

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

Case Number CASB 2020-02

I. Overview

The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (CAS Board or the Board), is releasing this Advance Notice of Proposed Rulemaking (ANPRM) on the impact of certain Generally Accepted Accounting Principles (GAAP) changes to the Cost Accounting Standards (CAS) to respond to public comments in these areas, specifically, operating revenue and lease accounting. Notice of this action was published in the Federal Register on November 5, 2020 (85 FR 70572)

Since the time that CAS were instituted in the 1970s, changes have been made to GAAP, driven by the need for improved uniformity and consistency, including in the measurement and assignment of costs, to achieve greater comparability, reliability and transparency of financial reporting used by investors and other users. This growth in GAAP content presents opportunities to modify or eliminate overlapping CAS requirements where GAAP standards may be applied reasonably as a substitute for CAS.

Section 820 of Public Law 114-328 directed the Board to conform CAS to GAAP to the maximum extent practicable. In accordance with 41 U.S.C. 1502(c), the Board is required to consult with interested persons concerning the advantages, disadvantages, and improvements anticipated in the pricing and administration of Government contracts as a result of the adoption of a proposed Standard prior to the promulgation of any new or revised CAS. On March 13, 2019, the Board published a Staff Discussion Paper (SDP) in the Federal Register (84 FR 9143) to solicit views with respect to the Board's statutory requirement to review and conform CAS requirements, where practicable, to GAAP. Respondents were invited to comment, among other things, on whether and how CAS may need to be modified to conform to changes to GAAP that occurred after a related CAS was promulgated. More specifically, the SDP asked what recommended actions, if any, the Board should take regarding the changes in GAAP for operating revenue and lease accounting rules.

This ANPRM addresses the public comments and also reflects research accomplished by the Board. The ANPRM is issued by the Board in accordance with the requirements of 41 U.S.C. 1502(c).

II. Summary of Public Comments

The Board received seven public comments to the SDP. These comments came from companies, industry associations, professional associations, and individuals. The SDP asked what recommended action, if any, the Board should take regarding the changes in GAAP for operating revenue and lease accounting rules.

Comments: Three respondents urged the Board to give these issues the highest priority in the CAS-GAAP conformance initiative. One of these commenters observed, “This category is high priority because of the immediate implications on the ability of contractors to comply with CAS. If a new GAAP rule is inconsistent with CAS, it may lead to inadvertent CAS violations, confusion over CAS requirements, inconsistent treatment among contractors and additional costs to maintain separate accounting practices for GAAP and CAS.”

Response: The Board appreciates these comments and recognizes the need to take immediate action to resolve the potential confusion as a result of these changes in GAAP on the interpretation of CAS. Accordingly, the Board has formulated questions and proposed revisions for public comment and is moving forward with this ANPRM to begin addressing the concerns with respect to operating revenue and lease accounting.

III. Operating revenue

The CAS Board is aware that different definitions of “operating revenue” in CAS and GAAP may be a source of confusion which should be addressed. The GAAP definition of “operating revenue,” found at Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 605-10-20, reads as follows:

Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations.

The CAS 403-30(a)(3) definition of “operating revenue” reads as follows:

...amounts accrued or charged to customers, clients, and tenants, for the sale of products manufactured or purchased for resale, for services, and for rentals of property held primarily for leasing to others. It includes both reimbursable costs and fees under cost-type contracts and percentage-of-completion sales accruals 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. It excludes incidental interest dividends, royalty, and rental income, and proceeds from the sale of assets used in the business.

The Board believes that the definition in GAAP is essentially equivalent to the CAS definition, except that the Board notes that, for purposes of management contracts under which the contractor essentially acts as an agent of the Government in the erection or operation of Government-owned facilities, the CAS definition of operating revenue includes only the fee

earned for managing the contracts. GAAP provides no such limitation. When the Board first promulgated CAS 403 in the 1970s, it explained 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.” The Board believes this rationale remains valid and, on this basis, has concluded that the interests of the parties in such contracts is protected by limiting the recognition of the contractor’s operating revenue to only the fee for managing the contract. More generally, the Board believes that reliance on the GAAP definition with retention of this limitation is suitable to achieve uniformity and consistency in the measurement, assignment and allocation of costs to contracts with the government. Therefore, the Board is proposing to rely on a definition of operating revenue that is more closely aligned to GAAP. The Board solicits public comments to the proposed change to the CAS definition of operating revenue.

The Board further notes that ASC 606, promulgated by FASB Update 2014-09, may have impacted cost accounting practices to the extent that: (i) changes were made to the measurement or allocation of related costs, such as state income taxes (reference DoD CAS Working Group Paper 81-25; or, (ii) changes were made to the composition of the allocation base for residual expenses (reference 9904.403-40(c)), causing a change to the assignment of residual expenses to cost accounting periods. The Board solicits public comments as to whether changes to cost accounting practices to conform Operating Revenue to ASC 606 should be considered to be a required change, a unilateral change, or desirable change in accordance with 48 CFR 9903.201-4(a)(4)(i), (ii), or (iii), respectively.

IV. *Lease accounting*

The CAS Board is aware that there has been a change in GAAP that requires lessees to report most operating leases as assets and liabilities on the balance sheet. There is no conforming or analogous requirement in CAS, and thus, there may be confusion. The Board has determined that this inconsistency should be addressed to avoid confusion and inconsistent treatment of contractors. As explained below, the Board is considering clarifications to CAS definitions to make clear that GAAP changes on lease accounting to report most operating leases as assets and liabilities on the balance sheet are not recognized for the purpose of computing Facilities Capital Cost of Money (FCCM) in CAS 414 and CAS 417.

GAAP historically provided for two accounting treatments for leased property: capital leases and operating leases. FASB Accounting Standards Update No. 2016-02 resulted in modifications to lease accounting. Formerly capital leases for lessees have been reclassified as finance leases, which, as described in ASC 842-10-25-2, applies when the lease meets any of the following criteria:

- (a) The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- (b) The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.

- (c) The lease term is for the major part of the remaining economic life of the underlying asset. However, if the commencement date falls at or near the end of the economic useful life of the underlying asset, this criterion shall not be used for purposes of classifying the lease.
- (d) The present value of the sum of the lease payments and any residual value guaranteed by the lessee that is not already reflected in the lease payments in accordance with paragraph 842-10-30-5(f) equals or exceeds substantially all of the fair value of the underlying asset.
- (e) The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

When none of the criteria in ASC 842-10-25-2 are met, the lessee classifies the lease as a right-of-use asset. Right-of-use assets were formerly classified as operating leases. Right-of-use assets are recorded on the balance sheet by the lessee as assets and amortized on a systematic basis representative of the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits. A corresponding lease liability is also recorded by the lessee at the present value of the lease payments not yet paid. It is the recording of right-of-use assets on the balance sheet that may cause the potential confusion as to whether these "assets" are intangible capital assets or tangible capital assets for CAS purposes.

The definition of "intangible capital asset" is found in several places in CAS, as referenced in 9903.301(a), see 9904.414-30 or 9907.417-30. The definition reads: "an asset that has no physical substance, has more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the benefits it yields." The definition of "tangible capital asset" is found several places in CAS, as referenced in 9903.301(a), see 9904.403-30, 9904.404-30, 9904.409-30, 9904.414-30 or 9904.417-30. The definition reads: "an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the services it yields." The previous GAAP treatment of operating leases did not classify them as "assets" on the balance sheet, thereby naturally excluding them from the CAS definition of intangible capital asset and tangible capital asset. The GAAP modification, which required reclassification of operating leases as right-of-use assets recorded on the balance sheet has caused confusion as to whether right-of-use assets are included in the CAS definition of intangible capital assets or tangible capital assets or should continue to be excluded.

The Board proposes to clarify that under CAS property formerly classified as operating leases and reclassified as right-of-use assets should be excluded from treatment as intangible capital assets and tangible capital assets for CAS at this time. Reporting operating leases as assets and liabilities on the balance sheet would have an impact on other standards, specifically CAS 414 and 417 which address cost of money computations that are used in lieu of paying interest to federal contractors and are unique to government contracting. Before right-of-use assets are considered for inclusion on balance sheets, the Board would need to further analyze the impact of these changes. Therefore, the Board is proposing to revise the definition of intangible capital assets shown at 9904.414-30(a)(4) and 9904.417-30(a)(1), as well as the definition of tangible capital assets shown at 9904.403-30(a)(5), 9904.404-30(a)(4), 9904.409-30(a)(3), 9904.414-30(a)(5), and 9904.417-30(a)(2), and add clarifying language in Appendix A

to 9904.414, in the Instructions for Form CASB CMF. Simultaneous with this ANPRM, the Board is considering other revisions to CAS 404, Capitalization of Tangible Assets, and CAS 409, Cost Accounting Standard Depreciation of Tangible Capital Assets, as part of the effort to conform CAS to GAAP which may affect any final rules released for these Standards.

List of Subjects in 48 CFR 9903 and 9904

Government Procurement, Cost Accounting Standards

For the reasons set forth in the preamble, Chapter 99 of Title 48 of the Code of Federal

Regulations is amended as set forth below:

PARTS 9903-CONTRACT COVERAGE and 9904-COST ACCOUNTING STANDARDS

1. The authority citation for Parts 9903 and 9904 continues to read as follows:

Authority: Pub. L. 111-350, 124 Stat. 3677, 41 U.S.C. 1502 (formerly Pub. L. 100-679, 102 Stat. 4506, 41 U.S.C. 422).

2. Section 9903.301 is amended by removing the phrase “*operating revenue*. See 9904.403-30” from the list of defined terms in subsection (a).

9903.301 Definitions

(a) * * *

* * * * *

Normal cost. * * *

Original complement of low cost equipment. * * *

* * * * *

3. Section 9904.403-30 is amended by removing the definition of “*operating revenue*” at paragraph (a)(3) and revising the definition of “*tangible capital asset*” at paragraph (a)(5) by adding additional text at the end of the paragraph as follows:

9904.403-30 Definitions

(a) * * *

(3) [Reserved]

(4) * * *

(5) * * * It includes assets classified as finance leases for financial accounting and excludes those classified as right-of-use assets and operating leases.

* * * * *

4. Section 9904.403-50 is amended by revising subparagraph (c)(1)(ii) to read as follows:

9904.403-50 Techniques for application

* * * * *

(c)(1)(i) * * *

(c)(1)(ii) The percentage of the segment’s operating revenue to the total operating revenue of all segments. 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. The operating revenue, however, of any

segment shall include amounts charged to other segments and shall be reduced by amounts charged by other segments for purchases.

* * * * *

5. Section 9904.404-30 is amended by revising the definition of “*tangible capital asset*” at paragraph (a)(4) by adding additional text at the end of the paragraph as follows:

9904.404-30 Definitions

(a) * * *

(4) * * * It includes assets classified as finance leases for financial accounting and excludes those classified as right-of-use assets and operating leases.

* * * * *

6. Section 9904.409-30 is amended by revising the definition of “*tangible capital asset*” at paragraph (a)(3) by adding additional text at the end of the paragraph as follows:

9904.409-30 Definitions

(a) * * *

(3) * * * It includes assets classified as finance leases for financial accounting and excludes those classified as right-of-use assets and operating leases.

* * * * *

7. Section 9904.414-30 is amended by revising the definition of “*intangible capital asset*” and “*tangible capital asset*” at paragraphs (a)(4) and (a)(5), respectively, by adding additional text at the end of each paragraph as follows:

9904.414-30 Definitions

(a) * * *

(4) * * * It includes assets classified as finance leases for financial accounting and excludes those classified as right-of-use assets and operating leases.

(5) * * * It includes assets classified as finance leases for financial accounting and excludes those classified as right-of-use assets and operating leases.

* * * * *

8. APPENDIX A TO 9904.414 is amended by revising the description under the subheading “Recorded, Leased Property, Corporate,” under the heading “Accumulation and Direct Distribution of Net Book Value (Col. 2)” in the Instructions for Form CASB-CMF, to read as follows:

APPENDIX A TO 9904.414-INSTRUCTIONS FOR FORM CASB CMF

Form CASB-CMF * * *

*Purpose * * **

*Basis * * **

*Applicable Cost of Money Rate (Col. 1) * * **

Accumulation and Direct Distribution of Net Book Value (Col. 2)

Recorded, Leased Property, Corporate.

The net book value of facilities capital items in this column shall represent the average balances outstanding during the cost accounting period. This applies both to items that are subject to periodic depreciation or amortization and also to such items as land that are not subject to periodic write-offs. Unless there is a major fluctuation, it is adequate to ascertain the net book value of these assets at the beginning and end of each cost accounting period, and to compute an average of the beginning and ending values. "Recorded" facilities are the capital items owned by the contractor, carried on the books of the business unit, and used in its regular business activity. "Leased property" is the capitalized value of leases for which constructive costs of ownership are allowed in lieu of rental costs under Government procurement regulations. Leases classified as operating leases or right-of-use assets for financial accounting purposes are excluded from facilities capital items reported on this form. Corporate or group facilities are the business unit's allocable share of corporate-owned and leased facilities. The net book value of items of facilities capital which are held or controlled by the home office shall be allocated to the business unit on a basis consistent with the home office expense allocation.

* * * * *

9. Section 9904.417-30 is amended by revising the definition of "*intangible capital asset*" and "*tangible capital asset*" at paragraphs (a)(1) and (a)(2), respectively, by adding additional text at the end of each paragraph as follows:

9904.417-30 Definitions

(a) * * *

(1) * * * It includes assets classified as finance leases for financial accounting and excludes those classified as right-of-use assets and operating leases.

(2) * * * It includes assets classified as finance leases for financial accounting and excludes those classified as right-of-use assets and operating leases.

* * * * *