directions should be more specific and aligned with the proposed revisions to the definitions identified above. AIA recommends that the amended verbiage should read:

> *Leases classified as right-of-use assets for financial accounting purposes that were formerly known as operating leases, are excluded from facilities capital items reported on this form.*

As stated above, AIA agrees with the Board that the clarifications within the definitions are necessary but believes the proposed changes as written will not achieve the desired goal as proposed.