



COST ACCOUNTING STANDARDS

Board Has Taken Initial Steps to Meet Recent Legislative Requirements

Accessible Version

February 2020

GAO Highlights

Highlights of [GAO-20-266](#), a report to congressional committees

Why GAO Did This Study

Each year, the federal government obligates billions of dollars on contracts for which the final costs depend, in part, on the amount of overhead and other costs charged to the contract.

Congress created the Board in 1970. The standards it created ensure contractors appropriately charge costs to government contracts. In contrast, GAAP is a set of financial reporting principles that commercial firms may use in preparing financial statements and which include the basis for recognizing and measuring costs in such statements. Industry representatives and others have raised concerns that complying with CAS may be burdensome and questioned whether the government could rely on GAAP.

In 2016, Congress included a provision in law that the Board, among other things, conform CAS with GAAP, where practicable. Congress also included a provision for GAO to assess Board efforts. This report assesses the extent to which the Board is taking steps to meet legislative requirements and describes the Board's efforts to conform CAS to GAAP.

GAO reviewed applicable laws, regulations and guidance, Federal Register notices and other documentation on the Board's activities. GAO also examined the Board's methodology for comparing CAS to GAAP and its preliminary analysis of two of the cost accounting standards. Finally, GAO interviewed Board members and federal procurement officials.

View [GAO-20-266](#). For more information, contact Timothy J. DiNapoli at (202) 512-4841 or tinapoli@gao.gov.

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What GAO Found

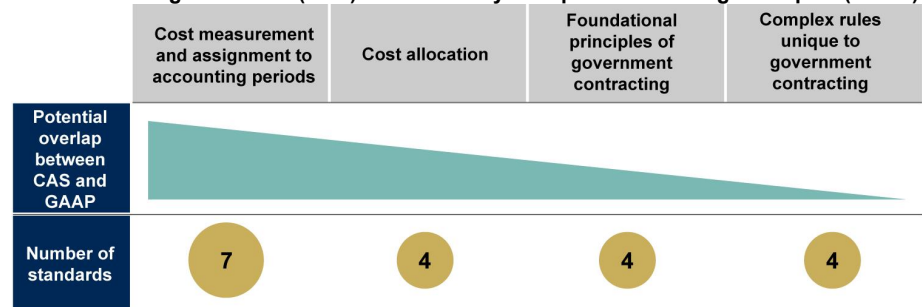
The Cost Accounting Standards Board (the Board) is generally meeting recent legislative requirements and has taken initial steps to assess the extent to which the government's Cost Accounting Standards (CAS) can be conformed with a set of 12 commercial financial reporting principles known as Generally Accepted Accounting Principles (GAAP).

Comprising five members representing the government and industry, the Board issued 19 standards between 1972 and 1980. After that point, the Board met intermittently until 2016. At that time, Congress included a provision in the National Defense Authorization Act for Fiscal Year 2017 to require the Board to meet quarterly, to review CAS-related disputes, to conform CAS with GAAP where practicable, and to report annually to Congress on its efforts, among other things.

Since the legislation went into effect, the Board has met regularly, has been briefed on CAS-related disputes, and is preparing its initial report to Congress. The Board has also taken initial steps to assess the extent to which CAS can be conformed with GAAP. The Board summarized its approach in a March 2019 staff discussion paper, which it released for public comment. In it, the Board:

- outlined a set of five guiding principles to assess whether proposed CAS changes are necessary and whether those changes would reduce the burden on contractors while protecting the government's interests,
- identified a roadmap that prioritized the Board's proposed review of the standards, and
- included a preliminary comparison of two of the seven standards identified as having the most overlap with GAAP (see figure).

Cost Accounting Standards Board Initial Assessment of the Potential Overlap between the 19 Cost Accounting Standards (CAS) and Generally Accepted Accounting Principles (GAAP)



Source: GAO presentation of Cost Accounting Standards Board information. | GAO-20-266

Some comments submitted in response to the discussion paper by industry groups stated that each of the 19 CAS should be eliminated unless proven to be absolutely necessary. Board members told GAO they were considering all options for refining CAS but noted that GAAP and CAS are focused on two separate goals—GAAP on businesses' high-level financial performance, CAS on allocating costs to individual government contracts. The Board and other government officials said that eliminating CAS requirements to rely purely on GAAP would limit the government's ability to protect its interests.

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Abbreviations

CAS	Cost Accounting Standards
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DOD	Department of Defense
FAR	Federal Acquisition Regulation
FASB	Financial Accounting Standards Board
G&A	general and administrative
GAAP	Generally Accepted Accounting Principles
TINA	Truth in Negotiations Act

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February 6, 2020

Congressional Committees

The federal government spends hundreds of billions of dollars each year to acquire goods and services that support agency needs. Agencies have flexibilities in how they acquire these goods and services, including the use of cost-based contracts.¹ Since at least 1949, the government has recognized the need to ensure that contractors' costs were allowable. However, while commercial financial accounting standards have been in place since the 1930s, those standards were developed for different purposes—financial statement reporting—and did not require contractors to allocate their costs (such as overhead expenses) to specific contracts. These commercial standards eventually became known as Generally Accepted Accounting Principles (GAAP). Following hearings in which potential overcharges on defense contracts were discussed, in 1970 Congress created the Cost Accounting Standards Board (the Board) to issue Cost Accounting Standards (CAS). These 19 standards, which went into effect between 1972 and 1980, defined, among other things, how contractors should properly allocate costs to certain defense contracts. Congress subsequently made these standards applicable to all government contracts, as determined by the Board.

While the CAS have served to protect the government's interests, industry representatives and others have raised concerns that CAS may impose compliance burdens on companies that have not done business with the Department of Defense (DOD) and may deter them from doing business with the federal government. For example, in 2017 we reported that a number of companies chose not to develop products for DOD due to contract terms and conditions that would be expensive to implement,

¹In this report, we use the term "cost-based contracts" to refer to all cost-type contracts as well as those fixed-price contracts where the contractor's estimated or actual costs play a role in determining the amount the government pays, as these types are potentially covered by the cost accounting standards. See Federal Acquisition Regulation (FAR) part 30.

including establishing a government-unique cost accounting system that would be needed to comply with the standards.²

Section 820 of the National Defense Authorization Act for Fiscal Year 2017 directed the Cost Accounting Standards Board, among other things, to conform CAS with GAAP, where practicable.³ Section 820 also required that, effective October 1, 2018, the Board:

- meet at least quarterly and publish notices and agendas in the Federal Register in advance of the meetings;
- annually review disputes involving CAS brought to various federal contract appeals boards or federal courts, and consider whether greater clarity in the standards could avoid such disputes; and
- annually submit a report to congressional committees describing the actions the Board has taken during the prior year to conform CAS to GAAP and to minimize the burden on contractors while protecting the interests of the federal government.⁴

Further, Section 820 included a provision for us to assess and report on certain efforts undertaken by the Board. This report assesses the extent to which the Board is meeting the administrative and reporting requirements prescribed by Section 820 and the steps taken by the Board to conform CAS to GAAP.

To conduct this work, we reviewed applicable laws, regulations, and guidance; reviewed Federal Register rules and notices and other documentation on the Board's activities from the enactment of the National Defense Authorization Act for Fiscal Year 2017 in December 2016 to November 2019; and discussed the Board's activities and future plans with Board members and officials from the Office of Federal Procurement Policy (OFPP), as the OFPP Administrator chairs the Board. We then compared these activities and plans with the Section 820 requirements. We also reviewed the Board's March 2019 staff discussion paper, which included the Board's methodology for comparing CAS to GAAP, as well as its preliminary analysis of two of the 19 CAS. We

²GAO, *Military Acquisitions: DOD Is Taking Steps to Address Challenges Faced by Certain Companies*, [GAO-17-644](#) (Washington, D.C.: July 20, 2017).

³See National Defense Authorization Act for Fiscal Year 2017, Pub. L. No. 114-328, § 820(a) (Dec. 23, 2016).

⁴Pub. L. 114-328 § 820(a), (d).

discussed that approach with Board members, OFPP officials, and representatives from the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA). We also reviewed public responses to the staff discussion paper to identify common themes. Finally, we reviewed relevant GAO reports and the relevant section of a report prepared by a congressionally chartered panel that was tasked with simplifying acquisition regulations.⁵

We conducted this performance audit from April 2019 to February 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The federal government has long recognized the need to protect itself by ensuring contractors have appropriately allocated costs on cost-based contracts. In terms of what is potentially covered by CAS, cost-based contracts include cost-type contracts and certain fixed-price contracts where the contractor's estimated or actual costs play a role in determining the amount the government pays. The total amount obligated annually by the government on these types of contracts is significant. For example, in fiscal year 2018, the federal government obligated approximately \$172 billion on cost-type contracts alone, according to our analysis of Federal Procurement Data System information.

⁵Cost Accounting Standards Board Review Panel, *Future Role of the Cost Accounting Standards Board*, SP-99-1; (Apr. 2, 1999). Other previously issued GAO reports include: *Cost Accounting Standards Board: Little Progress Made in Resolving Important Issues*, [GAO/AIMD-94-88](#) (Washington, D.C.: May 25, 1994); *Comments on DOD Proposal to Establish a Cost Accounting Standards Board*, B-214442 (Washington, D.C.: Mar. 20, 1984); *Comptroller General's Views on Issues Related to the Reestablishment of the Cost Accounting Standards Board Function and Certain Matters on CAS 408, "Accounting for Costs of Compensated Personal Absence"*, [GAO/PLRD-83-75](#) (Washington, D.C.: May 3, 1983); and *Feasibility of Applying Uniform Cost-Accounting Standards To Negotiated Defense Contracts*, B-39995 (Washington, D.C.: Jan. 19, 1970). The congressionally created panel report refers to The Advisory Panel on Streamlining and Codifying Acquisition Regulations (Section 809 Panel), *Report of the Advisory Panel on Streamlining and Codifying Acquisition Regulations—Volume 2*, (Arlington, VA.: June 2018).

Need for Uniform Cost Accounting Standards

In 1968, the House Banking and Currency Committee held hearings to determine whether to renew the Defense Production Act of 1950. A witness at the hearings, U.S. Navy Admiral Hyman G. Rickover, testified that defense suppliers could make excessive profits and disguise them as overhead costs or hide them in other ways in the absence of a set of uniform cost accounting standards. Witnesses at the time testified that it was difficult to compare costs among prospective contractors' cost estimates or even to assess costs incurred on contracts with the same contractor without a set of uniform and consistent standards. Congress subsequently directed us to study the feasibility of establishing such standards. In January 1970, we reported one of many examples of mischarges involving a contractor that had charged the government for costs above the allowed cost ceiling by moving them under a separate contract cost category.⁶ We concluded that then-existing financial reporting standards were neither created nor adequate for contract cost purposes. In addition, we concluded that it was feasible to create a set of cost accounting standards and recommended doing so.

Creation of Board and Cost Accounting Standards

In August 1970, Congress created the Board as an independent board within the legislative branch.⁷ The Board was initially chaired by the Comptroller General, who appointed four other members. The Board was authorized to promulgate standards designed to achieve uniformity and consistency in cost accounting practices used by federal contractors on defense contracts in excess of \$100,000.

The Board issued 19 cost accounting standards that went into effect between 1972 and 1980 for applicable DOD contracts. These standards covered areas such as consistency between how actual and estimated costs are calculated and reported, and ensuring that costs are not double-

⁶B-39995 (1970).

⁷Defense Production Act, Pub. L. No. 81-774 (Sept. 8, 1950), as amended by Pub. L. No. 91-379 (Aug. 15, 1970).

counted. The standards were intended to ensure that incurred costs were appropriately allocated to government contracts.⁸

Generally Accepted Accounting Principles

In contrast, GAAP is a set of U.S. accounting standards, conventions, and rules focused on measuring companies' financial performance. GAAP is meant to establish and improve financial accounting and reporting to provide useful information to investors and other users of financial reports, including measurement and recognition of costs in financial statements. Federal endorsement of generally accepted accounting practices or principles dates back to the Securities Act of 1933. Then, the Securities Exchange Act of 1934 created the Securities and Exchange Commission and gave it authority to oversee accounting and auditing methods for publicly traded companies.⁹ Subsequently, various professional accounting groups, with oversight by the Securities and Exchange Commission, began working to establish standards and practices for consistent and accurate financial reporting, which became known as GAAP. In 1973, the Securities and Exchange Commission recognized the Financial Accounting Standards Board (FASB) as the designated accounting standard setter for public companies in the United States, and FASB is responsible for GAAP.

History of the Cost Accounting Standards Board

In fiscal year 1981, Congress stopped funding the Board. However, after a number of disputes arose as to how to interpret various standards, Congress reestablished the Board in 1988.¹⁰ Congress placed the Board under OFPP, which is part of the Office of Management and Budget (OMB) within the executive branch. Congress also broadened the Board's authority by applying CAS to all federal contracts—they were previously applicable only to defense contracts.¹¹

⁸See 48 C.F.R. part 9904.401. Appendix I provides a description of the 19 cost accounting standards.

⁹15 U.S.C. § 77a, et seq. (May 27, 1933); 15 U.S.C. § 78a, et seq. (June 6, 1934).

¹⁰The Office of Federal Procurement Policy Act Amendments of 1988, Pub. L. No. 100-679, § 5 (Nov. 17, 1988).

¹¹Pub. L. No. 100-679, § 5, codified at 41 U.S.C. § 1501.

Table 1 provides more information on the differences between CAS and GAAP.

Table 1: Cost Accounting Standards and Generally Accepted Accounting Principles

Category	Cost Accounting Standards (CAS)	Generally Accepted Accounting Principles (GAAP)
Responsible board and its roles	The Cost Accounting Standards Board is an independent board located within the executive branch with exclusive authority to make, promulgate, and amend cost standards and interpretations designed to achieve uniformity and consistency in the cost accounting practices governing the measurement, assignment, and allocation of costs to contracts with the federal government.	The Financial Accounting Standards Board (FASB) is the independent, private-sector, non-profit organization that establishes commercial financial accounting and reporting standards for public and private companies, and non-profit organizations that follow GAAP. FASB is recognized as the designated accounting standard setter for public companies by the Securities and Exchange Commission, and GAAP is recognized as authoritative for non-government entities by organizations such as the state Boards of Accountancy and the American Institute of Certified Public Accountants.
Purpose	To standardize how companies measure, assign, and allocate costs to specific government contracts.	To standardize how companies report their total operations for a given period (e.g., monthly, quarterly, or annually) to provide useful information to users of financial reports, including measurement and recognition of costs in financial statements.
Scope	19 standards and related guidance.	A large body of concepts, objectives, standards, and conventions.
Requirements	Business segments meeting applicability criteria are required to follow CAS and submit a disclosure statement describing their cost accounting practices and procedures.	The Securities and Exchange Commission requires public companies to file information, such as financial statements, which are made available to the public.
When standards were issued or became effective and updated	The Board issued 19 standards, which went into effect from 1972 to 1980. These standards have been clarified as needed.	FASB issued its first GAAP standard in 1973, and has issued multiple updates per year.

Source: GAO summary of information from the Office of Management and Budget, the Securities and Exchange Commission, the Cost Accounting Standards Board Review Panel, the Defense Contract Audit Agency, the Financial Accounting Standards Board, and applicable regulations. | GAO-20-266.

The Board met intermittently to address issues associated with interpretations of the standards after it was reestablished in 1988. In the late 2000s, the Board revised two of the standards related to pension contributions by government contractors for their employees.¹² Effective in 2008, Congress changed the minimum contributions required to fund pension plans.¹³ This change caused pension contributions to greatly exceed CAS pension costs reflected in contract prices. The Board updated the CAS effective in 2012 to harmonize CAS pension costs with

¹²CAS 412 provides guidance to contractors and the government on how to determine and measure the components of pension costs for defined benefit plans in a given year. 48 C.F.R. § 9904.412. CAS 413 establishes criteria for adjustments and allocation of pension costs. 48 C.F.R. § 9904.413.

¹³Pension Protection Act of 2006, Pub. L. No. 109-280 (Aug. 17, 2006).

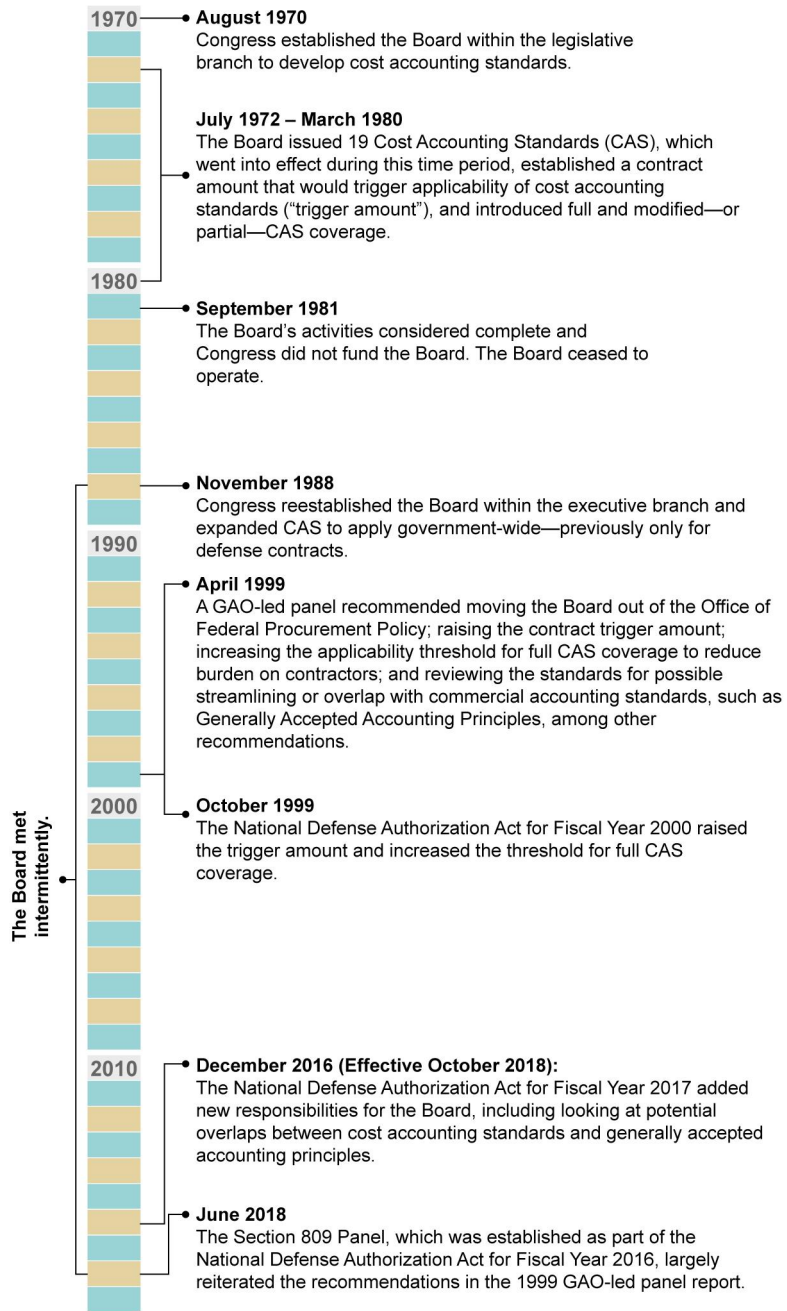
statutory changes to the pension funding requirements.¹⁴ However, the Board's changes did not address how costs were settled when pension plans were curtailed. In January 2013, we recommended that the Board set a schedule to revise parts of the CAS dealing with settlement of pension plan curtailments.¹⁵ Citing our recommendation, the Board began efforts to resolve this issue in July 2013 and the work is on-going.

While Board staff have been working to resolve these pension issues, the Board went several years without holding official meetings of the full board. Figure 1 illustrates the Board's activities over time.

¹⁴76 Fed. Reg. No. 81295 (Dec. 27, 2011), effective Feb. 27, 2012.

¹⁵GAO, *Pension Costs on DOD Contracts: Additional Guidance Needed to Ensure Costs Are Consistent and Reasonable*, [GAO-13-158](#) (Washington, D.C.: Jan. 22, 2013).

Figure 1: Cost Accounting Standards Board Activity—1970-2019



Source: GAO presentation of Cost Accounting Standards Board information from panel reports, a prior GAO report, and applicable laws. | GAO-20-266

The current Board is comprised of five members. The Administrator of OFPP is a member and serves as Board Chair. The other members include representatives from DOD, the General Services Administration, industry, and another private sector representative with cost accounting expertise. According to OFPP officials, the Board is also assisted by two OFPP staff—one on a full-time basis and one on a part-time basis—and a detailee from DCAA. In addition, OFPP officials said that the Board forms interagency working groups to address specific issues, such as pension harmonization. The Board receives its funding from OMB and does not have a separate funding source. According to OFPP officials, the Board's main expenses were salary reimbursement for the non-government employees who serve on the Board and publication costs for Federal Register notices.

Other federal agencies also have responsibilities to help administer the standards. For example, according to OFPP officials, most CAS-covered contracts are defense related. As such, DCAA reviews federal contractors' disclosure statements for adequacy and compliance—that is, whether the statements are current, accurate, and complete. Disclosure statements describe the company's actual or proposed cost accounting practices, including how they distinguish between costs, and how costs are allocated to contracts. DCAA also conducts audits to ensure contractors comply with CAS and with the contractors' disclosed and established cost accounting practices and procedures. In addition, DCMA monitors contractor performance and the contractor's business management systems, among other things, to ensure that the contractor is consistently following its cost accounting practices for contracts that are subject to CAS.

There is no definitive list of the companies, business segments or units, or contracts that are subject to CAS.¹⁶ Whether a contractor's business segment is required to comply with the standards on a particular contract

¹⁶The Section 809 Panel reported that CAS-covered contract data within the Federal Procurement Data System, while imperfect, could be used to roughly estimate the number of CAS-covered business segments and the total value of CAS-covered contracts. "Segment" is defined in the Federal Acquisition Regulation (FAR) as one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. FAR § 2.101. However, the Panel also noted that limitations in the Federal Procurement Data System do not allow a view of actual CAS-covered contracts, types of CAS coverage, or identification of CAS-covered business segments, among other limitations.

depends largely on the value of the government contracts it is awarded during the year that are cost-based. Once a contractor's business segment exceeds a certain dollar threshold of these "CAS-covered contracts," the business segment is required to comply with either (1) all 19 standards (termed "full CAS-coverage") or (2) four standards (termed "modified CAS-coverage").¹⁷ Full coverage applies to business segments with CAS-covered contracts with a combined value of \$50 million or more. Modified coverage may apply to business segments with a single CAS-covered contract of \$7.5 million or more, and combined CAS-covered contracts valued at less than \$50 million.¹⁸ Table 2 below lists all 19 CAS required under full coverage and the four CAS required under modified coverage.

¹⁷Appendix I provides more information on the CAS and their purpose.

¹⁸Appendix II provides more information on these thresholds and exemptions.

Table 2: Cost Accounting Standards Required under Full and Modified Coverage

Cost Accounting Standards	Standards required under full coverage	Standards required under modified coverage
401. Consistency in Estimating, Accumulating, and Reporting Costs	yes	yes
402. Consistency in Allocating Costs Incurred for the Same Purpose	yes	yes
403. Allocation of Home Office Expenses to Segments	yes	
404. Capitalization of Tangible Assets	yes	
405. Accounting for Unallowable Costs	yes	yes
406. Cost Accounting Period	yes	yes
407. Use of Standard Costs for Direct Material and Direct Labor	yes	
408. Accounting for Costs of Compensated Personal Absence	yes	
409. Depreciation of Tangible Capital Assets	yes	
410. Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives	yes	
411. Accounting for Acquisition Costs of Material	yes	
412. Composition and Measurement of Pension Costs	yes	
413. Adjustment and Allocation of Pension Cost	yes	
414. Cost of Money as an Element of the Cost of Facilities Capital	yes	
415. Accounting for the Cost of Deferred Compensation	yes	
416. Accounting for Insurance Cost	yes	
417. Cost of Money as an Element of the Cost of Capital Assets Under Construction	yes	
418. Allocation of Direct and Indirect Costs	yes	
419. Reserved (blank)	n/a	n/a
420. Accounting for Independent Research and Development Costs and Bid and Proposal Costs	yes	

Source: GAO summary of 48 C.F.R. § 9903.201-2 and 49 C.F.R. Part 9904. | GAO-20-266

Prior GAO Reports and Recent Studies Related to the Board and Cost Accounting Standards

We and congressionally established review panels have previously studied the potential impact of CAS on industry as well as possible changes to the CAS and the Board. For example:

- In April 1994, we reported that seven of eight companies we reviewed either kept their government contracting work separate from their commercial contracting or assigned additional staff to their government

contracting segments due to the increased demands of government contracting, citing, among other things, CAS as a factor in that decision.¹⁹

- In January 1997, we reported on DOD's efforts to address acquisition cost drivers based, in part, on a prior DOD-directed study that identified CAS as one of the 10 largest cost drivers on DOD contracts.²⁰ In that report, a DCMA official noted that, in his opinion, while the annual cost of maintaining a CAS-compliant system is relatively small, the cost to establish a CAS-compliant system may be significant.
- Congress asked us to lead a panel of experts to assess the future role of the Board. In April 1999, we issued the panel's report focused on the Board and CAS in light of acquisition reforms and the evolution of GAAP.²¹ The panel concluded that, among other things, the Board should review CAS and its attendant requirements to determine whether standards could be streamlined to reduce unnecessary burden on affected contractors. In addition, the panel made several recommendations, including moving the Board out of OFPP to ensure autonomy. Congress did not act on this recommendation. The panel also recommended reviewing contract applicability and full-coverage thresholds for CAS. Congress subsequently set the modified coverage ceiling at \$7.5 million in October 1999.²²
- In July 2017, most of the 12 companies we spoke with that had not done business with DOD told us they chose not to do so because it might trigger a large number of contract terms and conditions that would be expensive to implement.²³ One reason provided by the companies for not competing for certain types of DOD contracts was the requirement to establish a government-unique cost accounting system and to disclose and follow cost accounting practices consistently.
- In June 2018, the Section 809 Panel—having been established to advise Congress on streamlining defense acquisition regulations—released the

¹⁹GAO, *Acquisition Requirements: Impact on Company Structures and Operations*, [GAO/NSIAD-94-20](#) (Washington, D.C.: Apr. 19, 1994).

²⁰GAO, *Acquisition Reform: DOD Faces Challenges in Reducing Oversight Costs*, [GAO/NSIAD-97-48](#) (Washington, D.C.: Jan. 29, 1997).

²¹SP-99-1.

²²The new modified CAS coverage ceiling took effect 180 days after the enactment of the legislation. National Defense Authorization Act for Fiscal Year 2000, Pub. L. No. 106-65, §§ 802(a), (i) (Oct. 5, 1999).

²³[GAO-17-644](#).

second of three volumes of its report.²⁴ In its report, the panel made two recommendations related to CAS, which largely reiterated what the GAO-led panel recommended in 1999. In this regard, the Section 809 panel recommended that the Board should be relocated to the General Services Administration as an independent board with a budget sufficient to support at least three full-time, permanent staff. The panel also recommended raising CAS applicability threshold levels again to further reduce burden on contractors. Subsequently, in 2019, OMB submitted a legislative proposal on raising the CAS applicability threshold from \$2 million to \$15 million. OMB officials also indicated that they would continue analyzing the effects of additional threshold changes. Congress had not enacted the proposal into law at the time of this report.

Board Efforts Generally Comply with Recent Legislative Requirements

The CAS Board generally has complied or is in the process of complying with the administrative and reporting requirements prescribed by Section 820 of the National Defense Authorization Act for Fiscal Year 2017, including initial efforts to assess the extent to which CAS can be conformed with GAAP. To do so, the Board is taking steps to follow its statutorily prescribed four-step rulemaking process. The Board's initial efforts focus on the extent to which two of the 19 standards might be modified or eliminated; however, Board members indicated that these efforts may take several more years to complete.

CAS Board Has Generally Complied with Administrative and Reporting Requirements

The Board has generally complied with the administrative requirements prescribed under Section 820 thus far, including meeting regularly, generally publishing notices and agendas in advance of meetings, and reviewing disputes involving cost accounting-related matters. According to officials from the Office of Federal Procurement Policy, the Board is working on the first of its annual reports on its efforts, including those associated with efforts to conform the standards with GAAP where practicable. Table 3 highlights the steps the Board is taking to address

²⁴Section 809 Panel Report, vol. 2.

some of the administrative and reporting requirements mandated by Section 820.

Table 3: Cost Accounting Standards Board Efforts to Address Administrative and Reporting Requirements Prescribed by the Fiscal Year 2017 National Defense Authorization Act

Fiscal Year 2017 National Defense Authorization Act administrative and reporting requirements	Board actions between January 2018 and November 2019
The Board must meet at least quarterly and publish notices and agendas ahead of time in the Federal Register.	The Board had met 17 times since February 2018. The Board published quarterly agendas except one for the third quarter of fiscal year 2019. According to Office of Federal Procurement Policy officials, there was a lapse in posting agendas in Federal Register notices due to the partial, six-week shutdown of the federal government.
The Board must annually review disputes involving cost accounting standards brought to various federal contract appeals boards or federal courts, and consider whether to clarify the standards in an effort to avoid such disputes.	In June 2019, the Board was briefed by Defense Contract Management Agency personnel on cost accounting-related disputes that have occurred over the last five years. Board members stated that they have held internal discussions to identify dispute trends to determine whether to issue additional guidance or clarification.
The Board must annually submit a report to congressional committees on actions taken to: 1) Conform Cost Accounting Standards with Generally Accepted Accounting Principles, and 2) Minimize the burden on contractors while protecting the interests of the federal government.	According to Office of Federal Procurement Policy officials, the Board is in the process of developing the first required annual report—covering fiscal year 2019—and will provide it to Congress in fiscal year 2020.

Source: GAO analysis of Section 820 of the Fiscal Year 2017 National Defense Authorization Act, Pub. L. No. 114-328, Office of Federal Procurement Policy information, and Federal Register notices. | GAO-20-266

Board Has Undertaken Initial Efforts to Assess How CAS Can Be Conformed with GAAP

The Board has also taken initial steps to address Section 820's requirement that the Board review the standards and conform them to GAAP, where practicable (see table 4).

Table 4: Cost Accounting Standards Board Efforts to Address Conformance-Related Requirements Prescribed by the Fiscal Year 2017 National Defense Authorization Act

Fiscal Year 2017 National Defense Authorization Act Cost Accounting Standards conformance requirements	Board actions between January 2018 and September 2019
<p>The Board must:</p> <ul style="list-style-type: none"> Ensure cost accounting standards rely on commercial standards and accounting practices and systems to the maximum extent practicable, and Regularly review any cost accounting standards and conform such standards where practicable to GAAP. 	<p>The Board released a staff discussion paper in March 2019 outlining its guiding principles and the methodology it would use to identify areas in which CAS might be conformed to GAAP.</p>

Source: GAO analysis of Section 820 of the Fiscal Year 2017 National Defense Authorization Act, Pub. L. No. 114-328, Office of Federal Procurement Policy information, and Federal Register notices. | GAO-20-266

In carrying out this work, the Board is taking steps to follow a statutorily prescribed four-step rulemaking process for promulgating CAS or interpretations.²⁵ Figure 2 below outlines these requirements.

Figure 2: Cost Accounting Standards Board Rulemaking Process



Source: GAO presentation of 41 USC §1502(c). | GAO-20-266

In line with this process, between March and November 2018, the Board discussed the opportunities and methods available for conforming CAS to GAAP. The Board held informal discussions with its staff, industry representatives, and government agencies, such as DCAA. One of the messages coming from the feedback was for the Board to focus first on those standards that offered the greatest potential for change. By the end

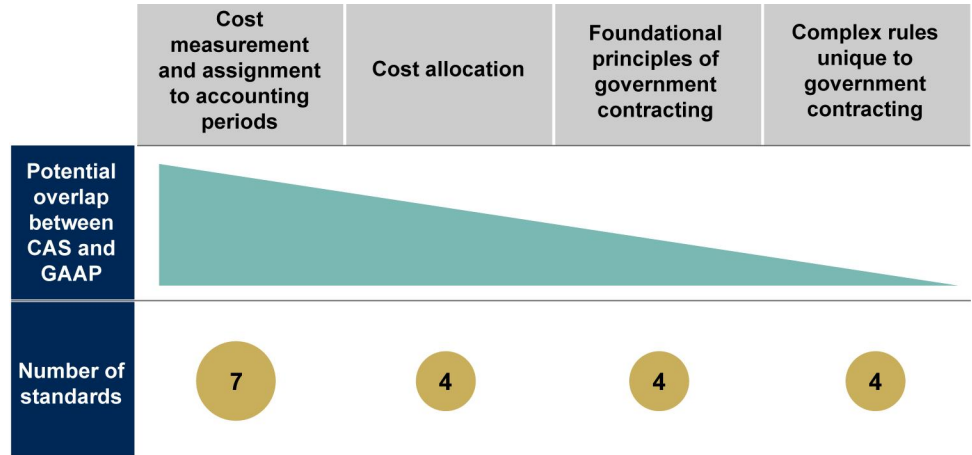
²⁵41 U.S.C. § 1502(c).

of 2018, the Board had completed development of the staff discussion paper. The Board expected to release this document in the Federal Register for public comment in January 2019; however, a partial shutdown of the federal government due to lapsed funding delayed its release until March 2019.

The March 2019 staff discussion paper (1) outlined a set of five guiding principles that the Board would use to assess whether proposed CAS changes are necessary and whether those changes would reduce the burden on contractors while protecting the government's interests, (2) identified a roadmap that prioritized the Board's proposed review of standards, and 3) included a preliminary comparison of two standards to GAAP.

- **Guiding Principles.** The guiding principles outlined in the staff discussion paper describe the elements the Board will consider when determining whether changes to the CAS will reduce burden on contractors while continuing to protect the interests of the federal government. As stated in the staff discussion paper, the Board will:
 - 1) reduce CAS requirements where practicable;
 - 2) consider whether the proposed action would reduce burden on contractors overall;
 - 3) consider whether other CAS or federal rules would protect the government's interests in case of any gaps created by relying on GAAP;
 - 4) monitor future changes to GAAP and the Federal Acquisition Regulation (FAR) to identify and evaluate their impact on CAS and revise CAS, as necessary; and
 - 5) monitor future significant disputes related to the conformance to GAAP and evaluate whether the Board should address them through clarifying guidance or rulemaking.
- **Prioritization.** The Board grouped the 19 CAS into four categories based on the Board's assessment of which standards are most likely to have overlap with GAAP (see figure 3).

Figure 3: Cost Accounting Standards Board Initial Assessment of the Potential Overlap between the 19 Cost Accounting Standards (CAS) and Generally Accepted Accounting Principles (GAAP)



Source: GAO presentation of Cost Accounting Standards Board information. | GAO-20-266

The Board plans to focus its initial efforts on the seven standards in the first group, which focus on cost measurement and assigning costs to accounting periods. According to its staff discussion paper, the Board’s proposed approach is to assess the standards by developing side-by-side comparisons of CAS requirements to corresponding GAAP requirements and identifying any gaps between the two. The Board will then evaluate the potential risk of any gaps identified, taking into account coverage by other CAS requirements and related regulations; for example, the FAR.²⁶ The Board will also assess whether there is a history of compliance issues for those standards. According to OFPP officials, such assessments will help the Board determine whether they need to update guidance related to a particular CAS. Lastly, the Board plans to assess changes that have occurred in GAAP relative to CAS and to evaluate the need to conform CAS to the updated GAAP. For example, the Board has

²⁶FAR part 30 describes policies and procedures for applying the Board’s rules and regulations, while FAR subpart 30.2 requires contracting officers to include specific provisions and clauses in contracts to implement the cost accounting standards.

identified two recent changes in GAAP that it states may not align with CAS.²⁷

- **Comparison.** The Board has begun this effort by looking at two standards focused on measuring and assigning costs (CAS 408 and CAS 409), since it believes that GAAP potentially provided additional coverage compared to when the two CAS were established in 1975. OFPP officials stated that these two standards provided a good opportunity to modify and potentially eliminate duplicative coverage while testing the soundness of the Board's approach to conform CAS to GAAP where practicable.

Public Response to the Board's Approach Has Been Mixed

The Board received seven separate comment letters on the staff discussion paper from five industry organizations, one commercial business, and one private individual. Our review of the comments found that they were largely supportive of the Board's guiding principles, but some commenters raised concerns regarding the Board's approach to its conformance effort and questioned whether it would ease the burden on contractors. For example, four respondents commented that the Board should not limit its focus to only revising or eliminating particular CAS when it was clear that GAAP provided adequate coverage. Instead, these industry groups stated that each CAS should be eliminated unless proven to be absolutely necessary due to the barriers to contractors that these groups believe the CAS create.

The Board members we met with stated that all options for refining CAS requirements were on the table. However, they also stated that GAAP and CAS are focused on two separate goals—the former on a business's high-level financial statement, the latter on individual contract costs. Board members, as well as DCAA and DCMA officials, noted that eliminating CAS requirements to rely purely on GAAP standards would

²⁷The Financial Accounting Standards Board's Accounting Standards Update No. 2016-02 requires lessees to report most operating leases as assets and liabilities on the balance sheet. According to the Board, this change may impact areas of CAS related to the allocation of residual costs in 48 C.F.R. § 9904-403-50(c)(1) and the calculation of cost of money in accordance with 48 C.F.R. § 9904.414. The Board noted that Accounting Standards Update No. 2014-09 requires revenue to be recognized when control of promised goods or services transfers to customers which may impact areas of CAS, such as the definition of "operating revenue" in 48 CFR 9904.403-30(a)(3).

limit the government's ability to compare contract proposals, assess actual costs to avoid overcharges by contractors, and protect its interests. For example, DCMA officials stated that the government has \$3.1 billion in pending litigation for identified CAS noncompliances. Recovery of increased costs is accomplished in part through contract clauses that entitle the government to recover specific cost increases on affected CAS-covered contracts.²⁸ Were CAS and the associated contract clauses eliminated, DCAA and DCMA officials noted that the government's ability to recover these costs would be greatly reduced. In addition, the Board is concerned that in modifying or perhaps even eliminating certain CAS requirements, and instead using GAAP, there is the risk that future GAAP changes would no longer cover the areas of CAS concern. This would leave the government vulnerable to the issues that the modified or eliminated CAS were originally created to address.

Members of the Board and staff we spoke with indicated that the Board is reviewing and assessing the public comments on the staff discussion paper to determine whether the Board needs to make changes to the paper's guiding principles or methodology going forward. According to the Board members, the Board will issue a Federal Register notice explaining any changes resulting from public input and its own additional deliberations. Additionally, they said the Board will consult with the Financial Accounting Standards Board—which is responsible for GAAP—to answer technical questions and ensure that the Board has an accurate understanding of GAAP coverage as they continue to perform side-by-side comparisons of CAS and GAAP. Further, the Board stated that it will publish a notice to address public comments on CAS to GAAP conformance projects and that additional staff discussion papers and associated notices will be published in the Federal Register for public comment as they are completed.

In addition to streamlining or eliminating CAS standards, some of the comments in response to the staff discussion paper pointed to other areas that the Board may want to consider to reduce the burden on government contractors. For example, some comments encouraged the Board to consider increasing CAS full-compliance dollar thresholds. Reassessing the CAS full-compliance threshold aligns with findings from

²⁸FAR § 52.230-2, Cost Accounting Standards, generally requires that a contractor must agree to an adjustment, with interest, to government contracts if it fails to comply with an applicable Cost Accounting Standard.

congressionally established panel reports from 1999 and 2018.²⁹ According to both panels' findings, increasing compliance thresholds is a way to decrease burden on many government contractors while still protecting the bulk of the government's contracting dollars. As previously noted, OMB recently submitted a legislative proposal to raise the threshold from \$2 million to \$15 million. OMB also indicated that it intends to continue studying available data to understand the costs and benefits of CAS threshold changes and whether additional changes to the threshold need to be made.

Agency Comments

We provided a draft of this report to DOD, the Office of Management and Budget, and the Cost Accounting Standards Board for their review and comment. DOD had no comments on the report. The Office of Management and Budget and the Board provided technical comments, which we incorporated where appropriate.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Defense; the Director, Defense Procurement and Contracting; the Director, Defense Contract Audit Agency; the Director, Defense Contract Management Agency; the Director, Office of Management and Budget; and the Administrator, Office of Federal Procurement Policy. In addition, this report will be available at no charge on the GAO website at <https://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-4841 or by e-mail at dinapolit@gao.gov. Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.



Timothy J. DiNapoli
Director, Contracting and National Security Acquisitions

²⁹SP-99-1 and Section 809 Panel, vol. 2.

List of Committees

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Chairman
The Honorable Jack Reed
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Richard Shelby
Chairman
The Honorable Richard J. Durbin
Ranking Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable Adam Smith
Chairman
The Honorable Mac Thornberry
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Committee on Armed Services
House of Representatives

The Honorable Pete Visclosky
Chairman
The Honorable Ken Calvert
Ranking Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Appendix I: Description of the 19 Cost Accounting Standards and Their Purpose

Table 5: Cost Accounting Standards, Their Purpose, and the Cost Accounting Standards Board Assessment of the Potential Overlap with Generally Accepted Accounting Principles (GAAP)

Cost Accounting Standard (CAS)	Initial effective date	Purpose	The Cost Accounting Standards Board's assessment of the potential overlap with GAAP
401. Consistency in Estimating, Accumulating and Reporting Costs	July 1, 1972	Requires that costs estimated in proposals be developed consistently with the practices used by the contractor in accumulating and reporting costs.	Limited opportunity to conform to GAAP
402. Consistency in Allocating Costs Incurred for the Same Purpose	July 1, 1972	Ensures that each type of cost is allocated only once and on only one basis to any contract or other cost objective.	Limited opportunity to conform to GAAP
403. Allocation of Home Office Expenses to Segments	July 1, 1973	Establishes criteria for allocation of home office expenses to the segments of the organization on the basis of a beneficial or causal relationship.	Much less opportunity to conform to GAAP
404. Capitalization of Tangible Assets	July 1, 1973	Establishes that the acquisition costs of tangible assets shall be capitalized based upon an established policy.	Most opportunity to conform to GAAP
405. Accounting for Unallowable Costs	April 1, 1974	Facilitates the negotiation, audit, administration, and settlement of contracts. It contains guidelines on (1) identification of costs specifically described as unallowable, at the time such costs first become defined or authoritatively designated as unallowable, and (2) the cost accounting treatment to be accorded such identified unallowable costs to promote the consistent application of sound cost accounting principles covering all incurred costs.	Limited opportunity to conform to GAAP
406. Cost Accounting Period	July 1, 1974	Provides criteria for selecting the time periods to be used as cost accounting periods for contract cost estimating, accumulating, and reporting.	Limited opportunity to conform to GAAP
407. Use of Standard Costs for Direct Material and Direct Labor	October 1, 1974	Provides criteria: (1) under which standard costs may be used for estimating accumulating, and reporting costs of direct material and direct labor, and (2) relating to the establishment of standards, accumulation of standard costs, and accumulation and disposition of variances from standard costs.	Most opportunity to conform to GAAP

Appendix I: Description of the 19 Cost Accounting Standards and Their Purpose

Cost Accounting Standard (CAS)	Initial effective date	Purpose	The Cost Accounting Standards Board's assessment of the potential overlap with GAAP
408. Accounting for Costs of Compensated Personal Absence	July 1, 1975	Establishes criteria for measuring and allocating the costs of compensated personal absences to final cost objectives. These costs include compensation paid by contractors to their employees for such benefits as vacation, sick leave, holiday, military leave, among others.	Most opportunity to conform to GAAP
409. Depreciation of Tangible Capital Assets	July 1, 1975	Provides criteria for assigning costs of tangible capital assets to cost accounting periods and for allocating such costs in an objective and consistent manner.	Most opportunity to conform to GAAP
410. Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives	October 1, 1976	Provides criteria for the allocation of general and administrative (G&A) expenses to final cost objectives and furnishes guidelines for the type of expense that should be included in the G&A expense pool. It also establishes that G&A expense shall be allocated on a cost input base that represents total activity.	Much less opportunity to conform to GAAP
411. Accounting for Acquisition Costs of Material	January 1, 1976	Provides criteria for the accounting of acquisition costs of material and includes provisions on using inventory costing methods. This standard does not cover accounting for the acquisition costs of tangible capital assets or accountability for government-furnished materials.	Most opportunity to conform to GAAP
412. Composition and Measurement of Pension Costs	January 1, 1976	Provides guidance for determining and measuring the components of pension costs and establishes the basis for assigning pension costs to cost accounting periods. [CAS 413 addresses the accounting treatment of actuarial gains and losses and the allocation of pension costs to segments of an organization.]	Little if any opportunity to conform to GAAP
413. Adjustment and Allocation of Pension Cost	March 10, 1978	Establishes criteria for (1) measuring actuarial gains and losses; (2) assigning actuarial gains and losses to cost accounting periods; and (3) allocating pension costs to segments of an organization.	Little if any opportunity to conform to GAAP
414. Cost of Money as an Element of the Cost of Facilities Capital	October 1, 1976	Provides criteria for measuring and allocating the cost of capital committed to facilities as an element of contract cost.	Little if any opportunity to conform to GAAP
415. Accounting for the Cost of Deferred Compensation	July 10, 1977	Provides criteria for measuring deferred compensation costs and assigning those costs to cost accounting periods. It applies to all deferred compensation costs except for compensated personal absences (CAS 408) and certain pension costs (CAS 412).	Most opportunity to conform to GAAP

Appendix I: Description of the 19 Cost Accounting Standards and Their Purpose

Cost Accounting Standard (CAS)	Initial effective date	Purpose	The Cost Accounting Standards Board's assessment of the potential overlap with GAAP
416. Accounting for Insurance Cost	July 10, 1979	Provides criteria for the measurement of insurance costs, the assignment of such costs to cost accounting periods, and their allocation to cost objectives.	Most opportunity to conform to GAAP
417. Cost of Money as an Element of the Cost of Capital Assets Under Construction	December 15, 1980	Establishes criteria for the measurement of the cost of money attributable to capital assets under construction, fabrication, or development as an element of the cost of those assets.	Little if any opportunity to conform to GAAP
418. Allocation of Direct and Indirect Costs	September 20, 1980	Requires the consistent classification of costs as direct or indirect, establishes criteria for accumulating indirect costs in indirect cost pools, and provides guidance relating to allocating indirect cost pools.	Much less opportunity to conform to GAAP
419. Reserved (blank)	N/A	N/A	N/A
420. Accounting for Independent Research and Development Costs and Bid and Proposal Costs	March 15, 1980	Provides criteria for the accumulation of independent research and development costs and bid and proposal costs and for the allocation of such costs to cost objectives.	Much less opportunity to conform to GAAP

Source: GAO summary of data from the Cost Accounting Standards Board Review Panel, the Defense Contract Audit Agency, and the Cost Accounting Standards Board. | GAO-20-266

The Cost Accounting Standards Board's Assessment of the Potential Overlap with GAAP

- Most opportunity to conform to GAAP (From most overlap to least overlap (top to bottom))
- Much less opportunity to conform to GAAP
- Limited opportunity to conform to GAAP
- Little if any opportunity to conform to GAAP

Appendix II: Cost Accounting Standards Applicability, Exemptions, and Compliance

Cost Accounting Standards Applicability. In general, a business segment is not subject to Cost Accounting Standards (CAS) until it receives a non-exempt contract of \$7.5 million or more from the federal government. Generally, a non-exempt contract is a contract that does not meet any of the exemptions listed below. Typically, once a business segment receives a non-exempt contract of \$7.5 million or more, all of its prospective non-exempt contracts or subcontracts over \$2 million are considered CAS-covered.¹

Summary of Exemptions. The following categories of contracts and subcontracts are exempt from all CAS requirements:²

- Sealed bid contracts;
- Negotiated contracts and subcontracts not in excess of the Truth in Negotiations Act (TINA) threshold, as adjusted for inflation (41 U.S.C. 1908 and 41 U.S.C. 1502(b)(1)(B)). For purposes of this exemption, an order issued by one segment to another segment shall be treated as a subcontract;
- Contracts and subcontracts with small businesses (Federal Acquisition Regulation (FAR) Subpart 19.3 addresses determination of status as a small business.);
- Contracts and subcontracts with foreign governments or their agents or instrumentalities or, insofar as the requirements of CAS other than CAS 401 and CAS 402 are concerned, any contract or subcontract awarded to a foreign concern;
- A contract or subcontract where the price is set by law or regulation;

¹The \$2 million threshold is tied to the Truth in Negotiations Act (TINA) requirement for certified cost or pricing data. TINA requires offerors to submit certified cost or pricing data if the procurement exceeds the TINA threshold and none of the exceptions to certified cost or pricing data requirements applies. See 10 U.S.C. § 2306a and 41 U.S.C. chapter 35.

²48 C.F.R. § 9903.201-1.

- A contract or subcontract authorized in FAR § 12.207 for the acquisition of a commercial item;
- A contract or subcontract with a value of less than \$7,500,000 if, at the time of award, the business segment of the contractor or subcontractor that will perform the work has not been awarded at least one contract or subcontract with a value of \$7,500,000 or more that is covered by the standards.
- Subcontracts under the North Atlantic Treaty Organization's Patrol Missile Hydrofoil Ship programs to be performed outside of the United States by a foreign concern;
- A firm-fixed price contract or subcontract awarded on the basis of adequate price competition without submission of certified cost or pricing data.

In addition, in cases where the prime contract is exempt from CAS under any of the exemptions at 48 C.F.R. § 9903.201-1 any subcontract under that prime is always exempt from CAS. Also, Title 41 of the U.S. Code was amended effective in 2018 to allow executive agency heads can waive CAS requirements for a contract or subcontract with a value of less than \$100 million if the business segment is primarily engaged in commercial work and would not otherwise be subject to CAS, or for exceptional circumstances where waiving CAS is necessary to meet agency needs.³

Compliance. There are two levels of CAS coverage—full and modified. Full coverage applies to business segments with CAS-covered contracts valued at \$50 million or more; those business segments must comply with all 19 standards. Modified coverage may apply to business segments with CAS-covered contracts valued less than \$50 million. Business segments that have contracts awarded with modified coverage must comply with four of the standards.⁴

Business segments with full CAS-covered contracts are also required to submit disclosure statements describing the company's actual or

³Effective October 1, 2018, 41 U.S.C. § 1502(b)(3)(A) was amended to increase the value of contracts eligible for waiver to \$100 million (from \$15 million). See Pub. L. No. 114-328, §§ 820 (a)(2), (d). However, neither the FAR nor the CAS regulations have been updated yet to reflect the statutory change. See FAR § 30.201-5(b)(1); 48 C.F.R. § 9903.201-5(a).

⁴See 48 C.F.R. § 9903.201-2. The four standards are CAS 401, 402, 405, and 406. See appendix I for additional information on the standards.

proposed cost accounting practices and procedures, including how they distinguish direct costs from indirect costs and the basis used for allocating indirect costs. The Defense Contract Audit Agency (DCAA) reviews disclosure statements for adequacy and compliance—that is, whether the statement is current, accurate, and complete—prior to contract award and during contract performance. DCAA may also complete CAS compliance audits at the request of the cognizant federal agency official after contract award.⁵ In some circumstances, the Defense Contract Management Agency (DCMA) will review disclosure statements that are not audited by DCAA. According to officials, both DCAA and DCMA provide audit findings to the cognizant federal agency official, who then disposes the audit findings by making the final determination of adequacy and compliance.

- The purpose of disclosure statement audits is to determine whether the contractor's disclosed or established practices are in compliance with CAS rules, regulations, and standards, as well as appropriate acquisition regulations. A CAS-related noncompliance may be found if a contractor with a CAS-covered contract proposes a practice that will violate CAS or a government acquisition regulations cost principle, or if the contractor's actual practices are either inconsistent with their own disclosure statement or noncompliant with the cost standards or principles. For example, in 1970, we, along with DCAA auditors, found instances where contractors charged costs as both direct and indirect costs to the same contract, resulting in the contractors recovering the same charge twice.⁶
- If an auditor discovers a noncompliance issue, the auditor will submit an advisory report to the cognizant federal agency official who makes the final determination. The consequences of a CAS noncompliance can range from a contract adjustment to litigation.⁷ According to the DCMA's Contract Dispute Resolution Center, there were 15 judicial decisions issued in CAS-related board and court cases in the last five years.

⁵The cognizant federal agency official is the contracting officer assigned by the cognizant federal agency to administer the Cost Accounting Standards. For DCAA audits, this person is most commonly a DCMA contracting officer but can be a contracting officer from another department or agency depending on the nature of contractor's government work.

⁶B-39995 (1970).

⁷FAR § 30.605.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

In addition to the contact named above, Bruce H. Thomas, Assistant Director; Peter Anderson; Jennifer Baker; Miranda Riemer; Jenny Shinn; Ryan Stott; and Roxanna T. Sun made key contributions to this report.

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