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Washington, DC
ksacilotto@wileyrein.com

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Section of Public Contract Law

321 N. Clark Street
Chicago, IL 60654-7598
(312) 988-5699
www.ambar.org/pubcon

June 7, 2019

Via Email to casb@omb.eop.gov

Office of Federal Procurement Policy
Attn: Mr. Raymond Wong
725 17th Street NW
Washington, DC 20503

Re: CASB Staff Discussion Paper on Conformance of the Cost Accounting Standards to Generally Accepted Accounting Principles (CASB Case 2019-01), 84 Fed. Reg. 9143 (March 13, 2019)

Dear Mr. Wong,

On behalf of the American Bar Association (“ABA”) Section of Public Contract Law (“Section”), I am submitting comments on the staff discussion paper cited above. The Section consists of attorneys and associated professionals in private practice, industry, and government service.¹ The Section’s governing Council and substantive committees include members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA’s Board of Governors. The views expressed herein are presented on behalf of the Section. They have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the position of the ABA.²

¹ Kara M. Sacilotto, Section Chair, Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, and Scott Flesch, Marian Blank Horn, and Kristine Kassekert, members of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.

² This letter is available in pdf format at http://www.americanbar.org/groups/public_contract_law/resources/prior_section_comments.html under the topic “Accounting, Cost and Pricing.”

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I. INTRODUCTION

On March 13, 2019, the Office of Management and Budget (“OMB”) issued a Staff Discussion Paper prepared by the Cost Accounting Standards Board (“CASB” or “Board”) to invite public comment concerning the conformance of the Cost Accounting Standards (“CAS”) to Generally Accepted Accounting Principles (“GAAP”). The National Defense Authorization Act for Fiscal Year 2017 (Pub. L. No. 114-328, 130 Stat. 2273) amended 41 U.S.C. § 1501(c)(2) to require the Board to review CAS and conform them, where practicable, to GAAP. In addition, the amended 41 U.S.C. § 1502(e) requires the Board to submit an annual report to the Congressional defense committees, the House Committee on Oversight and Government Reform,³ and the Senate Committee on Homeland Security and Governmental Affairs describing the actions taken during the prior year to conform CAS with GAAP and to minimize the burden on contractors while protecting the interests of the Government.

The Section applauds the Board for thoughtfully undertaking the effort to conform CAS to GAAP. But the Section is concerned that the CASB’s detailed line-by-line analysis of each Standard relative to GAAP will not accomplish what Congress intended: to minimize the burden on contractors to the extent *practicable*.⁴

II. COMMENTS

A. Summary

We urge the CASB to revisit its charge from Congress in a broader sense. When established, GAAP did not fully address the measurement, assignment, and allocation of costs, which prompted creation of the CAS. Since that time, GAAP has evolved considerably. To the extent that GAAP now meets the CASB’s primary objective of achieving cost-accounting uniformity and consistency, and reflects no preference for contractors or the Government, certain CAS can and should be eliminated—even where GAAP and CAS currently differ.

The government procurement environment has changed significantly since the CASB promulgated the Standards in the 1970s. In recent years, Congress has emphasized that unnecessary and burdensome government-unique rules discourage commercial companies from selling to the Government, thus limiting the Government’s access to products and services that it needs. The Section accordingly encourages the CASB to approach conformance of CAS to GAAP with the objective of reducing government-unique rules unless necessary to protect the Government’s interest.

In this regard, the CASB should interpret the term “practicable” (as used by Congress in Section 820 of the FY17 NDAA) in a broad sense. Rather than requiring clear reasons to eliminate any CAS before proposing to do so, the CASB should instead be looking for clear reasons to keep each Standard. So long as CAS is maintained, detailed differences between CAS and GAAP will continue to create barriers to commercial participation in government procurement. Although

³ Now the Committee on Oversight and Reform.

⁴ See § B.2.b, *infra*, for additional discussion.

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these detailed differences may indeed create different accounting outcomes, if GAAP accomplishes the CASB's primary objective of uniformity and consistency, without unduly advantaging either contracting party, then the corresponding Standard should be eliminated. Additionally, the Section encourages the CASB to approach the phrase "protecting the government's interests" within the scope of its authority: to achieve uniformity and consistency in cost accounting evenhandedly.

Regarding the term "practicable" used in the NDAA, the Section is concerned that the CASB's approach may be more in line with the term "practical." The Section acknowledges it may be "practical" to eliminate or conform CAS only when there is strong evidence that GAAP is substantially the same as CAS, whereas it is "practicable" to keep or conform CAS only when there is strong evidence that GAAP will not achieve the CASB's primary objectives of uniformity and consistency.

The Section appreciates the CASB's initial attempt to conform CAS 408 and 409 and we agree that these two Standards are ripe for conformance. However, because they are substantially similar to current GAAP and not a source of controversy, the Section urges the CASB to refocus its efforts on two recent GAAP changes (lease accounting and revenue) that could create acute, near-term challenges for contractors. The Section believes that if the CASB addresses lease accounting and revenue, then it can make immediate and impactful progress toward conforming CAS and GAAP, minimize burden on contractors, and protect the interests of the Government.

The Section also believes the CASB can make rapid, significant progress toward achieving Congress's objectives by endorsing implementation of the Section 809 Panel's recommendation no. 30. This particular recommendation, contained in Section 4 of the June 2018 Report Volume 2, calls for Congress to, among other things, significantly increase the CAS applicability thresholds.⁵ As the Section 809 Panel researched and explained, doing so will meaningfully reduce the number of CAS-covered contracts and, thus, the number of contractors that must comply with CAS. Although CAS-GAAP conformance is an important undertaking, it appears likely to achieve smaller incremental reductions in compliance burdens relative to the Section 809 Panel's recommendations for attracting more commercial companies to the government marketplace.

Finally, the Section urges the Board to avoid changes to CAS and implementing regulations that may extend CAS administration to GAAP. Such an outcome would reduce the benefits of eliminating Standards by adding new burdens not contemplated by Congress. The Government does not need to expand CAS into enforcing GAAP because costs inconsistent with GAAP are unallowable by rule, which provides a method for the Government to ensure contractors comply with the relevant GAAP requirements. *See* FAR 31.201-2(a)(3). And CAS already provides for consistent cost estimating, accounting, and reporting (via CAS 401) regardless of whether cost accounting practices are governed by CAS or GAAP.

⁵ The report is available here: https://section809panel.org/wp-content/uploads/2019/01/Sec809Panel_Vol2-Report_JUN2018_012319.pdf.

B. The Government Contracting Environment and GAAP has Changed

1. Historical Environment

The 1970s marked a notable decline of the domestic industrial era. Information technology was nascent. Government contract spending was mostly defense-related and primarily for products (not services) from relatively few large industrial companies. These products tended to be government-unique items developed with government funding. Non-competitive firm-fixed price contracts were prevalent, which were negotiated using cost-based pricing.

The Department of Defense, particularly Navy Vice Admiral Hyman Rickover, testified before Congress about the lack of uniformity and consistency in contractor cost accounting, which frustrated the Department's ability to negotiate fair and reasonable contract prices. Congress chartered the then-named General Accounting Office ("GAO") to study the feasibility of "cost accounting standards." Because GAAP did not sufficiently address uniformity and consistency of cost accounting, and because the GAO's study suggested that cost accounting standards were both necessary and feasible, in 1970 Congress created the CASB and charged it with developing cost accounting standards applicable to defense contractors. The focus of the CASB, when evaluating the need for CAS, was on achieving a reasonable degree of cost accounting uniformity and consistency in:

- The measurement of costs
- The assignment of costs to cost accounting periods
- The allocation of costs to contracts

2. Current Practices

Over the past 40 years, the economy transitioned into the information technology/knowledge era. Although the Government still acquires industrial products, information technologies and knowledge-based services have become the focus of government procurement. The commercial marketplace rapidly develops new technologies, primarily at private expense. Service contracting has become highly competitive, and the Government negotiates comparatively fewer service-contract prices based on costs. Long-term traditional contract types (i.e., firm-fixed price, cost-type) have in many cases transformed into shorter-term hybrid and IDIQ contracts (with option periods) that provide for task orders or line-items of varying types.

The commercial marketplace has become the engine of innovation. Both Congress and the Section 809 Panel have amplified the importance of government access to this market. However, the Government's industrial-era procurement rules remain in effect and can deter commercial companies from participating in government procurements, which limits both competition and the Government's access to knowledge and technologies.

GAAP has also evolved since the 1970s, especially in measuring costs and assigning them to accounting periods. Although the CASB's original objectives remain relevant in the current market environment, the CAS themselves have remained relatively unchanged, and certain CAS

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are no longer necessary to achieve cost accounting uniformity and consistency given developments in GAAP.

Although the nature of government contracting has evolved since the 1970s, the prevalence of cost-type contracting (to Congress's dissatisfaction) supports the continuing need for reliable and consistent contract cost accounting. But because GAAP now addresses cost measurement and assignment, fewer government-unique rules are needed to accomplish that consistency and reliability.

C. Guiding Principles

The Section generally agrees with the CASB's Guiding Principles for CAS-GAAP conformance but encourages the CASB to revisit its philosophical approach to the term "practicable" and phrase "protect the interests of the government." The Congressional record provides guidance in this regard, as detailed below.

With respect to the phrase "protect the interests of the government," the Section is concerned that the CASB may be interpreting it too broadly. In the context of CAS, consistent with the CASB's Statement of Objectives, Policies, and Concepts, "protecting the interests of the government" means achieving uniformity and consistency in cost accounting, without bias or prejudice to either contracting party. Any other interpretation of that phrase is a policy matter for each government agency and outside the CASB's scope, in the Section's reading.

D. Conformance of CAS to GAAP

1. FY 17 NDAA

The Section is concerned that the CASB may interpret the statutory language regarding CAS to GAAP conformance more narrowly than Congress intended. The Section notes that several passages from the FY17 NDAA committee and conference reports indicate Congress's desire for the CASB to act to reduce burdensome, government-unique rules:

The committee is concerned that the current cost accounting standards favor incumbent defense contractors and limit competition by serving as a barrier to participation by non-traditional, small business, and commercial contractors. To level the competitive playing field to access new sources of innovation it is in the government's interest to adopt more commercial ways of contracting, accounting, and oversight. The provision requires that cost accounting standards developed shall to the **maximum extent practicable** align with Generally Accepted Cost Accounting Principles, thereby **minimizing the requirement for government-unique cost accounting systems**.⁶

* * *

⁶ Senate Armed Services Committee Report, Section 811 (emphasis added).

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The provision also requires that cost accounting standards developed shall to the **maximum extent practicable** align with Generally Accepted Accounting Principles (GAAP), thereby minimizing the requirement for government-unique cost accounting systems.⁷

* * *

Additional language, though specific to the provisions addressing the CASB, further reflects the spirit of Congress to reduce the burden of government-unique rules:

The committee is frustrated by the continuous dependence of the Department of Defense on the use of cost type contracts. While there are some circumstances where cost-type contracts may be appropriate, the Department has over the years expanded the use of these types of contracts as a forcing mechanism to achieve absolute certainty in visibility over contractor costs. While this visibility has enabled the Department the ability to achieve some narrow cost reductions on certain contracts, it has come at the cost of reduced competition and innovation. The effect of the overuse of cost-type contracts is the narrowing of the industrial base **as commercial firms make a choice not to invest in the unique accounting and financial systems necessary to compete for a cost contract. This expensive barrier to entry has resulted in a smaller pool of defense unique companies that can comply with government unique requirements necessary to execute a cost contract. Commercial companies that choose not to invest in expensive government unique accounting systems are effectively precluded from doing business with the Department when DOD chooses to use cost contracts.** This provision, in combination with the preference for fixed-price contracts in a separate section of this Act, is designed to limit the use of cost contracts in the future and focus the Department on achieving greater value and innovation through accessing commercial, non-traditional, and small business contractors that are nimble enough to operate in a fixed-price environment.⁸

In light of Congress's expressed views, the Section urges the CASB to eliminate Standards where GAAP provides for uniformity and consistency in the measurement of costs and assignment of costs to accounting periods, and shows neither bias nor prejudice to either contracting party.

2. *Conformance Alternatives*

a. *The Section's recommended alternative*

To the extent GAAP provides for uniformity and consistency, the CASB should remove CAS related to the same area of cost even if doing so produces a transitory cost impact. The

⁷ Conference Report, Section 820 (emphasis added).

⁸ Conference Report, Section 826 (emphasis added).

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Section urges the CASB to focus on this alternative in light of the GAAP developments and views of Congress described above.

Any cost impact associated with eliminating CAS is a separate matter addressable with a fair and equitable transition plan similar to when contractors initially adopted Standards as they became effective. The Section encourages the CASB to weigh the long-term benefits of fewer government-unique rules relative to the short-term transitory consequences of eliminating particular Standards. Congress has expressed that eliminating government-unique rules will be beneficial in the long term. The Section encourages the CASB to adopt that sense of Congress except when compelling evidence suggests otherwise.

The Section believes that this approach will protect the Government's interests through the uniformity and consistency provided by GAAP and, in Congress's view, by removing unnecessary barriers to entry and reducing government-unique burdens on commercial business. We note that FAR 31.201-2, Determining Allowability, will still apply, thereby requiring contractor compliance with GAAP. Moreover, the Section supports retaining CAS 401 to protect the Government's interests as it relates to the CAS objectives of uniformity and consistency (i.e., any cost accounting practice, whether covered by CAS or GAAP, is subject to the consistency requirements of CAS 401).

b. Other alternatives

- (1) To the extent GAAP aligns with CAS, keeping CAS unchanged

The Section believes that this option falls short of Congress's directions. Because certain CAS and GAAP can overlap in substantial part, CAS may for some contractors add limited accounting burdens (i.e., certain CAS do not currently require contractors to maintain both GAAP and CAS accounting methods). But even in these cases, other burdens remain such as CAS-specific audits and the duplication of GAAP and CAS reviews by external auditors (not to mention the possibility of disagreement between contractors' external and government auditors). The burdens of CAS administration also remain, which the Section believes are among the most significant barriers to entry for commercial companies.

- (2) To the extent GAAP aligns with CAS, conform CAS to GAAP

The Section has assessed this as the *least* desirable option given Congress's directions, yet it appears this is the CASB's current direction. This alternative would either:

- Align CAS and GAAP entirely, rendering CAS duplicative yet no less burdensome, or
- Eliminate certain elements of CAS that align with GAAP, but retain certain unique aspects of CAS that do not align with GAAP.

Both of these alternatives require a detailed line-by-line analysis that the CASB seems to be undertaking. The result of either will be, in the Section's view, short of what Congress desires.

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Such a review will also require a significant investment of dedicated time and resources, which may be difficult to justify given the many competing priorities for both contractor and government resources.

The Section is concerned that pursuing this alternative will not relieve the burden of government-unique rules on commercial companies. Rather it will make the rules more nuanced and detailed, without conforming CAS to GAAP to the *maximum extent practicable* as directed by Congress

E. CAS-GAAP Conformance Roadmap

The Section generally agrees with CASB's categorization of the Standards relative to their ripeness for conformance to GAAP:

- Regarding Category 1 (CAS 404, 407, 408, 409, 411, 415, 416), the Section encourages the CASB to eliminate all of these Standards, to the *maximum extent practicable*, unless clear, compelling, and significant evidence exists to either keep or conform them.
- Regarding Category 2 (CAS 403, 410, 418, 420), the Section agrees that GAAP generally does not address cost allocation to contracts and, thus, conformance of these Standards is not yet practicable.
- Regarding Category 3 (CAS 412, 413, 414, 417), the Section encourages the CASB to evaluate CAS-GAAP conformance as it relates to the measurement and assignment of pension costs (i.e., CAS 412, 413). Although the measurement and assignment of costs differs between CAS and GAAP, GAAP has evolved to provide a greater degree of uniformity and consistency since the 1970s. The Section agrees that CAS 414 and 417 are necessarily unique to government contracting unless the Government, as a matter of procurement policy, decides to make interest an allowable contract cost.
- Finally, regarding Category 4 (CAS 401, 402, 405, 406), the Section generally agrees that GAAP does not address the cost accounting concepts in CAS 401, 402, and 405. However, the Section encourages the CASB to consider reassigning CAS 406 to Category 1 because GAAP provides for the determination of accounting periods.

F. Applicability of CAS clauses to GAAP compliance

The Section encourages the CASB not to extend CAS administration rules to GAAP compliance. These regulations currently do not apply to GAAP compliance.

If the CASB eliminates certain Standards where GAAP provides sufficient uniformity and consistency, then the CAS administration rules would no longer apply to those areas. Congress's statutory direction for this exercise did not contemplate expanding the Government's CAS administration burden or the Government's access to contractor records. The FAR cost principles and CAS 401 will sufficiently protect the government's interest without the added layer of CAS administration.

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III. CONCLUSION

The Section encourages the CASB to align its activities with Congress's desire to reduce government-unique regulatory burdens on, and eliminate barriers to entry for, commercial companies. While CAS-GAAP conformance is an important task, it will not produce immediate beneficial results like those available by implementing the Section 809 Panel recommendation no. 30. Because increasing the CAS applicability thresholds would greatly reduce the number of commercial companies that must comply with CAS, CAS-GAAP conformance becomes less critical. For those companies that must still comply with CAS after increasing the applicability thresholds, the CASB should next address the emerging CAS-GAAP issues concerning leases and revenue. The CASB can take these actions without waiting for further direction from Congress.

When undertaking CAS-GAAP conformance, the Section encourages the CASB to eliminate CAS where GAAP now addresses uniformity and consistency (even if CAS and GAAP do not closely align) so long as GAAP shows neither bias nor prejudice to either contracting party. Implementation plans can adequately address any transient cost impacts associated with adopting GAAP for contract costing purposes (a required change). In addition to FAR 31.201-2, which requires compliance with GAAP, future changes in GAAP necessitating cost accounting changes will be covered by CAS 401, which the Section agrees should be retained. Finally, the CASB should avoid using the CAS administration regime as a GAAP-enforcement mechanism. The CAS administration rules, beyond those invoked by CAS 401, do not currently, and should not in the future, apply to GAAP compliance.

The Section appreciates the opportunity to comment and would be happy to provide any further information or insights that your office might require.

Sincerely,

Linda T. Maramba

Linda Maramba
Chair-Elect, Section of Public Contract Law

cc:
Susan Warshaw Ebner
Jennifer L. Dauer
Annejanette Heckman Pickens
Council Members, Section of Public Contract Law
Chairs and Vice Chairs,
Craig Smith
Samantha S. Lee