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January 2, 2021

Mr. Mathew Blum

Office of Federal Procurement Policy

725 17th Street NW,

Washington, DC

20503

Re: CASB 2020–02

Advanced Notice of Proposed Rulemaking

Conformance of the Cost Accounting Standards

to Generally Accepted Accounting Principles for

Operating Revenue and Lease Accounting

Dear Mr. Blum,

This letter provides comments in response to the subject Advanced Notice of Proposed Rulemaking (ANPRM) published in the Federal Register November 5, 2020. The proposed rule discusses potential changes to the definition of “operating revenue” and the treatment of certain leases. I understand that, in promulgating the ANPRM, the CAS Board is implementing the direction of Congress as provided by Section 820 of Public Law 114-328, which directed the CAS Board to conform CAS to GAAP to the maximum extent practicable.

Apogee Consulting, Inc., is a boutique consultancy focused on the administrative needs of government contractors. Our clientele includes both large and small contractors, selling to diverse Federal agencies including the Department of Defense, the Department of Energy, and the Federal Transportation Administration.

That being said, I provide these comments as an individual. My opinions are my own and do not reflect those of any client or other entity.

1.

Operating Revenue

The Board proposes “to rely on a definition of operating revenue that is more closely aligned to GAAP.” In doing so, the Board further proposes to modify the GAAP definition to be inserted at 9904.403-50(c)(1)(2) so as to restrict the calculation of operating revenue to only fee earned “for management contracts under which the contractor essentially acts as an agent of the Government in the erection or operation of Government-owned facilities.” The rationale provided for this limitation is that “government-owned, contractor operated (GOCO) facilities ‘receive little or no benefits from home office activities’; and, without the limitation to fee, some contractors would be ‘forced to make greater allocations to GOCO’s than would be reimbursed to them under the terms of some GOCO contracts.’”

I appreciate the Board’s concerns in this area, and I agree that contractors should not be “forced” to allocate home office costs for which they will not receive reimbursement. That being said, the modification of the GAAP definition of “operating revenue” with respect to CAS 403-50(c) is unnecessary. The existing Cost Accounting Standards and regulations have sufficient flexibility to accommodate the GAAP definition—without modification—while protecting the contracting parties from having to make excess home office allocations to certain segments.

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Residual expenses are those home office expenses that are not otherwise allocable to segments. If a beneficial or causal relationship between home office expenses and segments could be established, then such expenses already would have been allocated to segments either directly to the segment, pursuant to 403-40(a)(1), or via an allocation base specified by 403-40(b)(1) – (b)(5). These home office allocations correspond to a contractor’s Disclosure Statement (CASB DS-1) at Part VIII, 8.3.1 (“Directly Allocated”) and 8.3.2 (“Homogeneous Expense Pools”). Thus, by definition, residual expenses are those home office expenses that are not susceptible to being allocated on a beneficial or causal basis; if they could be so allocated, then CAS 403-4(a)(1) requires that they must be. Consequently, the notion that some GOCO segments would receive excess allocations, based on a beneficial analysis of those allocations, seems to be contradicted by the very definition of residual home office expenses.

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Standard 403 already protects the Government from home office allocations where a segment receives little or no benefit from a particular home office function or activity.

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403-50(a)(2) states that “Where the expense of a given function is to be allocated by means of a particular allocation base, all segments shall be included in the base unless … [a]ny excluded segment did not receive significant benefits from, or contribute significantly to the cause of the expense to be allocated …”

2.

403-40(c)(3) states that “Where a particular segment receives significantly more or less benefit from residual expenses than would be reflected by the allocation of such expenses pursuant to paragraph (c) (1) or (2) of this subsection … the Government and the contractor may agree to a special allocation of residual expenses to such segment commensurate with the benefits received.”

3.

403-50(d) establishes rules for determining when a segment has received significantly less benefit in relation to other segments. In particular, 403-50(d)(2) identifies segments that may require special allocation as being “foreign subsidiaries, *GOCO's*, domestic subsidiaries with less than a majority ownership, and joint ventures.” (Emphasis added.)

Therefore, the notion that contractors would be “forced to make greater allocations to GOCO’s than would be reimbursed to them under the terms of some GOCO contracts” seems to be unfounded. To the extent that a GOCO (or other segment) received less benefit from a home office activity or function than would be commensurate with the normal allocation of residual home office expenses, the contractor and the government should agree on a special allocation, as provided by 403-40(c)(3).

In addition to the foregoing, I note that the issue of excess residual home office allocations has been exacerbated by the Board’s failure to modify the thresholds at which the three-factor allocation formula found at 403-50(c) must be used. If the thresholds had been raised—for

example, to take into account the impact of cumulative inflation experienced since original promulgation in 1972, which has been estimated to be more than 600 percent—then fewer contractors would be forced to use the three-factor allocation formula found at 403-50(c)(1), which includes the current definition of "operating revenue." Thus, one simple fix to address the Board's concern with potentially excessive residual home office allocations is to raise the 403-40(c)(2) thresholds to levels more appropriate for the twenty-first century.

2. **Should changes to cost accounting practices to conform Operating Revenue to ASC 606 be considered to be a required change, a unilateral change, or desirable change?**

In the ANPRM, the Board stated "The Board believes that the definition in GAAP is essentially equivalent to the CAS definition…." If the two definitions are essentially equivalent, it is difficult to envision what changes to contractor cost accounting practice might flow from the revision of the definition of Operating Revenue in Standard 403.

The Board may be asking a broader question—*i.e.*, will any contractor changes to cost accounting practice made as a result of conforming CAS and GAAP be required changes, unilateral changes, or desirable changes? If that is the question, I suggest it should be the subject of a separate Staff Discussion Paper. It is not clear why the Board would be asking such far-reaching questions in an ANPRM, rather than in an SDP. Nonetheless, I will attempt to respond to the question.

As a threshold matter, the Board should be aware that the CAS contract clauses found in 9903.201-4 (dated JUL 2011) appear to be obsolete when compared to the FAR contract clauses 52.230-2 through 52.230-5 (dated JUN 2020). This is based on a comparison of the clauses found at www.acquisition.gov , which is the official regulatory repository for the U.S. Government. This is an issue that the Board may wish to address in a future rule-making action.

To address the Board's question, when a contractor changes a cost accounting practice solely because of changes to GAAP requirements (absent any changes to a Standard), that would seem to be a unilateral change (*i.e.*, "a change in cost accounting practice from one compliant practice to another compliant practice that a contractor with a CAS-covered contract(s) elects to make that has not been deemed desirable by the cognizant Federal agency official and for which the Government will pay no aggregate increased costs.") I believe this is the case because a required change is defined as "a change in cost accounting practice that a contractor is required to make in order to comply with applicable Standards, modifications, or

interpretations thereto," or "a prospective change to a disclosed or established cost accounting practice when the cognizant Federal agency official determines that the former practice was in compliance with applicable CAS and the change is necessary for the contractor to remain in compliance [with CAS]." Since CAS is not changing— *i.e.*, there is no change to an applicable Standard or interpretation thereto—then it seems clear that any change in cost accounting practice solely driven by changes in GAAP requirements do not meet the definition of a required change. They must therefore be unilateral changes.

Some unilateral changes may be found to be desirable changes (*i.e.*, "a compliant change to a contractor's established or disclosed cost accounting practices that the cognizant Federal agency official finds is desirable and not detrimental to the Government and is therefore not subject to the no increased cost prohibition provisions of CAS-covered contracts affected by the change.") But the determination and finding that a unilateral change is a desirable change is solely within the discretion of the cognizant Federal agency official and is to be decided based on the individual facts and circumstances of the change. The Board need not provide any further direction.

There are two use cases where the Board's question poses a challenge. First, when conformance with GAAP results in a change or modification to an existing Standard that compels a contractor to then make a change in cost accounting practice. Second, when conformance with GAAP results in an elimination of a Standard, such that a contractor must now comply solely with GAAP—and that situation compels a contractor to then make a change in cost accounting practice. The second case seems probable if CASB Case 20-001 (the SDP regarding potential elimination of Standard 404 and/or 411) results in the elimination of one Standard or both.

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In the first case, the requirements of an existing Standard have been modified. Therefore, any contractor change in cost accounting practice that becomes necessary in order to comply with the modified Standard would seem to meet the definition of a required change. Consequently, the parties would need to negotiate an equitable adjustment as required by 9903.201-4(a)(4) and the contract's Changes clause.

b. In the second case, there is no modification to an existing Standard; indeed, a Standard will be eliminated in its entirety. If the contractor must now change a cost accounting practice in order to comply with GAAP, then it follows that it was the requirements of the original Standard that compelled the contractor's original cost accounting practice. In other words, the original cost accounting practice was required to comply with CAS. With the elimination of the Standard, the contractor must now comply with GAAP. (*See* 48 CFR 31.201-2(a): "A cost is allowable only when the cost complies with all of the following requirements … (3) Standards promulgated by the CAS Board, if applicable, *otherwise, generally accepted accounting principles and practices appropriate to the circumstances* ."") (Emphasis added.)

The elimination of a Standard that compels a contractor to make a change to cost accounting practice in order to comply with GAAP would seem to be a required change. Although the change in this use case does not meet the exact regulatory definition of "required change," it was the contractor's *original* cost accounting practice that was required to comply with the Standard. The requirements of the Standard distorted what the contractor's cost accounting practice would otherwise have been. Therefore, if the elimination of that distortion requires a change in cost accounting practice in order to comply with GAAP, then that change should be treated as a required change, just as in the first use case.

3. **Lease Accounting**

I have no comment on the Board's proposed clarification that right-of-use leases are neither tangible nor intangible capital assets for purposes of complying with CAS requirements. In its ANPRM, the Board wrote "Before right-of-use assets are considered for inclusion on balance sheets, the Board would need to further analyze the impact of these changes." I would encourage the Board to proceed with its analysis. Conformance of CAS and GAAP may require some flexibility on the Board's part with respect to traditional US-GAAP accounting treatment, and it is important to understand consequences associated with any changes that may come from conformance.

I am pleased to see the Board address these (and other) issues. However, in this comment letter I have also tried to point out other related areas that seem overripe for the Board's attention. Among those issues are: (1) increase of the thresholds at 9904.403-40(c)(2) to address (if nothing else) actual inflation experienced since they were first promulgated, and (2) analysis and comparison of the 2020 FAR CAS-related clauses with the 2011 clauses found in the CAS regulations. Both of these areas would seem to be "low-hanging fruit" that would be worthy of the Board's attention.

Thank you for considering these comments to the Advance Notice of Proposed Rulemaking.

Sincerely,

Nicholas Sanders

President and Principal Consultant

Apogee Consulting, Inc.