



June 5, 2019

VIA EMAIL

CASB@omb.eop.gov

Mr. Raymond Wong
Director, Cost Accounting Standards Board
Office of Federal Procurement Policy
725 17th Street, N.W.
Washington, D.C. 20503

RE: Reference Case CASB 2019-01

Dear Director Wong,

Johnson & Johnson ("J&J") is pleased to submit comments on the Cost Accounting Standards Board ("CASB") Staff Discussion Paper ("SDP") seeking to conform Cost Accounting Standards ("CAS") 408 and 409 with the Generally Accepted Accounting Principles ("GAAP").

J&J is the world's most comprehensive and broadly-based healthcare company, delivering products and services for the consumer, pharmaceutical, and medical devices and diagnostics markets. For more than 125 years, we have supplied a broad range of products and have led the way in innovation, beginning with the first antiseptic bandages and sutures. We are continuing this heritage of innovation today, bringing important new pharmaceutical products to market in a range of therapeutic areas, as well as developing important advancements in medical devices and new consumer products. J&J would like to bring our most innovative products, services, and solutions to the United States Government ("USG"). J&J Companies sell pharmaceutical, medical device and consumer products to various US Government agencies. J&J Companies also hold contracts, grants, and cooperative agreements with various agencies of the USG for research and development-related efforts. As one of the relatively small number of commercial entities in our industry engaged in supporting the Government in its efforts to develop vaccines and therapeutics to protect against pandemics and medical countermeasures, we are extremely interested in fostering a more hospitable environment for commercial companies to engage with the USG. While J&J Companies understand the need for the USG to mitigate financial risks, the onerous and duplicative regulatory and compliance burdens triggered by CAS coverage stifle the commercial marketplace's ability to bring cutting edge technologies and solutions to the USG. Our comments focus on practical solutions that the CASB can implement immediately to remove barriers to entry.

We understand that the CASB's current focus is on conforming CAS to GAAP pursuant to the requirements of the National Defense Authorization Act of Fiscal Year 2017. However, it appears that

the CASB has taken an overly restrictive interpretation on how it could accomplish Congress' goals in removing barriers to entry for innovative companies. The CASB should not solely focus on the specifics of conforming CAS to GAAP at the expense of an opportunity to address fundamental issues that impose significant barriers for the government to acquire innovative products and services. There are substantial efforts underway to reform the federal procurement system and CASB should make a concerted effort to align itself with these efforts.

More specifically, notwithstanding the SDP's rationale and decision to focus on a detailed analysis of conforming CAS to GAAP, J&J Companies advocate for the CASB to consider a more strategic approach to updating the CAS to provide greater utility to both the USG's ability to procure innovative products and services and to increase industry's willingness to participate in the USG's procurement process. This approach is to eliminate any CAS that do not provide an exceptionally high degree of value for most contracts that would be covered. This is necessary to avoid the 'tail wagging the dog', whereby the operations of a large commercial entity become bound by CAS requirements by the act of a government contractor entering into a single government contract covered by CAS. To warrant such a great impact to a commercial company, only those CAS that are substantially likely to have a significant value to the Government should be retained. It is difficult to conceive of an accounting change being made by a large commercial company for the primary purpose of advantaging the financial rewards under a government contract. We submit that accounting changes are far more likely to be made for purposes completely unrelated to government business, such as changes in laws. Furthermore, for those few situations in which Contracting Officers believe that protections are needed to assure the government is not disadvantaged under a cost-reimbursement or fixed price agreement due to accounting changes, other, agreement-specific protections can be established.

Accordingly, as a general matter,

- We are aligned with the American Bar Association's ("ABA's") position that CAS 404, 407, 408, 409, 411, 415, 416 should be eliminated.
- We submit that while GAAP does not address cost allocation to contracts to the degree of specificity contemplated by CAS 403, 410, 418, or 420, this level of specificity is not required to protect the USG's interests.
- With respect to CAS 412, 413, 414, 417, CASB wants to evaluate CAS vs. GAAP as it relates to the measurement and assignment of pension costs. Although the measurement and assignment of costs may differ, we submit that GAAP provides sufficient uniformity and consistency to protect the government's interests.
- We recommend that CAS 406 be eliminated.

Procurement Reform and Concerns with the Cost Accounting Standards

CAS requirements have remained static throughout the years and have not kept pace with modern government acquisition policies, procedures and practices¹ and Congress is beginning to take action that will mitigate the issues, perceived or real, that inhibit the government's ability to procure

¹ Section 809 Panel Report, Volume 2, Section 4, at 123. The Section 809 Panel was created by Section 809 the National Defense Authorization Act of Fiscal Year 2016. Volume 2, Section 4 of the Section 809 Panel Report deals with Cost Accounting Standards. See Section 809 of Fiscal Year 2016 National Defense Authorization Act (Pub. L. 114-92) for the establishment of the Section 809 Panel.

innovative products and services in a more effective and efficient manner. In the Fiscal Year (“FY”) 2017 National Defense Authorization Act (“NDAA”), Congress created a new and distinct CASB for the Department of Defense² and directed it to “ensure that the cost accounting standards used by Federal contractors rely, to the maximum extent practicable, on commercial standards and accounting practices and systems.”³ It is clear that Congress created the new DoD CASB because the current CASB is not functioning in a manner that is affecting the change that Congress and government contractors need.⁴ The Senate Armed Services Committee (“SASC”) Report for §811, stated:

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 provision requires that cost accounting standards developed shall to the maximum extent practicable align with Generally Accepted Cost Accounting Principles, thereby minimizing the requirement for government-unique cost accounting systems.**⁵

The SASC goes on to state: “The committee is disappointed that the Federal Cost Accounting Standards Board does not currently have a quorum of members and has not met in over three years. Due to this situation, it is doubtful that any credible reform will emanate out of this board in the future... .”⁶ Congress has left no doubt that it is seeking significant reform from the CASB, not merely conformance of CAS to GAAP. Based on Congress’ edict to the new DoD CASB, Congress is clear that it wants CAS to be eliminated, to the maximum extent possible, and it wants the USG to conform to commercial standards to the maximum extent possible. Although this will require serious effort, it is not an insurmountable task. In fact, the Section 809 Panel has provided a very clear and concise roadmap for the CASB to follow to achieve the procurement reform Congress and industry are seeking.

Section 809 Panel Recommendations

In Volume 2, Section 4 of its report, the Section 809 Panel, provides positive recommendations and tools that can be implemented to help CASB and CAS be more effective and efficient. In that section, the 809 Panel outlines in detail, the obstacles that the CASB has had to contend with since its creation in 1970. The recommendations the 809 Panel has made will allow the CASB to function more effectively and efficiently to respond better to changes in the marketplace and in the federal procurement system⁷. The 809 Panel recommends, in Recommendation 29, that 41 U.S.C. §§1501-1506 be revised to designate that the CASB be removed from the Office of Federal Procurement Policy and established as an independent organization within the executive branch⁸. This recommendation, amongst many others, would help the CASB tremendously.

² §820(b) of the FY2017 NDAA, Pub. L. No. 114-238, 130 Stat. 2000 (2017).

³ Ibid.

⁴ S. Rep. No. 114-255 at 208 and See Section 809 Panel Report, Volume 2, Section 4, at 117.

⁵ S. Rep. No. 114-255 at 208 (Emphasis added).

⁶ Ibid.

⁷ Although the 809 Panel was focused on U.S. Department of Defense procurements, the issues that they have identified have general applicability to the broader U.S. government procurement system. The issues and recommendations regarding the CASB are extremely relevant to application across the entirety of the federal procurement landscape and not just to the DoD procurement system.

⁸ Section 809 Panel Report, Volume 2, Section 4, at 114.

The Section 809 Panel discusses, at length, the many consequences that the static and immovable nature of CAS has had on the U.S. Government's ("USG") ability to procure innovative commercial products and services. CAS may serve a beneficial purpose in some very limited circumstances to protect the federal government from unnecessary financial risks. Unfortunately, CAS has not been applied in a manner commensurate with the financial risk that the federal government faces in cost-reimbursement contracts, particularly when contracting with commercial entities. Instead, it has been applied in an overbroad manner to contract types that pose no or very little risk to the federal government or it has been applied in a manner that ignores the market reality of how private parties contract with each other for products and services. It is imperative that the CASB take bold steps to align itself with this landscape, so that it is seen as a positive contributor to the procurement reform efforts.

Comment: CASB does not need to wait for Congress to take action prior to implementing some of the 809 Panel's recommendations.

Research indicates that CAS plays a significant role in inhibiting the USG's ability to receive the best products and services from innovative companies in the private sector.⁹ Furthermore, it has been stated that "CAS program requirements are not only incompatible with how business is conducted in today's marketplace, but they are incompatible with the way the government conducts its own business."¹⁰ We believe that under limited circumstances the CASB and some of the CAS may still be relevant today to mitigate unnecessary financial risk that the USG may face from contractors. However, there are several critical reforms that the CASB should pursue, prior to, or in conjunction with, conformance of CAS to GAAP. CASB may not have the authority to affect some of the greatest structural changes that have been recommended and that are needed to truly alter the procurement system. Nonetheless, CASB should take bold steps and amend the items that it does have the authority to amend and advocate for additional authority where is it limited.

The CASB should amend the monetary thresholds in accordance with the 809 Panel's recommendations.¹¹ The CASB should remove the reference to the TINA threshold and set the monetary threshold at \$25 Million.¹² The trigger contract exemption should also be eliminated because it is no longer necessary because the contract monetary threshold has been raised to \$25 Million.¹³ The full CAS-coverage threshold and disclosure statement threshold should both be raised to \$100 Million.¹⁴ The CASB does not need to wait for Congress to act to make these changes that will have an immediate impact by removing barriers to entry for many companies.

Most of the products and services that the federal government relies upon are available in today's marketplace for anyone to buy, but the government has not been able to evolve its practices and procedures so that they are optimized for the current market reality.¹⁵ One way in which the government has failed to adapt to the private sector is due to the federal government's version of "cost-reimbursable" contracts. In its version of cost-reimbursable contracts the government expects vendors to provide access to their financial systems and adhere to CAS. As previously stated, this method limits

⁹ Id. at 122-123.

¹⁰ Ibid.

¹¹ 809 Panel Report, Volume 2, Section 4, at 145.

¹² Ibid.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Id. at 17.

the number of companies willing to do business with the government and focuses on the contracting process and not the desired results. In contrast to the federal procurement system, the private sector's version of cost reimbursement contracts is more closely aligned to time & materials contracts¹⁶ and private sector vendors adhere to GAAP and do not require access to a contractor's financial systems.¹⁷ To properly align itself with the private sector, the federal government should adjust its preference from cost-reimbursable contracts to time & materials contracts and focus on achieving results at a fair and reasonable price, not on the contracting process. More specifically, the CASB should amend the types of contracts that are or may be exempt from full CAS-coverage to more closely align with where material, high-risk areas exist for the USG, namely traditional cost-reimbursable contracts and *not* agreements with commercial entities who are best characterized as *non-traditional government contractors*.

Comment: We recommend that the CASB utilize its exemption and waiver authority under 48 C.F.R. § 9901.307 to eliminate the possibility of full CAS-coverage on commercial and non-commercial contractors using certain types of contracts

Pursuant to 48 C.F.R. §9901.307, the CASB has the authority to “exempt classes or categories of contractors and subcontractors from cost accounting requirements, and establish waiver procedures for waiver of the requirements with respect to individual contracts and subcontracts.”¹⁸ The CASB should exempt all contractors, commercial and non-commercial, that enter into a negotiated fixed price, time & materials, or labor-hour contract with the USG from CAS. Additionally, all contracts less than \$100 million should be exempted from full CAS-coverage as well. This would align CAS with the commercial marketplace, while ensuring that the contracts that present the highest level of risk, cost-reimbursement contracts, would remain covered by CAS, thereby protecting the USG's interests.

Comment: We recommend that the CASB amend 48 C.F.R. §9903.201-1(b)(6) and 9903.201-1(b)(15) to eliminate the possibility of full CAS-coverage on contract types that are prevalent in the commercial marketplace.

Additionally, the CASB should amend 48 C.F.R. §9903.201-1(b)(6) to exempt both commercial and non-commercial items and services from CAS applicability. The current exemption states:

Firm fixed-priced, fixed-priced with economic price adjustment, (provided that price adjustment is not based on actual costs incurred), time-and-materials, and labor-hour contracts and subcontracts for the acquisition of commercial items.¹⁹

We recommend that 48 C.F.R. §9903.201-1(b)(6) be amended to read:

All firm fixed-priced, fixed-priced with economic price adjustment, (provided that price adjustment is not based on actual costs incurred), time-and-materials, and labor-hour contracts and subcontracts without regard to the commercial nature of the items and services procured.

Further, the CASB can amend 48 C.F.R. §9903.201-1(b)(15) in accordance with the 809 Panel's recommendation.²⁰ The 809 Panel recommends, and we agree, that the exemption should apply to any

¹⁶ Id. at 38.

¹⁷ Ibid.

¹⁸ 48 C.F.R. §9901.307.

¹⁹ 48 C.F.R. §9903.201-1(b)(6).

²⁰ 809 Panel Report, Volume 2, Section 4, at 145.

fixed price contract whose price is based upon price analysis without submission of certified cost or pricing data.²¹

These proposed changes utilize authority the CASB already possesses for the purpose of ensuring the USG can procure products and services as they are sold in the commercial marketplace without subjecting these commercial products and services to full CAS-coverage. These changes would allow the USG to focus its attention on cost-reimbursement contracts with *traditional government contractors*, which pose the greatest risk for the USG.

Comment: We recommend utilizing GAAP and eliminating CAS where possible because GAAP addresses uniformity and consistency.

GAAP has evolved over the last forty years and encompasses a robust framework to help ensure uniformity and consistency in preparing financial statements. At the top of the GAAP hierarchy are statements by the Financial Accounting Standards Board (“FASB”) and opinions by American Institute of Certified Public Accountants (“AICPA”). The next level consists of FASB Technical Bulletins and AICPA Industry Audit and Accounting Guides and Statements of Position. On the third level are AICPA Accounting Standards Executive Committee Practice Bulletins and positions of the FASB Emerging Issues Task Force (“EITF”). Also included are topics discussed in Appendix D of EITF Abstracts. On the lowest level are FASB implementation guides, AICPA Accounting Interpretations, AICPA Industry Audit and Accounting Guides and Statements of Position not cleared by the FASB. Also included are practices that are widely recognized and in broad use in industry.

The USG already relies upon compliance with GAAP to determine if a cost is allowable.²² In addition to the uniformity and consistency that GAAP already provides, publicly traded companies are required to be audited by external auditors, whose opinions about the company’s financial health are included and published with the other financial data with the Securities and Exchange Commission. Further, most public companies already have rigorous internal audit processes to ensure compliance with USG rules and regulations. Under §404 of the Sarbanes-Oxley Act of 2002, a public company’s management is required to assess the effectiveness of its internal control over financial reporting as of the end of each fiscal year.²³ A company’s internal control over financial reporting is designed to provide reasonable assurance as to the reliability of the company’s financial reporting and the preparation of external financial statements in accordance with GAAP. This assessment normally includes extensive documenting, evaluating and testing of the design and operating effectiveness of its internal controls over financial reporting. These audit processes are based on GAAP. Reporting based on GAAP allows for consistency in reporting and in accordance with established accounting standards.

CAS, unlike GAAP, has not evolved, so much so, that it is now seen as a hinderance and barrier to the USG’s ability to obtain innovative products and services.²⁴ GAAP provides uniformity and consistency in today’s business environment. Unlike CAS, GAAP does not create barriers for the USG to obtain the most innovative products and services available in the marketplace. To the contrary, because most companies adhere to GAAP, barriers to contracting with the USG would be removed if GAAP were adopted because there is no inconsistency between a USG procurement and commercial contracts.

²¹ Ibid.

²² 48 C.F.R. Part 31.201-2.

²³ 15 U.S.C. §7262, Public Company Accounting Reform and Corporate Responsibility, “The Sarbanes-Oxley Act of 2002” (116 Stat. 745).

²⁴ Section 809 Panel Report Volume 2, Section 4 at 114-116.

Based on the foregoing, full CAS-coverage is no longer needed to provide uniformity and consistency across the commercial marketplace to protect the interests of the USG. Instead, full CAS-coverage should be limited in scope to cost-reimbursement contracts with traditional *government* contractors because cost reimbursement contracts pose the highest level of risk to the USG.

We appreciate the opportunity to provide comments on the CASB's plans to conform CAS to GAAP and believe the positions outlined above are aligned with Congress' intent and will positively impact the government's ability to procure new innovative products and services.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Snellgrove", followed by a period.

Darren Snellgrove
Chief Financial Officer
Janssen Research & Development LLC