

## Recommendation 29: Revise 41 U.S.C. § 1501-1506 to designate the Cost Accounting Standards Board as an independent federal organization within the executive branch.

### Problem

The CASB's current configuration within OFPP is ineffective at providing oversight for application of CAS to federal government contracts. CASB has only rarely met in recent years, and member positions often go unfilled for long periods. Meanwhile, changes to government contracting require ongoing updates to the standards and resolution of questions about CAS applicability. Because CASB has not been responsive to these changes, contractors are overly burdened by the need for added layers of compliance to many rules that have not kept pace with new business models. CASB needs to be reinvigorated as an independent organization and removed from OFPP.

### Background

In 1970, Congress created the five-member CASB with authority to promulgate cost accounting standards designed to achieve more uniform and consistent cost accounting practices on national defense contracts and subcontracts.<sup>1</sup> The original CASB was part of what was then the General Accounting Office (GAO), and it was chaired by the Comptroller General. CASB met regularly and employed a staff of professional accountants who were responsible for conducting research and making recommendations to the board. Over the course of its existence, CASB promulgated 19 standards as well as detailed rules and regulations about the application of the statutory requirements to contracts and subcontracts.

The original CASB ceased to function at the end of FY 1981 when its funding expired and was not renewed. CAS and related regulations remained in effect, but in the absence of an active Board, there was no authority to make changes to CAS or regulations. It became clear that a functioning CASB was needed, and Congress created a new CASB in 1988 with the OFPP administrator as the board's chair.

For a variety of reasons, the new CASB did not begin to function until 1991.<sup>2</sup> The long delay in getting the new CASB functioning within OFPP has turned out to be prophetic. In recent years, dissatisfaction and frustration with the performance of CASB has grown. Notably, the Senate Armed Services Committee admitted in 2016 that it "is disappointed that the Federal Cost Accounting Standards Board does not currently have a quorum of members and has not met in over three years. Due to this situation, it is doubtful that any credible reform will emanate out of this board in the future."<sup>3</sup> The board's inactivity is due to frequent changes in the identity of the OFPP Administrator and long

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<sup>1</sup> Defense Production Act, Pub. L. No. 91-379, 84 Stat. 796, on August 15, 1970; codified at 50 U.S.C. App. 2179.

<sup>2</sup> The new Board's work was delayed for more than a year because there was a question about whether anyone currently employed by a government contractor or with other financial connections to the industry could serve as a private sector member of the Board without violating the Ethics in Government Act (18 U.S.C. § 208). The original sponsor of the OFPP legislation, Representative Jack Brooks, eventually informed the Administrator that Congress intended to create an exception to the Ethics Act. Based on advice from the Office of Government Ethics, the Administrator concluded that private sector representatives who were employees or consultants to contractor could serve on the Board as long as they recused themselves from the Board's consideration of matters such as waivers that were specifically and uniquely applicable to their employer or client.

<sup>3</sup> FY 2017 NDAA, S. Rpt. No. 114-255 § 811 (2016).

periods during which that position was vacant, as well as other prolonged vacancies among board members.

CASB has responsibilities that have been neglected. The board has “exclusive authority to prescribe, amend, and rescind cost accounting standards, and interpretations of the standards” that govern “measurement, assignment, and allocation of costs to contracts with the [f]ederal [g]overnment.”<sup>4</sup> As the sole organization with this authority, CASB must meet regularly and address issues promptly as they arise.

## Discussion

For the past 30 years, CASB has failed to address urgent issues in a timely way. For example, Congress has twice changed pension funding requirements in a way that made those requirements inconsistent with CAS funding requirements—once in the Omnibus Budget Reconciliation Act of 1987, and the second time in the Pension Protection Act of 2006.<sup>5</sup> CASB did not make changes in CAS requirements to eliminate the problems created by the 1987 Budget Act until 1995, and the contracting community was saved from what could have been a huge financial problem only because DoD issued a waiver permitting contractors to comply with the changed statutory requirements and ignore the conflicting CAS provisions until CASB changed the CAS provisions. A decade later, defense contractors identified a similar problem during the drafting of the Pension Protection Act of 2006. In response, Congress added a provision postponing the applicability of the statute to major defense contractors for 2 years, requiring CASB to issue final regulations harmonizing the CAS rules with the new statute and imposing a deadline on issuance of the harmonization rules.<sup>6</sup> CASB missed that harmonization deadline by more than 2 years.<sup>7</sup>

The standards and regulations published by the original CASB need to be updated to reflect fundamental changes in the nature of government procurement over the last 30 years. CASB has known for years that growth in the use of indefinite quantity and task order contracts has created issues about coverage and cost impact that the original board never contemplated and that urgently require the current board’s attention. Since its establishment in 1988, the new board has not published any new regulations or modified any existing standard or regulation to address those issues. The 19 standards that the original board promulgated were written in an era when CAS applied only to defense contracts and when most major defense contracts were for hardware. Those standards are now applicable to all government agencies that are acquiring services, software, health care, and other solutions for which the original standards may be difficult to apply. Because CASB has failed to address these problems, a commercial company selling the same service or product that it sells in the commercial market may find that its contracts are potentially subject to CAS coverage because of one

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<sup>4</sup> Cost Accounting Standards, 41 U.S.C. § 1502.

<sup>5</sup> Pub. L. No. 100–203, 101 Stat. 13301 (1987). Pension Protection Act of 2006, Pub. L. 109–280, 120 Stat. 780 (2006).

<sup>6</sup> Section 106(d) of the Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006).

<sup>7</sup> In fairness to the CAS Board, it worked closely with the government and with affected contractors to develop and implement a harmonization process that was designed to minimize disruption of the procurement cycle. The failure to meet the harmonization deadline was in part the result of negotiations with industry and the government to minimize disruption of the normal procurement process.

small line item in a hybrid contract, creating serious barriers to entry into the government market.<sup>8</sup> The challenge of applying CAS to hybrid contracts is addressed in detail elsewhere in this *Volume 2 Report*.

When the new CASB was created in 1988, the decision to move the board to OFPP was driven by concerns that it would have been unconstitutional for the board to resume operations in GAO, which is not part of the executive branch.<sup>9</sup> Although assigning responsibility for CAS to OFPP made sense in many ways, the activity of the CAS Board has been limited in the nearly 30 years it has been part of OFPP. The board recently resumed meetings in 2018 for what appears to be the first time in more than 6 years. Prior to that meeting, the most recent minutes posted on the Office of Management and Budget (OMB) website were from a meeting held October 5, 2011. Although there were reportedly meetings in 2017, there is no published evidence or record of them.

In response to the lack of activity by CASB, Section 820(a) of the FY 2017 NDAA required that CASB meet at least quarterly and publish in the Federal Register notice of each meeting and an agenda for each meeting.<sup>10</sup> The FY 2017 NDAA also requires that CASB appoint an executive secretary and authorizes creation of two additional senior staff positions for the board. Those new NDAA provisions are not yet effective, and there is little evidence that things have changed. CASB continues to lack a chair due to the vacant OFPP Administrator position, and it has demonstrated little potential to address well-known issues.

The FY 2017 NDAA also created a Defense Cost Accounting Standards Board (Defense CASB), effective October 1, 2018, to be responsible for making recommendations about changes to CASB, to be exclusively responsible for implementation of the cost accounting standards in DoD, and to “develop standards to ensure that commercial operations performed by Government employees at the Department of Defense adhere to cost accounting standards (based on cost accounting standards established under section 1502 of title 41 or Generally Accepted Accounting Principles [GAAP]) that inform managerial decision making.”<sup>11</sup>

Creation of the Defense CASB is an attempt to solve the problem of the nonfunctioning CASB. Adding another regulatory organization is the wrong solution. Government and industry representatives who spoke with the Section 809 Panel expressed they do not support creation of a Defense CASB. Stakeholders are concerned by the many unanswered questions raised by creating this board, including whether the new board will be biased toward DoD issues, and if the two boards will create competing sets of CAS.<sup>12</sup> Creation of a Defense CASB would almost certainly be counter-productive.

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<sup>8</sup> For example, if a software company enters into a contract with the Government to provide the same software and support services it offers in the commercial market at fixed prices, that contract would normally be exempt from CAS-coverage. If the contract includes a line item reimbursing the contractor for actual travel costs associated with providing support services, however, under the current regulations the entire contract could be CAS-covered because of that single cost-reimbursement line item. The value of the fixed price software and support services might be \$1 billion and the estimated value of the travel cost reimbursement might be only \$1 million, but the entire \$1.001 billion contract could be covered by CAS.

<sup>9</sup> In *The Boeing Co. v. United States*, 680 F.2d 132 (Ct. Cl. 1982), the Court found that Boeing’s argument that the original CAS statute was unconstitutional was “by no means insubstantial.” *Id.* at 141.

<sup>10</sup> Section 820 of the FY 2017 NDAA, Pub. L. No. 114-238, 130 Stat. 2000 (2017). Creation of Defense CASB codified at 10 U.S.C. § 190.

<sup>11</sup> Section 820(b) of the FY 2017 NDAA, Pub. L. No. 114-238, 130 Stat. 2000 (2017).

<sup>12</sup> See, for example, Paul E. Pompeo, “Senate Proposes Yet Another Cost Accounting Standards Board for Government Contractors,” *Arnold & Porter Advisory*, May 25, 2016, accessed May 15, 2018,

The most pressing problem with the current CASB formulation is the administration of the board at OFPP, partly due to a lack of leadership and subject matter expertise. The OFPP administrator position changes frequently and is often vacant, leaving the role in the hands of an acting administrator, most often a career civil servant versed in procurement policy, but without the requisite authority or experience in accounting and contract management to push forward needed CAS reforms.<sup>13</sup> Currently the administrator position has been unfilled since January 2016. As a practical matter, when there is no Senate-confirmed administrator, nothing of substance happens at the CASB. Even when there is someone in the job, most OFPP administrators are not accountants, have not previously shown an interest in the issues within the board's jurisdiction, and are not experientially well-qualified to lead the board. Based on CASB's consistent lack of activity, OFPP administrators clearly have not prioritized CAS.

Housing CASB in OFPP has also proven a problem from a budgetary point of view. The original board had a large and experienced professional staff that performed its own independent research, did its own drafting, and provided high-quality advice to the board members. Since its move to OFPP, CASB has essentially had no staff of its own due to inadequate funding from OFPP.<sup>14</sup> To the limited extent that it has done anything substantive, the OFPP CASB has effectively subcontracted its research and drafting to employees at other government agencies. Those employees are inevitably affected by their respective agency agendas and thus cannot provide the kind of independent analysis and advice that the board needs.

Nearly 20 years ago, these same issues were identified by a GAO CASB review panel created at the direction of Congress. The panel's 1999 report detailed the many problems resulting from the 1988 decision to place the CAS Board in OFPP.<sup>15</sup> It concluded the following:

*[P]lacement in OFPP/OMB has unduly constrained the Board's work and lent some credence to the contention that the Board's pronouncements have been unduly affected by procurement policy considerations...[T]he Panel believes that shifting the Board out of OFPP/OMB could reinforce its independence. This removal should facilitate the use of advisory committees, task forces, and staff for individual members, which would improve the CAS Board process and allow for greater acceptance of its pronouncements.<sup>16</sup>*

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<https://www.arnoldporter.com/en/perspectives/publications/2016/05/senate-proposes-yet-another>. John Chierichella and Adam Bartolanzo, "Defense Contractors to Face New Cost Accounting Oversight with Creation of Defense Cost Accounting Standards Board," Government Contracts & Investigations Blog, April 26, 2017, accessed May 15, 2018, <https://www.governmentcontractslawblog.com/2017/04/articles/department-of-defense/cost-accounting-standards-board/>. Robert Kramer, "Committee on Government Business Discusses the New Defense Cost Accounting Standards Board Proposal," Financial Executives International, August 19, 2016, accessed May 15, 2018, <https://www.financialexecutives.org/Influence/Committees/Government-Business/News/Committee-on-Government-Business-Discusses-the-New.aspx>.

<sup>13</sup> Since 2000, the position has been held by six appointed officials, with acting administrators for over six of those 18 years. (Administrators were Angela Styles, 2001-2003; David Safavian, 2004-2005; Paul Denett, 2006-2008; Dan Gordon, 2009-2011; Joe Jordan, 2011-2013; and Anne Rung, 2014-2016.)

<sup>14</sup> Section 820 (a) of the FY 2017 NDAA, Pub. L. No. 114-238, 130 Stat. 2000 (2017) includes a provision that requires funding for a staff of three at the Board. The proposed statutory change will address, as needed, a source of funding for the positions.

<sup>15</sup> GAO, *Future Role of the Cost Accounting Standards Board*, SP-99-1 (1999).

<sup>16</sup> *Ibid.*, 51.

Although placing CASB within OFPP may seem logical because of the ostensible relationship between procurement and cost accounting at the transactional level, CASB does not make procurement policy. It publishes very technical accounting rules about how costs on government contracts are measured, assigned to cost accounting periods, and allocated to individual contracts. The primary purpose of CAS and cost accounting regulations is to insure that the accounting for all costs charged on government contracts reflects sound and consistently applied principles, so costs are charged to contracts on the basis of demonstrable causal/beneficial relationships. The standards protect the government from abuses by contractors, but they also protect contractors from pressure by their government customers to manipulate accounting data in ways that do not reflect causal/beneficial relationships.

Neither OFPP administrators nor OFPP staff have expertise about the kinds of technical accounting and contract management issues that CASB's standards and regulations address. By maintaining an association between CAS and OFPP, CASB could make judgments biased toward procurement policy rather than content-neutral rules about how and when costs are charged to government contracts. To perform its functions adequately and efficiently, CASB should be an independent organization within the Executive Branch.

The 1999 GAO CASB review panel laid out criteria that a new CASB should meet. Among other things, GAO recommended there is a continued need for a CASB and that CASB should be an independent agency that is not "subject to the control of any other government agency that may have conflicting procurement policy/funding concerns."<sup>17</sup> Members should represent government and private industry, retaining a government majority. These members should be part-time; the chair may be a full-time employee. The panel also emphasized the board's authority: "the Board's regulations should be binding and take precedence over other regulations regarding the allocation, measurement, and assignment of costs."<sup>18</sup> These criteria should be heeded in the creation of a reinvigorated CASB.

The 1999 GAO CASB review panel devoted an entire chapter to the organization of CASB, with extensive findings on how to structure its composition, where to locate the board's operations, what types of restructuring authorities were needed to accomplish the recommendations, and what restructuring authorities were already permitted CASB's enabling legislation.<sup>19</sup> GAO proposed three alternatives to ensure CASB retained its impartiality and operated more efficiently, but that could also be designed to address the board's rulemaking requirements to ensure any regulations would be binding and not subject to constitutional challenge.

The first option recommended the General Services Administration (GSA) house the CASB's operations and provide administrative support to the board as an independent agency with its own appropriated funding. The second option was to place CASB within DoD as an independent agency with appropriated funding, but the 1999 GAO CASB review panel noted a substantial risk that the agency with the most CAS-covered contracts (DoD) could unduly influence the promulgation of the CAS for procurement policy reasons. The third option was to authorize CASB as a completely independent federal agency outside any existing agency, but that alternative was limited by the potentially high cost

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<sup>17</sup> Ibid, 52.

<sup>18</sup> Ibid, 52.

<sup>19</sup> Ibid, 46-56.

to the government to establish the CAS Board outside of a host federal agency. To date, none of these options have been initiated or addressed in any detail until they resurfaced in the context of the Section 809 Panel's streamlining mandate.

Contemplating those alternatives, both the Section 809 Panel and the 1999 GAO CAS Review Panel independently concluded that CASB should be an independent organization, outside of OFPP. The board needs to be physically located in an existing agency required to provide office space and facilities, including clerical support, but this agency should have no responsibility for CASB's substantive work. The GAO review panel noted that GSA provides a physical location for a number of government entities that are not part of GSA, making it a suitable home for CASB's offices.

The GSA model resolves the housing problem by moving CASB out of OFPP, but it does not address how to ensure the constitutionality of any regulatory promulgation. Both panels recognize that for regulations to be binding, members of any CASB should be officers of the United States under the Appointments Clause (Article II, Section 2, Clause 2 of the Constitution.)<sup>20</sup> To address this challenge, the Section 809 Panel recommends that any statutory enactment enabling the physical move of CASB out of OFPP also designate the OMB director as the principal officer over CASB with the authority to delegate CASB members to act as officers of the United States. OFPP should remain responsible for the mechanics of publishing the regulations in the Code of Federal Regulations, where they have been located since 1993, but it will have no responsibility for determining the substance of the CAS requirements.<sup>21</sup>

Concurrent with the physical move outside OFPP, independence could be assured in the statute by, among other things, establishing appointment rules for CASB members that assure impartiality through specific-term appointments; create limitations on removal to misconduct, malfeasance or not performing the functions of the office; and specify that CASB members will not be subject to the supervision of anyone at OMB. Models for such an administrative construct include the DoD Board of Actuaries<sup>22</sup> and the Federal Energy Regulatory Commission.<sup>23</sup>

Section 809 Panel analysis of CASB's inability to perform its mission identifies its location within OFPP as a core problem. CASB has a vital role to play in updating and overseeing cost accounting standards and regulations, and this role must be resumed. The Section 809 Panel has provided recommended changes to CAS program requirements, detailed in recommendations addressed elsewhere in this Volume 2 Report, and a reconstituted CASB is the appropriate organization to implement these recommendations.

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<sup>20</sup> Ibid, 49.

<sup>21</sup> Cost Accounting Standards Board, 48 CFR 99.

<sup>22</sup> 10 U.S.C. § 183(b)(2), Department of Defense Board of Actuaries, "Members: The members of the Board shall serve for a term of 15 years, except that a member of the Board appointed to fill a vacancy occurring before the end of the term for which the member's predecessor was appointed shall only serve until the end of such term."

<sup>23</sup> 42 U.S.C. § 7171 (b), Appointment and Administration, Federal Energy Regulatory Commission, "...Member shall hold office for a term of 5 years and may be removed ...only for inefficiency, neglect of duty, or malfeasance in office."

## Conclusions

CASB should be removed from OFPP. Such a move will require legislative action and a commitment to long-term, adequate funding. Legislation should be enacted that includes the following features:

- CASB should be physically located in GSA, which will provide office space and facilities, including clerical support. GSA will have no responsibility for CASB's substantive work.
- CASB should have a budget sufficient to support a full-time, permanent staff of at least three people.
- CASB should be part of the Executive Branch, but completely independent of any department of any other agency.
- The existing requirements for CASB to meet at least quarterly and to publish minutes of its meetings should be retained.
- Section 820 of the FY 2017 NDAA creating a Defense CASB should be repealed.
- CASB should have five members, much like the current board, with the following qualifications:
  - The CASB chair should be either a full-time government employee or a part-time special government employee. In either case, the chair should have extensive experience in administering and managing as a senior government official major CAS-covered contracts negotiated and awarded using the methods required by FAR Part 15.
  - Two members of CASB should be government employees, at least one of whom should be from DoD, both with experience in administering and managing CAS-covered contracts negotiated and awarded using the methods required by FAR Part 15. Government auditors and investigators should not be eligible to serve as members of CASB, both to avoid conflicts of interest and because they typically lack the administrative and management experience needed.
  - One member should be a senior employee or retired senior employee of a government contractor with substantial experience in the private sector involving administration and management of CAS-covered contracts negotiated and awarded using the methods required by FAR Part 15.
  - One member should be from the accounting profession, with substantial professional experience as an accountant involving CAS-covered contracts negotiated and awarded using the methods required by FAR Part 15.
- Authority to appoint the members of the CAS Board should be vested in the Director of OMB.
- There should be rules for member appointment, including the chair, that include limits on removal; appointment terms consistent with the length of experience necessary to govern, administer and reform CAS; and that provide for independence in the decisional and regulation process free from supervision by OMB.

- The statute creating CASB should also direct that the board’s standards and regulations will continue to be published by OFPP, and/or other relevant regulatory bodies, in Part 99 of 48 CFR.
- Disestablish the Cost Accounting Standards Board and remove its statute from chapter 15 of Title 41 (“Division B, Office of Federal Procurement Policy”). Create a new independent board codified in Title 31 (“Financial Management”).

## **Implementation**

### ***Legislative Branch***

- Modify the 41 U.S.C. § 1501–1506 as described above.
- Modify 48 C.F.R. chapter 99.

### ***Executive Branch***

- Make administrative arrangements to house and support CASB operations.

### ***Implications for Other Agencies***

- CAS is applicable to all federal agencies, and all agencies would be affected by the recommended statutory revisions.