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OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Chapters 9903 and 9904

Conformance of Cost Accounting Standards to Generally Accepted Accounting Principles for Operating Revenue and Lease Accounting

AGENCY: Cost Accounting Standards Board, Office of Federal Procurement Policy, Office of Management and Budget.

ACTION: Notice of Proposed Rule Making

SUMMARY: The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (CAS Board or the Board), is releasing this notice of proposed rulemaking (NPRM) to elicit public comments on proposed changes to the Cost Accounting Standards (CAS) to conform them with changes in Generally Accepted Accounting Principles (GAAP) related to operating revenue and lease accounting. This proposed rule follows issuance of an advanced notice of proposed rulemaking (ANPRM) 85 FR 70572 (November, 5, 2020), and a Staff Discussion Paper (SDP) 84 FR 9143 (March 13, 2019).

DATES: Comments must be in writing and must be received by **INSERT DATE 60 DAYS**

AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]

ADDRESSES: Respondents are strongly encouraged to submit comments electronically to ensure timely receipt. Electronic comments may be submitted to OMBCASB@omb.eop.gov. Be sure to include your name, title, organization, and reference case **2021-01**. If you must submit by regular mail, please do so at Office of Federal Procurement Policy, 725 17th Street, NW, Washington, DC 20503, ATTN: John L. McClung.

Privacy Act Statement: The CAS Board proposes the rule to elicit public views pursuant to 41 U.S.C. 1502. Submission of comments is voluntary. The information will be used to inform sound decision-making. Please note that all comments received in response to this document may be posted or released in their entirety, including any personal and business confidential information provided. Do not include any information you would not like to be made publicly available. Additionally, the OMB System of Records Notice, OMB Public Input System of Records, OMB/INPUT/01, 88 FR 20913 (available at www.federalregister.gov/documents/2023/04/07/2023-07452/privacy-act-of-1974-system-of-records), includes a list of routine uses associated with the collection of this information.

FOR FURTHER INFORMATION CONTACT: John L. McClung, Manager, Cost Accounting Standards Board (telephone: 202-881-9758; email: john.l.mcclung2@omb.eop.gov).

SUPPLEMENTARY INFORMATION

I. Background

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) (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. The Board recognized that since the initial promulgation of CAS 403 (38 FR 26680, Dec. 14, 1972), numerous changes have been made to GAAP. 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. Furthermore, some changes in GAAP may create inconsistencies not contemplated during the initial promulgations of CAS requiring action by the Board.

Public comments received on the SDP, amongst other things, urged the Board to prioritize efforts to address changes in GAAP related to operating revenue and lease accounting. In response to these comments, the Board issued an advanced notice of proposed rulemaking (ANPRM) on November 5, 2020 (85 FR 70572) that described changes to the CAS that, if adopted, would (i) align CAS with GAAP on the handling of operating revenue and (ii) clarify CAS definitions to make clear that GAAP changes on lease accounting are not recognized for CAS purposes.

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

II. Operating revenue

A. *Overview.* The definitions of operating revenue in CAS and revenue in GAAP are currently different. The GAAP definition of “revenue,” found at Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 606-10-20, 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 charge[d] 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.”

In the ANPRM, the Board stated its belief that the definition in GAAP is essentially equivalent to the CAS, but noted that when a contractor essentially acts as an agent of the Government in the erection or operation of Government-owned facilities, CAS limits the measurement of

operating revenue to only the fee earned for managing the contract. The Board also noted that GAAP does not provide such a limitation. The ANPRM included language that, if adopted, would remove the definition of operating revenue from CAS 403 and rely on the definition of revenue in GAAP, but 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.” Finally, the ANPRM asked 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.

B. *Public comments.* The Board received three sets of public comments in response to the ANPRM. These comments came from industry associations with inputs from member companies.

Comment: All commenters agree with relying on GAAP for operating revenue. However, they believe 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,” was unnecessary. The commenters pointed out the additional conceptual framework GAAP includes related to the principal versus agent relationship in contracts with customers.

Response: While GAAP does not provide an express limitation in measuring revenue under this specific type of government contract, the Board agrees that it does recognize a conceptual framework consistent with the intent of the CAS 403 limitation. In determining revenue, GAAP, specifically FASB ASC 606 - Revenue from contracts with customers, requires an entity to

consider whether it is acting as a principal or an agent for each specified good or service promised to a customer. ASC 606-10-55-38 reads as follows:

“An entity is an agent if the entity’s performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging the specified goods or services to be provided by the other party. An entity’s fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.”

The relationship of a contractor performing on GOCO facilities contracts is similar enough to that of an agent as described in ASC 606-10-55-38, that the Board expects a government contractor would record revenue the same using the GAAP, as it would under CAS. For these reasons, the NPRM proposes to delete the definition of operating revenue in its entirety from CAS 403 and rely on the definition of revenue in GAAP.

Comment: All commenters believed the proposed changes related to operating revenue fall under the definition of a required change. They all also believed the Board should view this topic more broadly to all CAS/GAAP efforts and suggested the Board exempt CAS/GAAP conformance efforts from the cost impact process by adding to the existing exemption for External Restructuring (see 48 CFR 9903.201-8). The main rationale provided was that the CAS/GAAP conformance efforts are not expected to have a material impact on the government or contractor;

however, the administrative burden associated with preparing and evaluating cost impact proposals could be significant with minimal to no impacts.

Response: The Board agrees that the proposed changes fall under the definition of a required change. Because the CAS and GAAP definitions of operating revenue are essentially the same, the Board does not anticipate any material impact to the Government or contractors as a result of this change. The Board also appreciates the need for careful consideration of the cost and benefits associated with CAS/GAAP conformance efforts, and the potential role the cost impact process may play in executing changes. However, the Board does not believe it would be prudent to make an across-the-board determination that all future CAS/GAAP conformance efforts are required changes, and also exempt from the cost impact process in advance of performing due diligence on each case to determine that the changes are consistent with its Guiding Principles—i.e., that they minimize burden on contractors, protect the interests of the Federal Government, and materially achieve uniformity and consistency in cost accounting, without bias or prejudice to either party. For operating revenue, the Board has provisionally determined that the change is required and an exemption from the cost impact process is clearly warranted due to the efficiency gained without prejudice to either party. More specifically, there would be a quantifiable administrative burden on both parties to execute the required cost impact process and, in this case, the administrative burden on both parties would clearly outweigh the minimal benefit derived by either party from the cost impact process.

C. *NPRM.* Based on public comment and additional research conducted by the Board, the Board continues to believe that the definition of operating revenue in CAS and revenue in GAAP are essentially equivalent. Based on the additional research on ASC 606-10-55-38 discussed above, the Board now further believes that entities would operate as agents for the government

when performing under a GOCO facilities contract. On this basis, the Board has provisionally concluded that the CAS 403 definition of operating revenue has become unnecessary to protect the Government's interests and may be deleted in its entirety to allow for reliance on GAAP and other CAS Standards. The Board has also provisionally concluded that accounting changes related to conformance of the CAS definition of operating revenue to GAAP ASC 606 is a required change as described at 48 CFR 9903.201-4(a).

These actions would be 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 Federal Government. Furthermore, the Board's provisional conclusion of relying on GAAP for the definition of operating revenue in CAS 403 would align 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 eliminate CAS coverage no longer necessary.

Therefore, the Board is proposing a rule that would (i) modify CAS 403 to rely on GAAP for revenue and (ii) exempt properly disclosed changes related to this conformance effort from the contract price and cost adjustment requirements of this part 9903. The NPRM would also remove the term "operating" in relation to revenue in CAS 403. The Board believes this change is necessary to avoid confusion and make clear that the definition of revenue in GAAP is consistent with "operating revenue" as historically used in CAS. Additional research by the Board revealed that the CAS standard predated the codification of GAAP by FASB. Operating Revenue was defined to exclude other forms of revenue (or income) beyond the contractor's normal operations. As noted above, this change is consistent with the definition of revenue in

GAAP which makes clear revenue is generated by “*activities that constitute the entity’s ongoing major or central operations.*”

The Board seeks comment on the NPRM and requests specific input on whether there are any instances where an entity might not consider itself an agent, based on ASC 606-10-55-38, when performing on a GOCO contract.

III. Lease accounting

A. *Overview.* Since the initial promulgations of CAS 414 and 417, changes have been made to GAAP related to lease accounting that have caused confusion about which assets should be included in the calculations of Facilities Capital Cost of Money (FCCM). Specifically, the GAAP requirements to treat “right of use” assets, that were formerly known as operating leases, as assets and liabilities require clarification from the Board to avoid confusion or inconsistent treatment. In the ANPRM, the Board proposed clarifications to the CAS definition and handling of tangible capital assets to make clear that GAAP requirements to classify “right of use” assets on an entity’s balance sheet should not be recognized as assets for the purpose of computing FCCM in CAS 414 and CAS 417.

B. *Public comments.* The Board received three sets of public comments to the ANPRM from industry associations with inputs from member companies. All of the comments essentially addressed the same issue regarding the need for further clarification.

Comment: All commenters agreed with the need for the definitional changes of both tangible and intangible assets to include financing leases and exclude operating leases. However, they believed the Board’s proposed language may still be too ambiguous to achieve the desired goal of avoiding confusion or inconsistent treatment. One commenter further explained that the

proposed changes to the definitions of tangible and intangible capital assets associate all right-of-use (“ROU”) assets with operating leases and that this linkage may not hold true because leases in general are associated with ROU assets. For example, ROU assets from financing leases may be reported within the property, plant, and equipment asset category; whereas, ROU assets from operating leases may be reported as a separate asset category. To avoid confusion, commenters urged the Board to modify the definitions of tangible and intangible assets to exclude only ROU operating lease assets. By making this change, ROU assets for operating leases will be inherently recognized as a separate asset category for CAS purposes—neither tangible nor intangible.

Response: The Board appreciates these comments and has considered the recommendations in the proposed rule to provide additional clarity.

C. *NPRM.* Based on public comment, the Board is proposing a rule that would make clarifications to CAS addressing which assets should be included in the calculations of Facilities Capital Cost of Money (FCCM). The NPRM adopts language in the ANPRM with additional clarification. Specifically, the Board is proposing to revise the definition of intangible capital assets shown at 48 CFR 9904.414-30(a)(4) and 9904.417-30(a)(1), as well as the definition of tangible capital assets shown at 48 CFR 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. The Board seeks public comment on the NPRM.

Christine J. Harada,

Senior Advisor Office of Federal Procurement Policy, and Chair, Cost Accounting Standards Board, performing by delegation the duties of the Administrator for Federal Procurement Policy.

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 purposes and excludes those right-of-use assets that were formerly known as operating leases.

* * * * *

4. Section 9904.403-40 is amended by removing the two instances of the word “operating” in paragraph (C)(2) as follows:

9904.403-40 Fundamental Requirement.

(c) Residual Expense

(1) * * *

(2) Residual expenses shall be allocated pursuant to 9904.403–50(c)(1) if the total amount of such expenses for the contractor's previous fiscal year (excluding any unallowable costs and before eliminating any amounts to be allocated in accordance with paragraph (c)(3) of this subsection) exceeds the amount obtained by applying the following percentage(s) to the aggregate ~~operating~~ revenue of all segments for such previous year: 3.35 percent of the first \$100 million; 0.95 percent of the next \$200 million; 0.30 percent of the next \$2.7 billion; 0.20 percent of all amounts over \$3 billion. The determination required by this paragraph for the 1st year the contractor is subject to this Standard shall be based on the pro forma application of this Standard to the home office expenses and aggregate ~~operating~~ revenue for the contractor's previous fiscal year.

(3) * * *

* * * * *

5. 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 revenue to the total revenue of all segments. For this purpose, the method used for determining revenue for financial accounting shall be used. The revenue, however, of any segment shall include amounts charged to other segments and shall be reduced by amounts charged by other segments for purchases.

* * * * *

6. 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 purposes and excludes those right-of-use assets that were formerly known as operating leases

* * * * *

7. 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 purposes and excludes those right-of-use assets that were formerly known as operating leases.

* * * * *

8. 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 purposes and excludes those right-of-use assets that were formerly known as operating leases.

(5) * * * 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

* * * * *

9. 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 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. 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.

* * * * *

10. 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 purposes and

excludes those right-of-use assets that were formerly known as operating leases.

(2) * * * 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.

* * * * *