

## Federal Cost Accounting Standards Are Inching Toward GAAP

By **Angela Styles**

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On March 13, 2019, the Cost Accounting Standards Board, or CASB, issued a staff discussion paper on the potential conformance of seven of the 19 federal cost accounting standards, or CAS, to generally accepted accounting principles, or GAAP.[1] As many may recall, this CAS to GAAP conformance review was mandated by the Fiscal Year 2017 National Defense Authorization Act, and the first review was due to Congress by Dec. 23, 2016.[2] Better late than never, the paper initiates the first of four potential stages of the CASB's rulemaking process for CAS 408 and CAS 409, relating to compensated personal absence and the depreciation of tangible capital assets respectively.[3]



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### Differences between CAS and GAAP

The paper explains that while the CAS and GAAP were created for different purposes, “there appear to be some areas of overlap that have arisen since the CAS were first promulgated.”[4] The CAS were designed to provide protections to the federal government from the potential “effects of inconsistent or improper contractor cost accounting, which could result in entities shifting costs incurred in one segment to another segment or on one contract to another contract, e.g., between private sector and government contracts.”[5]

GAAP, on the other hand, was created to record and present financial information for use internally to operate the business and externally for stakeholders, such as the U.S. Securities and Exchange Commission, shareholders and banks. In other words: “While CAS and GAAP record and present the same costs, they do so with different perspectives and different purposes.”[6] However, the CASB staff asserts that “over time,” since the CAS were promulgated in the 1970s, the Financial Accounting Standards Board, or FASB, has adopted “a number of new requirements related to the measurement and assignment of costs” that have created an overlap between GAAP and CAS.[7] This “growth in GAAP content presents potential to modify or eliminate overlapping the CAS requirements.”

### CAS Standards for Review and Not for Review

To attempt to rectify decades of longstanding differences between the CAS and GAAP, the CASB staff determined that the following seven standards, focused primarily on cost measurement and assignment, “offer the most opportunity to conform the CAS to the existing content in GAAP”:

- CAS 404 - Capitalization of tangible assets
- CAS 407 – Use of standard costs for direct material and direct labor
- CAS 408 – Accounting for costs of compensated personal absence
- CAS 409 – Depreciation of tangible capital assets
- CAS 411 – Accounting for acquisition costs of materials
- CAS 415 – Accounting for the costs of deferred compensation
- CAS 416 – Accounting for insurance costs

The other 12 CAS are divided into three additional categories that the CASB has determined hold little opportunity to conform to GAAP.

- Category 2: Standards focused on allocation of costs,[8]
- Category 3: Standards for unique government needs[9] and
- Category 4: Standards that are generally foundational principles.[10]

At this time, the board does not intend to conduct any additional review of the 12 standards in Categories 2 through 4.

For the two standards the CASB staff determined offer the most potential to conform, CAS 408 and 409, the paper provides an extensive comparison of the CAS to GAAP and concludes that although there are a few potential gaps in coverage, GAAP could possibly be used in place of the CAS.

The other five standards — 404, 407, 411, 415 and 416 — identified for potential conformance will have to wait, but the CASB is open to conformance comments on these standards.

### **CAS 408 Review**

The first standard for conformance review — CAS 408 (relating to compensated personal absences) — was promulgated by the CASB in 1974 and became effective in 1975.[11] The accounting standard was developed based upon the CASB's belief that the then current procurement regulations did not ensure that the cost of compensated personal absences were being assigned to the cost accounting period when the labor was performed or the base compensation paid.[12] In 1975, there was not a similar provision in GAAP. Not until 1980 did the FASB publish an accounting standard for compensated absences — FAS-043-12-40.

Now, 38 years after FASB published a standard for compensated absences, the CASB staff has found one potential gap between CAS 408 and GAAP for which they are seeking comment. CAS 408 states that a compensated absence must be assigned to the cost accounting period when it is earned. GAAP allows an employee's right to an unused compensated absence to be carried forward to a future accounting period. The CASB is requesting specific comments on the magnitude of accumulated compensated personal absence costs that may accumulate but not vest under GAAP.

## **CAS 409 Review**

CAS 409 — relating to the depreciation of tangible capital assets — was promulgated and became effective in 1975.[13] At the time CAS 409 was issued, the CASB believed that the accelerated depreciation methods allowed for tax purposes were inequitable to the government because the costs were not charged to contracts over the longer useful life of the asset.[14] The paper asserts that GAAP in 1975 allowed the use of the Internal Revenue Code’s accelerated depreciation methods.[15]

The paper identifies three potential differences between CAS 409 and ASC 360-10-35-3 that the CASB staff believes may affect the potential to conform CAS to GAAP: Service lives, gains/losses within 12 months of transfer and residual values.

First, the board is concerned that GAAP does not require that the determination of the service life of an asset be based upon the “actual historical” life of the contractor’s other assets or experience. The CASB is requesting comments on whether service life under GAAP is determined using “general circumstances not unique to the contractor.”

Second, CAS 409 states that “[g]ains and losses on disposition of a tangible capital assets transferred in other than an arms-length transaction and subsequently disposed of within 12 months from the date of transfer shall be assigned to the transferor.”[16] The CASB’s fear was that an asset for which there is a loss would be transferred from a commercial segment to a government segment and the asset for which there is a gain would be transferred from a government segment to a commercial segment. GAAP contains no such accounting requirement, so the CASB staff is seeking data on the frequency and magnitude of such asset transfers.

The request seems to ignore the likely possibility that CAS 409 has inhibited such transfers for federal contractors, so the data is hard to find. A better ask would simply be whether the accounting burden would be decreased if such a transfer was treated in FAR Part 31 as an unallowable cost and CAS 409 simply eliminated.

Finally, the CASB staff’s concern about residual values is fairly unclear. CAS 409 does not allow contractors to charge depreciation costs that would significantly reduce the book value of a tangible capital asset below its residual value. [17] GAAP (ASC 360-10-35-4) does not contain such a requirement. However, if CAS 409 is eliminated and a federal contractor following GAAP decides to charge the government for a depreciation cost that would significantly reduce the book value of a tangible capital asset below its residual value, FAR 31.205-11(a) would require the contractor to treat the depreciation cost as an unallowable cost. That does not appear to be a problem, but the paper inexplicably asks for public comment on when residual value used for CAS 409 and salvage value under GAAP might differ, while also noting earlier in the paper that CAS 409 “residual value” and GAAP “salvage value” are defined the same.

## **Conclusion**

While the paper is less than what Congress or federal contractors hoped to see, it is a start and a small step toward decreasing the regulatory burden on federal contractors. Now it is the private sector’s turn to engage and provide details about the many changes that are needed. Comments are due May 13, 2019.

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[1] 84 Fed. Reg. 9143 (Mar. 13, 2019).

[2] Pub. L. 114-328 (requiring the CASB “within one year after the date of enactment ... and on an ongoing basis thereafter, review” all 19 CAS “and conform such standards, where practicable, to Generally Accepted Accounting Principles.” ).

[3] The subsequent stages are Advanced Notice of Proposed Rulemaking, Notice of Proposed Rulemaking and Final Rule.

[4] Staff Discussion Paper at 3.

[5] Id. at 1.

[6] Id. At 2.

[7] There are some reasonable questions about the accuracy of the discussion paper's assertions regarding GAAP requirements at the time CAS were adopted. See *infra* endnote 15.

[8] CAS 403 – Allocation of home office expense to segment, CAS 410 – Allocation of business unit general and administrative expenses to final cost objectives, CAS 418 – Allocation of direct and indirect costs and CAS 420 – Accounting for independent research and development costs and bid and proposal costs.

[9] CAS 412 – Composition and measurement of pension costs, CAS 413 – Adjustment and allocation of pension costs and CAS 417 – Cost of money as an element of the cost of capital assets under construction.

[10] CAS 401 – Consistency in estimating, accumulating and reporting costs, CAS 402 - Consistency in allocating cost incurred for the same purpose, CAS 405 – Accounting for unallowable costs and CAS 406 – Cost Accounting Period.

[11] 39 Fed. Reg. 33681 (Sept. 19, 1974).

[12] Id.

[13] 40 Fed. Reg. 4259 (Jan. 29, 1975).

[14] Staff discussion paper at 24.

[15] Staff discussion paper at 24. This assertion appears to be inaccurate. As of December 1971, the Accounting Principles Board (the predecessor to FASB), required depreciation over the useful life of an asset: “The cost of a productive facility is one of the costs of the services it renders during its useful

economic life. Generally accepted accounting principles require that this cost be spread over the expected useful life of the facility in such a way as to allocate it as equitably as possible to the periods during which services are obtained from the use of the facility.” Section 4073.05 A P B Accounting Principles 2458.

[16] CAS 409-50(j)(4).

[17] CAS 409-50(h).