financial executives international

COMMITTEE ON GOVERNMENT BUSINESS

17 November 2020

Cost Accounting Standards Board
ATTN: Mr. Mathew Blum
Office of Federal Procurement Policy
725 17th Street NW
Washington, DC 20503

Submitted via email to: CASB@omb.eop.gov

Subject: Financial Executives International Committee on Government Business Comments on CASB Staff Discussion Paper on Conformance of the Cost Accounting Standards ("CAS") to Generally Accepted Accounting Principles ("GAAP") for Capitalization of Tangible Assets and Accounting for Acquisition Costs of Material

Reference: CASB Case Number 2020-01

Mr. Blum:

I am pleased to offer the following comments on the Cost Accounting Standards Board ("CASB") Staff Discussion Paper ("SDP") on conformance of CAS to GAAP for Capitalization of Tangible Assets and Accounting for Acquisition Costs of Material (*Federal Register* notice dated September 18, 2020 - 85 FR 58399) on behalf of the Financial Executives International – Committee on Government Business ("FEI-CGB"). FEI is a professional association representing the interests of more than 10,000 chief financial officers, treasurers, controllers, tax directors and other senior financial executives from major companies throughout the United States. FEI represents both the providers and users of financial information. CGB formulates policy opinions on government contracting issues for FEI in line with the views of the membership.

FEI-CGB reviewed the CASB SDP prepared in response to the National Defense Authorization Act of FY2017 (Pub. L. 114–328, 130 Stat. 2273) which amended 41 U.S.C. 1501(c)(2) to require the Board to review CAS and conform them, to the extent practicable, to GAAP. As the SDP points out, CAS was designed to achieve uniformity and consistency in determining costs on US Government contracts. CAS focuses on the measurement, assignment and allocation of cost at the contract level. GAAP is a common set of accounting pronouncements that prescribe how financial statements are prepared, including recognition, measurement, presentation and disclosure. The purpose of GAAP is to provide a conceptual framework and acceptable accounting methods and practices for financial reporting.

Given that there is some overlap in membership between FEI-CGB and the Aerospace Industries Association ("AIA") Cost Principles Committee ("CPC"), FEI-CGB is aware of, and generally endorses, the technical content of AIA's comments on CASB Case Number 2020-01. Specifically, FEI-CGB agrees with AIA's responses to the queries on the comparisons to the GAAP and CAS requirements presented in the appendices to the AIA letter, and thus incorporates those appendices to this response. FEI-CGB's comments concerning other aspects of the SDP are presented below.

Comments on the Guiding Principles for Evaluating Benefits and Drawbacks:

On the surface, the initiative to streamline the US Government procurement process by shifting reliance for government cost accounting from CAS to GAAP makes sense. Specifically, all public companies and nonprofit organizations are already required to prepare financial statements based on GAAP. Accordingly, using GAAP to govern government contract cost accounting would seem to eliminate the administrative effort needed to maintain an additional "set of CAS books" (i.e., the CAS specific entries) to meet CAS requirements. For example, the SDP considers using GAAP accounting for Capitalization of Tangible Assets and Acquisition of Material. GAAP would be used not only for financial reporting, but also for estimating, reporting, and accumulating costs for Government contracting purposes. However, FEI-CGB strongly believes that any significant potential benefit from the conformance of CAS to GAAP will be achieved only if (i) compliance is based solely upon GAAP requirements and (ii) compliance determinations reflect the results of reviews performed by the individual company's outside audit firms who have both the proficiency and practical experience to determine compliance with GAAP.

Comments on CAS-GAAP Conformance for CAS 404 and CAS 411:

The SDP's grouping of the standards relative to the anticipated opportunity for conformance with GAAP appears reasonable. However, the underlying theory of the CAS-GAAP conformance initiative appears to be that a combination of CAS 401, CAS 402, and CAS 406 (i.e., the Principal Three CAS) combined with increases in the scope of GAAP requirements since the earlier establishment of the individual Standards potentially renders CAS coverage in some areas as more or less redundant and unnecessary. GAAP coverage in these areas has increased significantly over the years to the point where the CAS and GAAP concepts are much the same in many respects. A recent survey of AIA membership shows little material risk to the Government if CAS 404 and CAS 411 were eliminated.

Removal of a Standard has the potential to eliminate time and expense for the US Government (i.e., the CASB, Government audit agencies, and Government contracting officers) and contractor support for CAS audits (e.g., Government requested briefings and data for reviews and testing). The alignment of CAS with GAAP, where appropriate, provides standardization of costing for Government Contractors. There should be fewer adjustments required to match financial statements with CAS contract requirements. This would also provide a more understandable contracting environment for companies considering doing business with the Federal Government.

If you wish to engage with the FEI-CGB on this matter, we would be amenable to meeting with you at your convenience. Please contact Ms. Marisa Peacock at the FEI office in Morristown, NJ at phone number (973) 765-1007or email at mpeacock@financialexecutives.org for arrangements.

Thank you for your consideration in this matter.

Respectfully,

Mr. Mark A. Smith
Chairman, Financial Executives International – Committee on Government Business

Andrej Suskavcevic
President & CEO, Financial Executives International

Distribution: Laurie Schmidgall – Vice Chair, FEI-CGB
Marisa Peacock – Manager, Technical Activities, FEI

FEI CGB Responses to Questions within CASB Case Number 2020-01, Staff Discussion Paper on "Conformance of CAS to GAAP for Capitalization of Tangible Assets and Accounting for Acquisition Costs of Material"

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(1) Views on the Initial Analysis of CAS 404 and the Board's Preliminary Observations and Specific Questions for Public Feedback

The Board notes that at the time the initial CAS 404 was promulgated there was little variability in capitalization thresholds and with the growth in GAAP content since the promulgation of the initial CAS 404, perhaps the threshold in CAS 404 is no longer a necessary constraint. Would GAAP requirements provide some reasonable limitations for selecting capitalization thresholds?

Yes, GAAP requirements would provide reasonable limitations for selecting capitalization thresholds. While GAAP is not prescriptive about capitalization thresholds, generally, an entity's materiality thresholds would serve to limit the upper bound of its capitalization policy. Expensing long-lived assets in amounts that in the aggregate exceed materiality thresholds would result in a departure from GAAP that would most likely trigger unfavorable external audit findings causing both financial statement audit adjustments and control deficiency reporting by external auditors to the entity's Audit Committee.

In addition, we note that other limitations on selecting capitalization thresholds exist. The other limitations include:

- 48 CFR § 31.205-11(c) limits allowable depreciation to "the amount used for financial accounting purposes" regardless of a contractor's CAS coverage status. Further, that same cost principle requires depreciation to "be determined in a manner consistent with the depreciation policies and procedures followed in the same segment on non-Government business." This protects the government from a contractor's attempts to "game" capitalization practices and ensures expense/capitalization decisions will be driven by competition in the private sector marketplace.

- Marketplace competiveness, in general, will also act to curb contractor's capitalization policy decisions. If the capitalization threshold is raised to a level that is too high, then the contractor will record expenses that may lead to non-competitive indirect cost rates. Conversely, if the capitalization threshold is set too low, then the contractor will have created a future stream of non-variable (fixed) indirect costs that will not change in accordance with fluctuations in its business base. From the contractor's perspective, neither outcome is desirable. Consequently, the impact on the contractor's competitive position in the marketplace will act as a natural "brake" on any tendencies to establish an unreasonable capitalization threshold, should CAS 404 be eliminated.

- 48 CFR § 31.201-3 ("Reasonableness") establishes that costs that are not reasonable are not allowable costs and are not reimbursable by the Federal government. (See also § 31.201-2 ("Determining Allowability").) We note that there is no presumption of reasonableness; the burden is on the contractor to prove its costs are reasonable if challenged by a contracting officer. This gives the government the ability to challenge and, if appropriate, disallow either depreciation costs or excessive expenses resulting from capitalization practices that are unreasonable, should CAS 404 be eliminated.

- The requirement to comply with the tax code will also curb contractors' ability to create unreasonable capitalization thresholds. See, for example, 26 CFR § 1263(a) through (h), discussing distinctions between the requirements to capitalize costs "to acquire or produce real or tangible personal property used in your trade or business, such as buildings, equipment, or furniture" from "de minimis amounts," which can be deducted so long as the treatment is consistent with that used for financial reporting purposes. §1263(g) states "Except for paragraph (f) of this section (the de minimis safe harbor election), a change to comply with this section is a change in method of accounting to which the provisions of sections 446 and 481 and the accompanying regulations apply. A taxpayer seeking to change to a method of accounting permitted in this section must secure the consent of the Commissioner in accordance with § 1.446-1(e) and follow the administrative procedures issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's consent to change its accounting method." (Emphasis added.)

- Finally, we believe that the banking covenants imposed on many of our member companies impose limits on the amount of funds that can be used for capital expenditures. For example, a covenant between lender and borrower might state that "Borrower and Lender shall not permit the aggregate amount of all Capital Expenditures of Borrower and Lender during any fiscal quarter to exceed the amount indicated for such fiscal quarter set forth on Schedule XXX hereto." Consequently, any contractor subject to similar restrictions will be reluctant to change its current capitalization thresholds, lest it breach its agreement(s) with its lenders.

The Board would especially appreciate comments as to the kind of documentation for capitalization policies maintained by contractors and whether the documents would be maintained regardless of the CAS requirement.

All 15 of AIA survey respondents stated that they maintained written statements of accounting policies and practices for capitalization that were separate from their Disclosure Statements. Similarly, all 33 FEI survey private sector respondents provided that same answer. This unanimous response should give the CAS Board confidence that these written documents are not created in response to a requirement of CAS 404, but instead because they are associated with good business management practices.

Several respondents added that maintaining such written policies and procedures is an integral part of the overall financial controls framework of the enterprise. Company policies regarding asset capitalization generally cover topics such as minimum valuation, timing of capitalization and retirement, impairment evaluations, and minimum useful lives. Consequently, we believe that this documentation would survive elimination of a CAS requirement for the documentation to exist.

We also note that many defense contractors are subject to the Accounting System adequacy criteria found at 48 CFR 252.242-7006(c). Among the adequacy criteria is the requirement that a contractor maintain a sound internal control environment, accounting framework, and organizational structural. The fundamental GAAP requirement to maintain a strong enterprise financial controls framework (as noted above), coupled with the requirement that many defense contractors must maintain that framework in order to maintain the adequacy of their accounting system, ensures that robust capitalization policies and practices will be maintained by contractors even if CAS 404 does not require them to do so.

Does this mean that contractors subject to CAS 404 would also be required to submit a Disclosure Statement?

Contractor business units are subject to CAS 404 because they are subject to Full CAS Coverage. (Ref: 48 CFR 9903-201-2(a).) Generally speaking, contractor business units subject to Full CAS Coverage must also submit a Disclosure Statement, either concurrently or within 90 days of the start of the next cost accounting period. (Ref: 48 CFR 9903.202-1(b).) In some cases, segments subject to Modified CAS coverage must still submit a Disclosure Statement (Ref: 48 CFR 9903.202-1(c).). Therefore, it is highly likely that any contractor business unit that is currently subject to CAS 404, or that would become subject to CAS 404, would also be required to generate and submit a Disclosure Statement regardless of whether CAS 404 was in existence.

The Disclosure Statement Part IV, Depreciation and Use Allowances, requires that a contractor describe cost accounting practices for capitalization, depreciation, and gains/losses on dispositions. How satisfactorily does the level of detail required in the Disclosure Statement address the requirement for written policies in the current Standard?

It is our consensus experience that the Disclosure Statement requirements associated with capitalization, depreciation, and gains/losses on disposition (found in Part V) largely, if not entirely, duplicate the information contained in our capitalization policies. Elimination of the requirement to maintain policies would not significantly affect the government's insight into a contractor's cost accounting practices in this area. Indeed, the FEI's survey of commercial entities indicated that all 33 respondents maintained written statements of accounting policies and practices related to capitalization, even though they are not subject to CAS or Disclosure Statement requirements.

Another point to be considered is that other US Government agencies require a capitalization policy and consistent practices in order to legally deduct depreciation and other expenses. For example (and as noted in our response above to the inquiry on capitalization thresholds), see 26 CFR § 1263. We believe that these other constraints will protect the government's interests in this area.

In CAS 404-50(d)(2), the acquired company has tangible assets that did not generate depreciation or cost of money allocated to Federal contracts and the assets would be valued by the acquirer at no more than the fair value, and GAAP limits the value of the assets to fair value. Are these two requirements for measurement at the fair value equivalent?

Yes, both GAAP and CAS requirements are equivalent in this area. Our members note that CAS 404 does not currently define the term "fair value." However, 48 CFR 9904.415-30 does define that term—and the definition is essentially identical to that in the ASC. Consequently, contractors (and contract auditors) have tended to use the definition in GAAP and/or CAS 415 for purposes of complying with the requirements of 9904.404-50(d)(2).

In CAS 404-50(d)(1), the acquired company has tangible assets that generated depreciation or cost of money allocated to Federal contracts, and the assets would be valued at net book value of the acquired company. In comparison, GAAP limits the value of the assets to the fair value. How comparable are net book value and fair value? As a practical matter, how are these requirements in GAAP and CAS applied by government contractors who acquire another government contractor, meaning are two different sets of books for CAS

(net book value) and financial accounting (fair value) kept or is there a harmonization for one measurement with perhaps the net book value considered the fair value?

Yes, contractors that acquire another government contractor have two sets of books to address the differing requirements of CAS and GAAP in this area. This is because Fair Value and Book (or Carrying) Value are not equivalent terms and should not be assumed to be comparable values. The fair value of an asset can differ significantly from an entity's carrying value of the asset. Eliminating CAS and relying on GAAP in this area would eliminate the need to keep two sets of books and potentially reduce contractor compliance costs. If the Board eliminates CAS 404, however, additional action by the Board as described below will be necessary to avoid certain unintended consequences.

Currently, GAAP provides for an increase to fair market value for the assets of an acquired company as a result of a business combination. This incremental increase in asset amount, however, is not recognized as depreciation costs for government contracts because CAS 404 measures the assets at the net book value of the acquired company. In this way of limiting measurement of the asset, CAS assures the amount of depreciation paid by the government does not increase as a result of the business combination. Similarly, the purpose of FAR 31.205-52 is to assure the amount of depreciation for the assets of the acquired company is not increased as a result of the business combination.

If the Board eliminates CAS 404, presumably FAR 31.205-52(a) would be modified to replace the existing reference to CAS 404 with language treating the increased depreciation costs as unallowable costs. This would cause the recurrence of a previous unintended consequence harming contractors. The harm occurs when such assets are increased to fair market value and, as required by CAS 405-40(e), the related depreciation costs are included as part of the base for allocating indirect costs. The share of the indirect costs allocated to the unallowable depreciation for the increased asset amount causes otherwise allowable indirect costs to be treated as unallowable. Therefore, the government doesn't just avoid paying the increase in cost from a business combination, they unintentionally punish contractors by treating part of other indirect costs as unallowable. This unintentional harm to contractors was recognized by the government when it occurred in 1999 and required a class deviation at the time until FAR was modified to reference CAS 404.

If the CAS Board eliminates CAS 404, the CAS Board will need to take action to avoid a recurrence of this unintended consequence. The best solution would be to add language to CAS 405-40(e) that mirrors the current language in CAS 404-50(d)(1) so that only the depreciation up to the net book value of the acquired company's assets would be included in the allocation base. By relying on FAR 31.205-52, with some modification to replace the reference to CAS 404, and by a minor modification to CAS 405 the CAS Board would protect the government from paying certain increased depreciation costs from business combinations and protect contractors from being harmed by limiting the amount of unallowable cost to the increased depreciation without amplification.

The CAS Board is considering the action it should take not only on CAS 404 taken as a whole with respect to the current CAS-GAAP conformance case, but if CAS 404-50(d) and (e) are retained, what action should the Board take, if any, in response to the change in

financial accounting requirements and terms? For example, with elimination of the pooling of interest method to new transactions as of June 2001 in GAAP, what action should the Board take to revise CAS 404-50(e)? Similarly, with elimination of the term "purchase method" in GAAP, what action should the Board take to revise CAS 404-50(d)?

We believe the Board should eliminate CAS 404 in its entirety because we believe GAAP adequately protects the government's interests in this area. If the goal is convergence, the recommendation is elimination of CAS 404-50(e), since there is no manner in which a contractor can comply with both CAS 404-50(e) and GAAP requirements as currently written, without maintaining at least two sets of fixed asset subledgers. Consequently, the current situation requires maintaining at least two "sets of books," one for government contract cost accounting and another for financial reporting. If CAS 404 is eliminated, that could potentially permit contractors to eliminate the need for two sets of books, which would reduce operations costs as well as audit support costs.

However, if the Board elects to retain aspects of CAS 404 (e.g., 404-50(d) or 404-50(e)), then we would recommend the Board add "or the "acquisition method" to CAS 404-50(d) after the words "purchase method." This would, as a minimum, reflect the current GAAP terminology used for the treatment of business combinations. In addition, we recommend that the Board establish a periodic review of changes to GAAP. For example, the Board could invite members of the Financial Accounting Services Board (FASB) to speak at a Board meeting periodically—perhaps once every five years—to identify changes to GAAP that may have impacts to Cost Accounting Standards.

Are there any other gaps between CAS 404 and GAAP that the Board did not identify but should consider?

We were impressed with the Board's thoroughness and could not identify any other gaps between CAS 404 and GAAP that should be considered.

The Board is interested in public comments with facts and data of the history of CAS 404 non-compliance issues raised and how they were resolved. In particular, what is the frequency and magnitude of the issues identified on Government contracts? Furthermore, could the issue raised have been considered non-compliant with GAAP, other CAS or FAR?

Many of our members have been CAS covered for many years – in some cases, decades – and cannot recall ever having to deal with a CAS 404 noncompliance. Eight of 15 survey respondents stated that they have never had an alleged noncompliance with CAS 404. However, some of our larger members (and seven out of 15 respondents) have experienced issues in this area. One respondent (a Top Five DoD contractor) stated that it had received a CAS 404 noncompliance "but not in the past 15 years." According to another respondent, allegations of CAS 404 noncompliance have been raised outside of CAS-compliance audits,—i.e., treated as a cost disallowance matter rather than as a matter of CAS noncompliance.

Another respondent (a Top Five DoD contractor), indicated it has had several CAS 404 non-compliances alleged in the past, however, no issues have been alleged since 2012. Several of the issues were identified during DCAA's audit of incurred costs. Of the various issues, the contractor only made one payment to the Government (in 2006). That one issue was a disagreement regarding whether installation of telecommunication services wiring should have been capitalized as a leasehold improvement rather than expensed. All other CAS 404-related issues were settled without payment to the Government. That same contractor had a corporate-wide audit in 2018, with zero audit findings.

In summary, AIA's members believe that CAS 404 noncompliance risks are minimal and that, when they occur (which is infrequently) they tend to be resolved without payment to the Government. We further believe that many of the issues that were noted by survey respondents arose through the context of other than a CAS compliance audit. Consequently, we believe that the Government's interests in maintaining the ability to identify disagreements with contractor expense/capitalization decisions, and to recover any overpayments made as a result of those decisions, will be adequately protected through administrative surveillance and audit of claimed incurred costs, without the need to maintain the requirements of CAS 404.

AIA Reponses to CASB Queries in CAS 404 Comparison Table

CAS 404 Requirement	GAAP Requirement	Observations and Queries
CAS 404-40 Fundamental Requirement		
(a) The acquisition cost of tangible capital assets shall be capitalized. Capitalization shall be based upon a written policy that is reasonable and consistently applied.	ASC 360-10-05-3Property, plant and equipment typically consist of long-lived tangible assets used to create and distribute and entity's products and services and include: (a) Land and Improvements, (b) Buildings, (c) Machinery and equipment, and (d) Furniture and fixtures. ASC 235-10-50-1 Information about the accounting policies adopted by an entity is essential for financial statement users…a description of all significant accounting policies of the entity shall be included as an integral part of the financial statements. ASC 210-10-S99-13 Property Plant & Equipment requires entities to include the basis for determining amounts. (Applicable only to publicly traded companies subject to the Securities & Exchange Commission rules) FASB Statements on Accounting Concepts No. 6 contains a detailed definition and characteristics of Assets, which include tangible and other forms	***<u>CASB Query:</u>*** *Would contractors maintain written policies for capitalization regardless of a requirement to do so in CAS?* **<u>AIA Response:</u>** All 15 of AIA survey respondents stated that they maintained written statements of accounting policies and practices for capitalization that were separate from their Disclosure Statements. Similarly, all 33 FEI survey private sector respondents provided that same answer. This unanimous response should give the CAS Board confidence that these written documents are not created in response to a requirement of CAS 404, but instead because they are associated with good business management practices. Several respondents added that maintaining such written policies and procedures is an integral part of the overall financial controls framework of the enterprise. Company policies

CAS 404 Requirement	GAAP Requirement	Observations and Queries
	of assets. By definition assets are capitalized. FASB Statements on Accounting Concepts No. 5 also states under 67a; “Historical cost (historical proceeds). Property, plant, and equipment and most inventories are reported at their historical cost, which is the amount of cash, or its equivalent, paid to acquire an asset, commonly adjusted after acquisition for amortization or other allocation” ASC 210-10-45-4 Excludes depreciable assets from consideration as current assets. Current assets are expected to be used in one year (operating cycle) ASC 360-10-35-4The cost of a productive facility is one of the costs of the services it renders during its useful economic life. Generally Accepted Accounting Principles (GAAP) 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 periods which services are obtained from the use of the facility. This procedure is known as depreciation accounting, a system of accounting which aims to distribute cost or other basic value of	regarding asset capitalization generally cover topics such as minimum valuation, timing of capitalization and retirement, impairment evaluations, and minimum useful lives. Consequently, we believe that this documentation would survive elimination of a CAS requirement for the documentation to exist. .

CAS 404 Requirement	GAAP Requirement	Observations and Queries
	tangible assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation not valuation.	**<u>CASB Query:</u>** Disclosure Statement Part IV - Depreciation and Use Allowances, requires that a contractor describe cost accounting practices for capitalization, depreciation, and gains/losses on dispositions. *How satisfactorily does the level of detail required in the Disclosure Statement address the requirement for written policies in the current Standard?* **<u>AIA Response:</u>** Both Part IV-Depreciation and Use Allowances, which is applicable to educational institutions and Part V-Depreciation and Capitalization Practices, applicable to other contractors, require sufficient description of cost accounting practices for capitalization, depreciation, and gains/losses on dispositions. Furthermore, the cognizant Federal Agency Official review of a contractor's Disclosure Statement (often with the assistance of DCAA and/or other contractor auditors) provides assurance that the Disclosure Statement will describe these practices to the satisfaction of the government.

CAS 404 Requirement	GAAP Requirement	Observations and Queries
		As noted in our response to the question on written policies for capitalization, it seems clear that these written documents are not created in response to a requirement of CAS 404, but instead because they are associated with good business management practices. Thus, contractors' written policies will exist after the elimination of CAS 404.
(b) The contractor's policy shall designate economic and physical characteristics for capitalization of tangible assets. (1) The contractor's policy shall designate a minimum service life criterion, which shall not exceed 2 years, but which may be a shorter period. The policy shall also designate a minimum acquisition cost criterion which shall not exceed $5,000, but which may be a smaller amount. (2) The contractor's policy may designate other specific characteristics which are pertinent to his capitalization policy decisions (e.g., class of asset, physical size, identifiability and controllability, the extent of integration or independence of constituent units). (3) The contractor's policy shall provide for identification of asset accountability	ASC 360-10-05-3 Property, plant and equipment typically consist of long-lived tangible assets used to create and distribute an entity's products and services and include: (a) Land and Improvements, (b) Buildings, (c) Machinery and equipment, and (d) Furniture and fixtures. FASB Statements on Accounting Concepts No. 6 contains a detailed definition and characteristics of Assets. ASC 360-10-35-4 - requires that the asset 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.	**<u>CASB Query:</u>** Disclosure Statement Part IV - Depreciation and Use Allowances, requires that a contractor describe cost accounting practices for capitalization, depreciation, and gains/losses on dispositions. *How satisfactorily does the level of detail required in the Disclosure Statement address the requirement for written policies in the current Standard?* **<u>AIA Response:</u>** See our response to this question on the previous page. The current Disclosure Statement provides for a sufficient description of contractors' cost accounting practices in this area. Further, the requirement that a cognizant Federal Agency Official review each Disclosure Statement for adequacy provides assurance that the Disclosure Statement will describe these practices to the

CAS 404 Requirement	GAAP Requirement	Observations and Queries
units to the maximum extent practical. (4) The contractor's policy may designate higher minimum dollar limitations for original complement of low cost equipment and for betterments and improvements than the limitation established in accordance with paragraph (b)(1) of this subsection, provided such higher limitations are reasonable in the contractor's circumstances.		satisfaction of the government. **CASB Query:** GAAP does not have a minimum dollar threshold. *Would GAAP requirements provide some reasonable limitations for selecting capitalization thresholds?* **AIA Response:** Generally, the entity's materiality thresholds, as applied to GAAP-based financial statements, would serve to limit the upper bound of its capitalization policy. In addition to GAAP requirements, AIA members note that contractor thresholds could be challenged by the government under 31.201-3 (Reasonableness) and any resulting depreciation deemed excessive could be challenged by the government under 31.205-11 (Depreciation). Further, as noted in our response to the Board's question starting on Page 4, other factors, including Internal Revenue Code limits, marketplace competitiveness, and restrictions on capital expenditures frequently found in lender agreements, will serve to constrain a contractor's ability to change its capitalization thresholds.

CAS 404 Requirement	GAAP Requirement	Observations and Queries
		Members noted that the current CAS 404 capitalization threshold of $5,000 has not changed since 1996. Consequently, it has not been adjusted for inflation during the intervening 24 years. GAAP permits contractors to adjust their thresholds to changing circumstances (subject to the constraints noted above). This flexibility is desirable and should not pose a risk to the government. **CASB Observation:** The CAS Disclosure Statement would provide a description of the contractor's accounting practices.
(c) Tangible assets shall be capitalized when both of the criteria in the contractor's policy as required in paragraph (b)(1) of this subsection are met, except that assets described in subparagraph (b)(4) of this subsection shall be capitalized in accordance with the criteria established in accordance with that paragraph.	ASC 835-20-25-5 –The capitalization period shall end when the asset is substantially complete and ready for its intended use.	***CASB Query:*** *Are these requirements equivalent?* **AIA Response:** No, these are not equivalent. The CAS reference is speaking to the attributes (including valuation) determining capitalization, but the GAAP language, instead, addresses the timing of capitalization. GAAP is more prescriptive than CAS which does not prescribe the timing of the capitalization period. The CAS language essentially requires that a contractor follow its capitalization policies. GAAP also requires that a company follow its capitalization policies pursuant to ASC 235-10-50-1.

CAS 404 Requirement	GAAP Requirement	Observations and Queries
(d) Costs incurred subsequent to the acquisition of a tangible capital asset which result in extending the life or increasing the productivity of that asset (e.g., betterments and improvements) and which meet the contractor's established criteria for capitalization shall be capitalized with appropriate accounting for replaced asset accountability units. However, costs incurred for repairs and maintenance to a tangible capital asset which either restore the asset to, or maintain it at, its normal or expected service life or production capacity shall be treated as costs of the current period.	ASC 360-10-35-33 -- Estimates of future cash flows used to test the recoverability of a long-lived asset (asset group) that is in use, including a long-lived asset (asset group) for which development is substantially complete, shall be based on the existing service potential of the asset (asset group) at the date it is tested. The service potential of a long-lived asset (asset group) encompasses its remaining useful life, cash- flow-generating capacity, and for tangible assets, physical output capacity. Those estimates shall include cash flows associated with future expenditures necessary to maintain the existing service potential of a long-lived asset (asset group), including those that replace the service potential of component parts of a long-lived asset (for example, the roof of a building) and component assets other than the primary asset of an asset group. Those estimates shall exclude cash flows associated with future capital expenditures that would increase the service potential of a long-lived asset (asset group).	***CASB Query:*** *Are these requirements equivalent?* **AIA Response:** No, these are not equivalent. The GAAP language appears to be speaking to recoverability assessments, or tests of impairment. The CAS 404 language addresses betterments/improvements to an existing asset. Members noted that ASC 360-10-30-1, in addition to IRS Regulations found at 26 CFR §§ 1.263(a)–3(j), 1.263(a)-3(k), and 1.263(a)-3(l), provide equivalent requirements to CAS 404-40(d).

CAS 404 Requirement	GAAP Requirement	Observations and Queries
CAS 404-50 Techniques for Application		
(a) The cost to acquire a tangible capital asset includes the purchase price of the asset and costs necessary to prepare the asset for use. (1) The purchase price of an asset shall be adjusted to the extent practical by premiums and extra charges paid or discounts and credits received which properly reflect an adjustment in the purchase price. (i) Purchase price is the consideration given in exchange for an asset and is determined by cash paid, or to the extent payment is not made in cash, in an amount equivalent to what would be the cash price basis. Where this amount is not available, the purchase price is determined by the current value of the consideration given in exchange for the asset. For example, current value for a credit instrument is the amount immediately required to settle the obligation or the amount of money which might have been raised directly through the use of the same instrument employed in making the credit purchase. The current value of an equity security is its market value. Market value is the current or prevailing price of the security as indicated by recent market quotations. If such values are unavailable or not	ASC 835-20-05-1 states that the historical cost of acquiring an asset includes the costs necessarily incurred to bring it to the condition and location necessary for its intended use. ASC 360-10-20 Defines Activities – The term is construed broadly. It encompasses physical construction of the asset. In addition, it includes all the steps required to prepare the asset for its intended use. For example, it includes administrative and technical activities during preconstruction stage, such as development of plans or the process of obtaining permits form governmental authorities. It also includes activities after construction has begun in order to overcome unforeseen obstacles such as technical problems, labor disputes, or litigation. ASC 845-10-30-1 In general, the accounting for nonmonetary transactions should be based on the fair values of the assets (or services) involved, which is the same basis as that used in monetary transactions. Thus, the cost of a nonmonetary assets acquired in exchange for another nonmonetary	***<u>CASB Query:</u>*** *Are these requirements equivalent?* **<u>AIA Response:</u>** Yes, despite differences in wording and order, the requirements are essentially the same.

CAS 404 Requirement	GAAP Requirement	Observations and Queries
appropriate (thin market, volatile price movement, etc.), an acceptable alternative is the fair value of the asset acquired. (ii) Donated assets which, at the time of receipt, meet the contractor's criteria for capitalization shall be capitalized at their fair value at that time. (2) Costs necessary to prepare the asset for use include the cost of placing the asset in location and bringing the asset to a condition necessary for normal or expected use. Where material in amount, such costs, including initial inspection and testing, installation and similar expenses, shall be capitalized.	asset is the fair value of the asset surrendered to obtain it, and a gain or loss shall be recognized on the exchange. The fair value of the asset received shall be used to measure the cost if it is more clearly evident than the fair value of the asset surrendered. Similarity, a nonmonetary asset received in a nonreciprocal transfer shall be recorded at the fair value of the asset received. A transfer of a nonmonetary asset to a stockholder or to another entity in a nonreciprocal transfer shall be recorded at the fair value of the asset transferred and a gain or loss shall be recognized on the disposition of the asset. ASC 845-10-50-1 An entity that engages in one or more nonmonetary transactions during a period shall disclose in financial statements for the period all of the follow: (a) the nature of the transactions, (b) The basis of accounting for the assets transferred, and (c) Gains or losses recognized on transfers. ASC 820-10-05 (Details Measuring “Fair Value”)	

CAS 404 Requirement	GAAP Requirement	Observations and Queries
(b) Tangible capital assets constructed or fabricated by a contractor for its own use shall be capitalized at amounts which include all indirect costs properly allocable to such assets. This requires the capitalization of general and administrative expenses when such expenses are identifiable with the constructed asset and are material in amount (e.g., when the in-house construction effort requires planning, supervisory, or other significant effort by officers or other personnel whose salaries are regularly charged to general and administrative expenses). When the constructed assets are identical with or similar to the contractor's regular product, such assets shall be capitalized at amounts which include a full share of indirect costs.	ASC 835-20-05-1 states that the historical cost of acquiring an asset includes the costs necessarily incurred to bring it to the condition and location necessary for its intended use. As indicated in that paragraph, if an asset requires a period of time in which to carry out the activities necessary to bring it to that condition and location, the interest cost incurred during that period as a result of expenditures for the asset is a part of the historical cost of acquiring the asset. ASC 360-10-20 Defines Activities – The term is construed broadly. It encompasses physical construction of the asset. In addition, it includes all the steps required to prepare the asset for its intended use. For example, it includes administrative and technical activities during preconstruction stage, such as development of plans or the process of obtaining permits form governmental authorities. It also includes activities after construction has begun in order to overcome unforeseen obstacles such as technical problems, labor disputes, or litigation.	***<u>CASB Query:</u>*** *Are these requirements equivalent?* **<u>AIA Response:</u>** No, the CAS and GAAP requirements are similar but not completely equivalent. GAAP does not permit capitalization of administrative expense to inventory and excludes capitalization of general administrative expense; instead permitting capitalization only of very specific costs that would otherwise be reported as administrative expense (i.e. costs of obtaining a permit). CAS requires addition of general administrative expense by application of G&A using a rate that is calculated based upon total administrative expenses. Therefore, the amount of G&A included in capitalized costs is far higher under CAS than would be experienced applying just GAAP guidance.

CAS 404 Requirement	GAAP Requirement	Observations and Queries
		It is possible that if the requirements of 404-50(b) were eliminated, contractors would still be required to allocate G&A to self-constructed capital assets in order to comply with other Standards (e.g., CAS 410 and/or 418).
(c) In circumstances where the acquisition by purchase or donation of previously used tangible capital assets is not an arm's length transaction, acquisition cost shall be limited to the capitalized cost of the asset to the owner who last acquired the asset through an arm's-length transaction, reduced by depreciation charges from date of that acquisition to date of gift or sale	ASC 805-50-30-5 When accounting for a transfer assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests shall initially measure the recognized assets and liabilities transferred at the carrying amounts in the accounts of the transferring entity at the date of transfer.	**<u>CASB Query:</u>** Are these requirements equivalent? **<u>AIA Response:</u>** Yes, these requirements are equivalent.

CAS 404 Requirement	GAAP Requirement	Observations and Queries
(d) The capitalized values of tangible capital assets acquired in a business combination, accounted for under the “purchase method” of accounting, shall be assigned to these assets as follows: (1) All the tangible capital assets of the acquired company that during the most recent cost accounting period prior to a business combination generated either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be capitalized by the buyer at the net book value(s) of the asset(s) as reported by the seller at the time of the transaction. (2) All the tangible capital asset(s) of the acquired company that during the most recent cost accounting period prior to a business combination did not generate either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be assigned a portion of the	ASC 805-10-25-1: An Entity shall account for each business combination by applying the acquisition method ASC 805-20-30-1: The acquirer shall measure the identifiable assets acquired, the liabilities, and any non-controlling interest in the acquiree at their acquisition-date fair values.	The Board has identified this as a potential gap between CAS and GAAP. ***<u>CASB Query:</u>*** *How comparable are fair value and net book value? Are these two requirements in CAS and GAAP for measurement at the fair value equivalent?* **<u>AIA Response:</u>** Fair Value and Book (or Carrying) Value are not equivalent terms and should not be assumed to be comparable values. The fair value measurement requirements are not precisely the same. Our members note that CAS 404 does not currently define the term “fair value.” However, 48 CFR 9904.415-30 does define that term—and the definition is essentially identical to that in the ASC. Consequently, contractors (and contract auditors) have tended to use the definition in GAAP and/or CAS 415 for purposes of complying with the requirements of 9904.404-50(d)(2).

CAS 404 Requirement	GAAP Requirement	Observations and Queries
cost of the acquired company not to exceed their fair value(s) at the date of acquisition. When the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess.		***<u>CASB Query</u>**: How comparable are net book value and fair value? How are these requirements in GAAP and CAS applied by government contractors who acquire another government contractor, meaning are two different sets of books for CAS (net book value) and financial accounting (fair value) kept or is there a harmonization for one measurement with perhaps the net book value considered the fair value?* **<u>AIA Response:</u>** Fair Value and Book (or Carrying) Value are not equivalent terms and should not be assumed to be comparable values. The fair value measurement requirements are not precisely the same. Contractors that acquire another government contractor have two sets of books to address the differing requirements of CAS and GAAP in this area. The fair value of an asset can differ significantly from an entity's carrying value of the asset. Converging CAS and GAAP in this area would eliminate the need to keep two sets of books and potentially reduce contractor compliance costs. FAR 31.205-52 could provide protection to the government from paying increased depreciation costs due to a business combination. Elimination of CAS 404

		would require moving language from CAS 404-50(d) to CAS 405 to address harm to contractors related to the amplification of unallowable depreciation costs in indirect cost allocation bases.
CAS 404 Requirement	**GAAP Requirement**	**Observations and Queries**
		<u>CASB Query:</u> With elimination of the term "purchase method" in GAAP, what action should the Board take to revise CAS 404-50(d)? **<u>AIA Response:</u>** We believe the Board should eliminate CAS 404 in its entirety because we believe GAAP adequately protects the government's interests in this area. As to this specific question, we recommend elimination of CAS 404-50(d), because it no longer appears to be relevant since the term "purchase method" has been eliminated.
(e) Under the "pooling of interest method" of accounting for business combinations, the values established for tangible capital assets for financial	Current under GAAP the only acceptable method is now the acquisition method as required by ASC 805-10-25-1 ….."An Entity shall account for each business	***<u>CASB Query:</u>*** *With elimination of the pooling of interest method to new Transactions as of June 2001 in GAAP, what action should the Board take to revise CAS 404-50(e)?*

accounting shall be the values used for determining the cost of such assets.	combination by applying the acquisition method" ASC 105-10-70-2 Pooling of interest was one of the specific grandfathered items which allowed for continued application for transactions that had an ongoing effect in the entity's financial statements at the time of ASC Codification.	**AIA Response:** We believe the Board should eliminate CAS 404 in its entirety because we believe GAAP adequately protects the government's interests in this area. As to this specific question, we recommend elimination of CAS 404-50(e), because it no longer appears to be relevant since the "pooling of interest method" has been eliminated.

CAS 404 Requirement	GAAP Requirement	Observations and Queries
(f) Asset accountability units shall be identified and separately capitalized at the time the assets are acquired. However, whether or not the contractor identifies and separately capitalizes a unit initially, the contractor shall remove the unit from the asset accounts when it is disposed of and, if replaced, its replacement shall be capitalized.	ASC-205-10-20 Asset Group is the unit of accounting for a long-lived asset or assets to be held and used, which represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets.	***CASB Query:*** *Are these requirements equivalent?* **AIA Response:** These requirements are similar. The GAAP requirement defines the Unit of Account (or asset) to be capitalized, which could mean a single capital asset (similar to CAS) or else a larger piece of a factory, if the reporter cannot determine cash flows at a lower level. In contrast, the CAS requirement is focused on treatment associated with removal and/or replacement of the asset accountability unit, however identified and capitalized, from the books. As a practical matter, in application these requirements in handling independent and interdependent assets would result in materially the same cost treatment.

(2) Views on the Initial Analysis of CAS 411 and the Board's Preliminary Observations and Specific Questions for Public Feedback

CAS 411 – Accounting for Acquisition Costs of Material

CAS 411 was published on May 5, 1975 at 40 FR 19425. The Standard applies only to those materials held for sale or consumed in the productive process. Preliminary work on the development of this Standard resulted from the absence of a requirement in agency regulations that the same costing method be used for similar categories of material within the same business unit and that the method be consistently applied. The CASB held the view that a Cost Accounting Standard on this subject might improve cost assignment and cost measurement in accounting for acquisition costs of material.

Even in 1975, some 45 years ago, commenters questioned the need for the standard given the existing coverage in the cost principles and GAAP. GAAP has continued to be significantly improved and refined since the original promulgation of CAS 411 while the Standard has remained essentially unchanged. Current day GAAP contains requirements that align closely to those found in CAS 411, enough so to render CAS 411 duplicative of GAAP and unnecessary to protect the Government from the risks initially identified by the CASB that required the original promulgation of the Standard.

Elimination of this Standard will provide benefits to both the government and industry as it eliminates the time and cost of the CASB's maintenance of the Standard, Government audit agencies' maintenance of related audit programs, fieldwork and issuance of audit reports, contractors' support of audits, and Government disposition of audit reports issued. In addition, while on its own CAS 411 is not a deterrent to doing business with the Government, it does represent an opportunity to incrementally reduce burdens that deter commercial and nontraditional companies from doing business with the Government.

AIA recommends eliminating CAS 411 from the Cost Accounting Standards requirements. We have provided responses to the CASB's requests for comments within the SDP text below and to the specific queries posed by CASB within its "CAS 411 Requirements Comparison with GAAP" table below.

Comments about CAS 411 compared with GAAP with respect to the requirement to have "written statements of accounting policies and practices for accumulating the costs of material and for allocating costs of material to cost objectives" (see CAS 411-40(a)).

While GAAP does not explicitly require a written statement of accounting policies and practices, approximately 70% of the AIA member companies surveyed and 77% of FEI commercial companies surveyed do in fact have specific written policies and procedures addressing this area. As noted by the CASB during the promulgation of CAS 411, many companies had written policies and practices in place before the CAS 411 requirement existed and we note today that companies continue have such policies and procedures. We agree with the CASB's statement that as a practical matter, companies maintain written documentation regardless of an explicit requirement to do so in the CAS.

Further, we agree that companies subject to the Standard are also required to submit Disclosure Statements. A survey of our member companies showed that 100% of those required to comply with CAS 411 also file CASB Disclosure Statements. Since CAS 411 is only required for contractors subject to full CAS coverage, the vast majority of contractors required to comply with CAS 411 would have a Disclosure Statement.

It should also be noted that Enterprise Resource Planning (ERP) software systems used by contractors to manage their day-to-day business activities related to material management and accounting for such activity include documented business scripts that document how the system works. This too would be another source for written statements of accounting practices related to how the costs of material are accumulated and allocated.

The CASB notes the use of the same $50 million threshold for a single contract or accumulation of contract awards within the same accounting period for determining both full CAS coverage and submission of a Disclosure Statement*. Does this mean that all contractors subject to CAS 411 would also be required to submit a Disclosure Statement? If not, in what circumstances would a contractor be subject to CAS 411 but not be required to submit a Disclosure Statement?*

The answer to the CASB's first question is "yes". We are not aware of a circumstance where a contractor's business unit would be subject to full CAS coverage and never have had a requirement to file a disclosure statement. In our view, there is only one potential circumstance where a contractor's business unit would have contracts subject to full CAS coverage but no longer have a requirement for a disclosure statement, and this would be an extremely limited circumstance. This circumstance would be if a CAS segment's Government business falls below the revenue threshold requirement for a disclosure statement but is continuing to execute on CAS covered backlog contracts subject to full coverage. However, we are not aware of a situation where such a business unit would never have had a requirement for a disclosure statement.

The Disclosure Statement Part II, Direct Costs, requires that a contractor describe cost accounting practices for material, including the description of costs to be treated as direct material, method of charging direct material, timing of charging direct material, and treatment of variance from standard costs. *How satisfactorily does the level of detail required in the Disclosure Statement address the requirement for written policies in the current Standard?*

Although our experience is that contractors do maintain written policies and procedures, we also believe that the content and level of information required in the Disclosure Statement itself is sufficient in lieu of specific written policies. The required Disclosure Statement content sufficiently describes a contractors accounting practices relative to accounting for acquisition costs of material. For example, the disclosure statement covers, in part, the following areas of applicability and interest:

- Description of Your Cost Accounting System for Government Contracts and Subcontracts (1.4.0)
- Fiscal Year and Cost Accounting Period (1.7.0, 1.7.1)
- Description of Direct Material (2.1.0)
- Method of Charging Direct Material, Direct Charge Not Through an Inventory Account and Charged Direct from a Contractor-owned Inventory Account (2.2.0, 2.2.1, 2.2.2)
- Timing of Charging Direct Material (2.3.0)
- Variances from Standard Cost for Direct Material (2.4.0)

These sections of the Disclosure Statement provide information on the contractor business unit's cost accounting system, their accounting period, a description of materials determined to be considered direct material, the basis of costs (e.g. actual, standard, etc.), inventory valuation method (e.g. average, standard, FIFO, etc.), the timing of when direct material gets charged to contracts, and how standard cost variances are dealt with when applicable.

Another noteworthy point is that currently, only those contractors that have contracts subject to full CAS coverage are required to follow CAS 411. For contractors that have only contracts subject to modified CAS coverage, contracts that meet a CAS exemption, or are only subject to the FAR requirements, the requirements of CAS 411 do not apply. Therefore, currently the applicability of CAS 411 is already limited to those major contractors who would already have a Disclosure Statement and eliminating CAS 411 would only concern a portion of the total population of U.S. government contracts.

For additional commentary, please see AIA's response in the CAS 411 Comparison Table below, CAS 411-40 Fundamental Requirement.

Comments about CAS 411 compared to GAAP with respect to the average cost method for inventory costing. CAS provides for the use of the moving average cost method or the weighted average cost method. By comparison, GAAP simply provides for the use of an "average" method without defining or describing specific average methods. Are there any average methods in use other than weighted average and moving average?

While the CASB is correct in that GAAP does not define specific "average" inventory costing methods, in our research of various GAAP pronouncements and discussions with member companies' GAAP accountants we have failed to uncover an average method beyond weighted average and moving average methods. Additionally, 100% of the AIA and FEI member companies surveyed use either the moving average, weighted average or standard cost method for inventory costing.

Furthermore, in today's world, the logic behind inventory valuation methods is built into very expensive ERP systems, and is not changed haphazardly. Our survey of FEI member companies show that ERP changes are driven overwhelmingly (i.e. 82%) by either new ERP system implementations/upgrades or organization type transaction activities (e.g. M&A). None of the respondents noted they change ERP systems in order to solely change inventory valuation/costing methods.

Are there circumstances in which the use of an average method compliant with GAAP should not be acceptable for accounting for government contracts?

No. As provided above, AIA is unaware of an average costing method compliant with GAAP beyond the moving average or weighted average methods. Noteworthy, the guiding principles of GAAP align identically with the fundamental requirements of CAS 411, so even if there was another inventory average costing method for GAAP, such method would almost certainly be acceptable for accounting for government contracts. GAAP's guiding principles require the use of a consistently applied inventory method that is rational, reasonable and matches inventory costs with revenues. Identical to GAAP, CAS 411 requires that the inventory costing method chosen must be, "used in a manner which results in systematic and rational costing of issues of material to cost objectives. The same costing method shall, within the same business unit, be used for similar categories of material." (9904.411-40(e)). In our view, the principles and requirements of GAAP in this area are more restrictive than CAS.

Are there any other gaps between CAS 411 and GAAP that the Board did not identify but should consider?

AIA has not identified any additional gaps between CAS 411 and GAAP not already noted by the CASB.

Comments with facts and data of the history of CAS 411 noncompliance issues raised and how they were resolved. In particular, what is the frequency and magnitude of the issues identified on Government contracts? Furthermore, could the issue raised have been considered non-compliant with GAAP, other CAS or FAR?

Issues raised by DCAA/DCMA with CAS 411 compliance are extremely infrequent with our member companies. There is virtually no history of CAS 411 non-compliance issues raised at AIA member companies. Only two, or 15% of AIA member companies surveyed reported allegations of non-compliances with CAS 411. Of those two member companies, only one had those allegations sustained and the ultimate dollar magnitude of the noncompliance was not significant (less than $100,000).

Comments and especially recommendations of any changes to the Standard to conform it to GAAP.

As supported throughout this letter, we do not believe that this Standard is needed to promote consistent cost assignment and cost measurement in accounting for acquisition costs of material. This standard is unnecessary, and AIA recommends that it be eliminated.

AIA Reponses to CASB Queries in CAS 411 Comparison Table

CAS 411 Requirement	**GAAP Requirement**	**Observations and Queries**
CAS 411-40 Fundamental Requirement		
(a) The contractor shall have, and consistently apply, written statements of accounting policies and practices for accumulating the costs of material and for allocating costs of material to cost objectives.	**ASC 330 - Inventory** ASC 330-10-30-15 Consistency Required: Because of the common use and importance of periodic [financial] statements, a procedure adopted for the treatment of inventory items shall be consistently applied in order that the results reported may be fairly allocated between years. ASC 330-10-50-1 Basis for Stating Inventories: The basis for stating inventories shall be consistently applied and shall be disclosed in the financial statements; whenever a significant change is made therein, there shall be disclosure of the nature of the change and, if material, the effect on income. **ASC 340-40 – Contracts with Customers** ASC 340-40-25-7 Recognition – General: Costs that relate directly to a contract (or a specific anticipated contract) include any of the following: a. Direct labor (for example, salaries and wages of employees who provide the promised services directly to the	In addition to the corresponding GAAP content, there is additional content in FAR, DFARS and CAS as outlined below: CAS 9903.201-4(c)(1-2) Disclosure and Consistency of Cost Accounting Practices: The Contracting Officer shall insert the clause set forth below….requires the Contractor to comply with CAS 9904.401, 9904.402, 9904.405, and 9904.406, to disclose….actual cost accounting practices , and to follow consistently disclosed and established cost accounting practices. DFARS 252.242-7004(d)(1) Material Management and Accounting System Criteria: The MMAS shall have adequate internal controls to ensure system and data integrity, and shall have an adequate system description including policies, procedures, and operating instructions that comply with FAR and Defense FAR Supplement. CAS 9904.401-40 Fundamental Requirement: (a) A contractor's practices used in estimating costs in pricing a proposal shall be consistent with his cost accounting practices used in

CAS 411 Requirement	GAAP Requirement	Observations and Queries
	customer) b. Direct materials (for example, supplies used in providing the promised services to a customer) c. Allocation of costs that relate directly to the contract or to contract activities (for example, costs of contract management, and supervision, insurance, and depreciation of tools and equipment used in fulfilling the contract) d. Costs that are explicably chargeable to the customer under the contract e. Other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors) **<u>ASC 606 – Revenue Recognition</u>** <u>ASC 606-10-05-3</u>: The core principle of this topic is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. <u>ASC 606-10-05-4</u>: An entity recognizes revenue in accordance with that core principle by applying the following steps:	accumulating and reporting costs. (b) A contractor's cost accounting practices used in accumulating and reporting actual costs for a contract shall be consistent with his practices used in estimating costs in pricing the related proposal. <u>Cost Accounting Standards Board Disclosure Statement</u> <u>Section 2.1.0 and 2.2.0 Description of Direct Material and</u> <u>Method of Charging Direct Material</u>: Direct material as used here is not limited to those items of material actually incorporated into the end product; they also include material, consumable supplies, and other costs when charged to Federal contracts or similar cost objectives as Direct Material. (Describe on a continuation sheet the principal classes or types of material and services which are charged as direct material; group the material and service costs by those which are incorporated in an end product and those which are not.) ***<u>CASB QUERY:</u>*** *Are these requirements equivalent? Is the CAS 411 requirement for written policies and procedures adequately addressed by other requirements in CAS or GAAP?*

CAS 411 Requirement	GAAP Requirement	Observations and Queries
	a. Step 1: Identify the contract(s) with a customer…..The guidance in this topic applies to each contract that has been agreed upon with a customer and meets specific criteria.	***AIA RESPONSE:*** *Yes, the requirements from CAS and GAAP in this area are equivalent and yes, the CAS 411 requirement for written policies and procedures are adequately addressed by other requirements in CAS and GAAP.* *There is alignment between CAS and GAAP on the requirement to consistently apply inventory costing methods. The basis for consistency under GAAP is ASC 330-10-30-15 and ASC 330-10-50-1 which is essentially the same requirement under CAS at 9904.411-40(e) and 9903.201-4(c)(1-2).* *Additionally, if the CAS 411 requirement for written policies and procedures were to be removed, the USG is adequately protected by various other FAR and GAAP related requirements. In addition to the above noted contracting related content in CAS and DFARS by the CASB, there are various GAAP related requirements for inventory policies and procedure, which include but are not limited to SEC filings and audits; and Sarbanes-Oxley control requirements. Lastly, as a matter of sound business practice written policies and procedures aid in properly executing critical operational activities. Clearly, policies and procedures* are required for many *other business reasons beyond CAS 411 and would not go away simply because a CAS standard was eliminated.* *Furthermore, the CASB Disclosure statement includes disclosures of a contractor's business*

CAS 411 Requirement	GAAP Requirement	Observations and Queries
		and processes and Part II is extremely detailed relative to accounting for material costs.
(b) The cost of units of a category of material may be allocated directly to a cost objective provided the cost objective was specifically identified at the time of purchase or production of the units.	<u>ASC 606-10-05-3</u>: The core principle of this topic is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. <u>ASC 606-10-05-4</u>: An entity recognizes revenue in accordance with that core principle by applying the following steps: b. Step 1: Identify the contract(s) with a customer…..The guidance in this topic applies to each contract that has been agreed upon with a customer and meets specific criteria.	While there is no corresponding GAAP content related to the allocation of material costs to contract, there is additional content in CAS and FAR as outlined below: <u>FAR 2.101, CAS 402-30 and CAS 418-30 Definitions</u>: "Direct cost" means any cost that is identified specifically with a particular final cost objective. Direct costs are not limited to items that are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives. <u>CAS 418-50(a)(3)</u>: Labor or material costs identified specifically with one of the particular cost objectives listed in paragraph (d)(3) of this subsection shall be accounted for as direct labor or direct material costs CAS 418-50(d)(3): (i) final cost objectives, (ii) good produced for stock or product inventory…. <u>FAR 31.205-26(d) Material costs</u>: When materials are purchased specifically for and are identifiable solely with the performance under a

CAS 411 Requirement	GAAP Requirement	Observations and Queries
		contract, the actual purchase cost of those materials should be charged to the contract. *CASB QUERY: Are these equivalent requirements?* *AIA RESPONSE: Yes, the requirements from CAS and GAAP in this area are essentially equivalent. While GAAP doesn't specifically address timing of the allocation, that requirement is adequately covered in section 2.3.0 (Timing of Charging Direct Material) of the disclosure statement. Additionally, we believe all the aforementioned references provide adequate coverage in this area.*
(c) The cost of material which is used solely in performing indirect functions, or is not a significant element of production cost, whether or not incorporated in an end product, may be allocated to an indirect cost pool. When significant, the cost of such indirect material not consumed in a cost accounting period shall be established as an asset at the end of the period.	<u>GAAP Master Glossary Definition – Inventory</u>: The aggregate of those items of tangible personal property that have any of the following characteristics: a. Held for sale in the ordinary course of business b. In process of production for such sale c. To be currently consumed in the production of goods or services to be available for sale The term inventory embraces goods awaiting sale (the merchandise of a trading concern and the finished goods of a manufacturer), goods in the course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies).	<u>FAR 2.101, CAS 402-30 and CAS 418-30 Definitions</u>: "Indirect cost" means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective. <u>CAS 402-50(e) Techniques for Application</u>: Any direct cost of a minor dollar amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives, provided that such treatment produces results which are substantially the same as the results which would have been obtained if such costs had been treated as a direct cost.

CAS 411 Requirement	GAAP Requirement	Observations and Queries
	<u>ASC 360 Property, Plant and Equipment</u>: Spare parts…..should be capitalized and included in property. If their aggregate cost is not significant, however, they may, less desirably, be classified as prepaid expenses or with maintenance supply inventories…..various accounting techniques may be used for these items, including: Expensing items on purchase – this method is appropriate only when aggregate costs are relatively small or lives are relatively short.	<u>DFARS 252.242-7004(d)7-8) Material Management and Accounting System Criteria</u>: The MMAS shall have adequate internal controls to ensure system and data integrity, and shall maintain a consistent, equitable, and unbiased logic for costing of material transactions The MMAS shall have adequate internal controls to ensure system and data integrity, and where allocations from common inventory accounts are used, have controls …. to ensure that— (i) Reallocations and any credit due are processed no less frequently than the routine billing cycle; (ii) Inventories retained for requirements that are not under contract are not allocated to contracts; and (iii) Algorithms are maintained based on valid and current data; *CASB QUERY: Are these equivalent requirements?* *AIA RESPONSE: Yes, the requirements from CAS and GAAP in this area are essentially equivalent. While GAAP does not directly address indirect material purchases, CAS 402-50(e) seems to apply for immaterial items while*

CAS 411 Requirement	GAAP Requirement	Observations and Queries
		the FAR and CAS definitions of “Indirect” apply for indirect purchases.
(d) Except as provided in paragraphs (b) and (c) of this subsection, the cost of a category of material shall be accounted for in material inventory records.	<u>ASC 606-10-05-3</u>: The core principle of this topic is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. <u>ASC 606-10-05-4</u>: An entity recognizes revenue in accordance with that core principle by applying the following steps: a. Step 1: Identify the contract(s) with a customer…..The guidance in this topic applies to each contract that has been agreed upon with a customer and meets specific criteria. <u>GAAP Master Glossary Definition – Inventory</u>: The aggregate of those items of tangible personal property that have any of the following characteristics: a. Held for sale in the ordinary course of business b. In process of production for such sale c. To be currently consumed in the production of goods or services to be available for sale The term inventory embraces goods awaiting sale (the merchandise of a trading concern and	<u>DFARS 252.242-7004(d)(5) Material Management and Accounting System Criteria</u>: The MMAS shall have adequate internal controls to ensure system and data integrity, and shall Establish and maintain adequate levels of record accuracy, and include reconciliation of recorded inventory quantities to physical inventory by part number on a periodic basis. A 95 percent accuracy level is desirable. If systems have an accuracy level below 95 percent, the Contractor shall provide adequate evidence that— (i) There is no material harm to the Government due to lower accuracy levels; and (ii) The cost to meet the accuracy goal is excessive in relation to the impact on the Government CAS 411-30 Definitions: Material inventory record means any record used for the accumulation of actual or standard costs of a category of material recorded as an asset for subsequent cost allocation to one or more cost objectives. *CASB QUERY: Are these equivalent requirements?*

CAS 411 Requirement	GAAP Requirement	Observations and Queries
	the finished goods of a manufacturer), goods in the course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies).	*AIA RESPONSE: Yes, the requirements from CAS and GAAP in this area are equivalent. Additionally, the DFARS and CAS adequately address these areas. The DFARS MMAS criteria focuses heavily on inventory accuracy. And the "Subsequent cost allocation to one or more cost objectives" in CAS 411 and "Held for sale"/"In process of production" in GAAP seem to be equivalent.*
(e) In allocating to cost objectives the costs of a category of material issued from company-owned material inventory, the costing method used shall be selected in accordance with the provisions of 9904.411-50, and shall be used in a manner which results in systematic and rational costing of issues of material to cost objectives. The same costing method shall, within the same business unit, be used for similar categories of materials.	See GAAP requirements outlined below for costing methods under the various CAS 411-50 cites. <u>ASC 330-10-05-02: A</u>n inventory has financial significance because revenues may be obtained from its sale, or from the sale of the goods or services in the production of which it is used. Normally such revenues arise in a continuous repetitive process or cycle of operations in which goods are acquired, created, and sold, and further goods are acquired for additional sales. <u>ASC 330-10-05-3:</u> Thus, the inventory at any given date is the balance of costs applicable to goods on hand remaining after the matching of absorbed costs with the concurrent revenues. <u>ASC 330-10-30-9</u>: The major objective in selecting a method should be to choose the one which, under the circumstances, most clearly reflects periodic income.	<u>DFARS 252.242-7004(d)7-8) Material Management and Accounting System Criteria</u>: The MMAS shall have adequate internal controls to ensure system and data integrity, and shall maintain a consistent, equitable, and unbiased logic for costing of material transactions The MMAS shall have adequate internal controls to ensure system and data integrity, and where allocations from common inventory accounts are used, have controls …. to ensure that— (i) Reallocations and any credit due are processed no less frequently than the routine billing cycle; (ii) Inventories retained for requirements that are not under contract are not allocated to contracts; and (iii) Algorithms are maintained based on valid and current data;

CAS 411 Requirement	GAAP Requirement	Observations and Queries
	ASC 330-10-30-1: The primary basis of accounting for inventories is cost, which has been identified generally as the price paid or consideration given to acquire an asset. As applied to inventories, cost means in principle the sum of applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location. ASC 330-10-30-14: Although selection of the method should be made on the basis of the individual circumstances, financial statements will be more useful if uniform methods of inventory pricing are adopted by all entities within a given industry.	Cost Accounting Standards Board Disclosure Statement Section 2.2.1 and 2.2.2 Direct Charge Not Through and Inventory Account and Charged Direct from a Contractor-Owned Inventory Account *CASB QUERY: Are these equivalent requirements?* *AIA RESPONSE: Yes, the requirements from CAS and GAAP in this area are equivalent. In addition to the above noted observations by the Board, the consistency criteria in CAS 401 would also apply. 9904.401-20 states "Consistency in the application of cost accounting practices is necessary to enhance the likelihood that comparable transactions are treated alike."ASC330-10-05-02 mentions "continuous repetitive processes" and MMAS mentions "consistent, equitable, and unbiased logic for costing of material transactions".*
CAS 411-50 Techniques for application		
(a) Material cost shall be the acquisition cost of a category of material, whether or not a material inventory record is used. The purchase price of material shall be adjusted by	ASC 330-10-30-1 Initial Measurement: The primary basis of accounting for inventories is cost, which has been defined generally as the price paid or consideration given to acquire an asset. As applied to inventories, cost means in principle the sum of the applicable expenditures and charges directly or indirectly incurred in	FAR 31.201-5 Credits: The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.

CAS 411 Requirement	GAAP Requirement	Observations and Queries
extra charges incurred or discounts and credits earned. Such adjustments shall be charged or credited to the same cost objective as the purchase price of the material, except that where it is not practical to do so, the contractor's policy may provide for the consistent inclusion of such charges or credits in an appropriate indirect cost pool.	bringing an article to its existing condition and location. It is understood to mean acquisition and production cost, and its determination involves many considerations.	<u>FAR 31.205-26</u> Material Costs (a) Material costs include the costs of such items as raw materials, parts, subassemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and in-transit insurance. In computing material costs, the contractor shall consider reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work). (b) The Contractor shall—(1) Adjust the costs of material for income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts, and credits for scrap, salvage, and material returned to vendors; and (2) Credit such income and other credits either directly to the cost of the material or allocate such income and other credits as a credit to indirect costs. <u>FAR 52.216-7(h)(2) Allowable Cost and Payment Clause, Final Payment</u>: The Contractor shall pay to the Government any refunds, rebates, credits, or other amounts (including interest, if any) accruing to or received by the Contractor or any assignee under this contract, to the extent that those amounts are properly allocable to costs for which the Contractor has been reimbursed by the Government.

CAS 411 Requirement	GAAP Requirement	Observations and Queries
		CASB QUERY: Are these in combination equivalent requirements? *AIA RESPONSE: Yes, the requirements from CAS and GAAP in this area are equivalent. Both CAS and GAAP define material cost as the net cost incurred to acquire an item. CAS provides additional information on how to treat discounts and credits, but these items are also covered in various sections of the FAR – actually in more detail than in CAS.* *CAS provides no additional guidance beyond what already exists between material cost as defined in GAAP and FAR 31.205-26(a) and treatment of discounts and credits as defined in FAR 31.205-26(b), FAR 31.201-5, FAR 52.216-7(h)(2). Additionally, the Disclosure Statement section 3.2.1 addresses Cash Discounts; Trade Discounts, Refunds, Rebates, and Allowances; Income from Sale of Scrap; and Income from Sale of Salvage.*
(b) One of the following inventory costing methods shall be used when issuing material from a company-owned inventory: (1) The first-in, first-out (FIFO) method.	<u>ASC 330-10-30-9 Determination of Inventory Costs</u>: Costs for inventory purposes may be determined under any one of several assumptions as to the flow of cost factors, such as first-in first-out (FIFO), average, and last-in first- out (LIFO).	CAS 411-30 Definitions: Moving average cost means an inventory costing method under which an average unit cost is computed after each acquisition by adding the cost of the newly acquired units to the cost of the units of inventory on hand and dividing this figure by the new total number of units.

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(2) The moving average cost method. (3) The weighted average cost method. (4) The standard cost method. (5) The last-in, first-out (LIFO) method.	<u>ASC 330-10-30-12 Determination of Inventory Costs</u>: Standard costs are acceptable if adjusted at reasonable intervals to reflect current conditions so that at the balance-sheet date standard costs reasonably approximate costs computed under one of the recognized bases.	Weighted average cost means an inventory costing method under which an average unit cost is computed periodically by dividing the sum of the cost of beginning inventory plus the cost of acquisitions by the total number of units included in these two categories. *CASB QUERY: Are these equivalent requirements? In addition to weighted average and moving average, are there any other average methods in use acceptable for GAAP?* *AIA RESPONSE: Yes, the requirements from CAS and GAAP in this area are equivalent and we are not aware of any other average methods in use acceptable for GAAP.* *Both CAS and GAAP allow for the same methods for inventory costing: FIFO, LIFO, average, or standard. Although CAS goes into extra detail by defining different types of average costing (moving average and weighted average), industry is not aware of any other alternative average costing methods as confirmed through both review of textbooks and recent survey of 24 (i.e 100%) AIA and FEI member companies.*
(c) The method of computation used for any inventory costing method	<u>ASC 330-10-50-1 Basis for Stating Inventories</u>: The basis of stating inventories shall be consistently applied and shall be disclosed in the	<u>CAS 418-40(a) Fundamental Requirements</u>: A business unit shall have a written statement of accounting policies and practices for classifying

CAS 411 Requirement	GAAP Requirement	Observations and Queries
selected pursuant to the provisions of this Standard shall be consistently followed.	financial statements; whenever a significant change is made therein, there shall be disclosure of the nature of the change and, if material, the effect on income. A change of such basis may have an important effect upon the interpretation of the financial statements both before and after that change, and hence, in the event of a change, a full disclosure of its nature and of its effect, if material, upon income shall be made	costs as direct or indirect which shall be consistently applied. Cost Accounting Standards Board Disclosure Statement Section 2.1.0 and 2.2.0 Description of Direct Material and Method of Charging Direct Material: Direct material as used here is not limited to those items of material actually incorporated into the end product; they also include material, consumable supplies, and other costs when charged to Federal contracts or similar cost objectives as Direct Material. (Describe on a continuation sheet the principal classes or types of material and services which are charged as direct material; group the material and service costs by those which are incorporated in an end product and those which are not.) *CASB QUERY: Are these equivalent requirements?* *AIA RESPONSE: Yes, the requirements from CAS and GAAP in this area are equivalent.* *Both CAS and GAAP require that the method for computing and stating inventory be defined and consistently followed.* *Sound inventory policies and procedures are critical for prudent business operations and are also generally required for any type of financial reporting, be it for the SEC, Sarbanes-Oxley, or*

CAS 411 Requirement	GAAP Requirement	Observations and Queries
		any other audit requirements. Thus, these policies and procedures could not go away even if the CAS 411 requirement went away. Furthermore, as noted above, the logic behind inventory methods are built into very expensive ERP systems and are not changed haphazardly. Our survey of FEI member companies show that ERP changes are driven overwhelmingly (i.e. 82%) by either new ERP system implementations/upgrades or organization type transaction activities (e.g. M&A). None of the survey respondents noted they change ERP systems in order to solely change inventory valuation/costing methods. *Additionally, companies performing on a significant amount of US Government contracts must maintain a written CASB Disclosure Statement that defines accounting policies and procedures, including inventory costing. Sections 2.1.0 and 2.2.0 of the Disclosure Statement specifically discuss material and methods of charging material in much detail. Thus again, if this specific CAS went away, the requirement would still be fulfilled.*
(d) Where the excess of the ending inventory over the beginning inventory of material of the type described in 9904.411-40(c) is estimated to be significant	<u>GAAP Master Glossary Definition – Inventory</u>: The aggregate of those items of tangible personal property that have any of the following characteristics: a. Held for sale in the ordinary course of business	<u>FAR 2.101 and CAS 402-30 Definitions</u>: "Indirect cost" means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

CAS 411 Requirement	GAAP Requirement	Observations and Queries
in relation to the total cost included in the indirect cost pool, the cost of such unconsumed material shall be established as an asset at the end of the period by reducing the indirect cost pool by a corresponding amount.	b. In process of production for such sale c. To be currently consumed in the production of goods or services to be available for sale The term inventory embraces goods awaiting sale (the merchandise of a trading concern and the finished goods of a manufacturer), goods in the course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies).	CAS 402-50(e) Techniques for Application: Any direct cost of a minor dollar amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives, provided that such treatment produces results which are substantially the same as the results which would have been obtained if such costs had been treated as a direct cost. *CASB QUERY: Are these equivalent requirements?* *AIA RESPONSE: Yes, the requirements from CAS and GAAP in this area are equivalent.* *As described previously, both CAS and GAAP are consistent in the requirements for inventory costing. In this case, CAS makes clear that when the excess cost of material (e.g., consumables or supplies) used solely in performing indirect functions is significant, it must be treated as an asset (i.e., inventory) and not simply expensed within the indirect pool. This entirely aligns with the GAAP definition of inventory which includes goods to be consumed indirectly in production, ensuring that any significant amounts of such material would be classified as an asset until used.*