

Official Case Record

Date: May 1, 1996

FAR Case: 95-003

Case Title: Impairment of Long-Lived Assets

Originator: O

Sponsor: N

Committee: Cost Principles

Case Manager: Haberlin

FAR/DFARS: 31.205-11, 31.205-16

Statute:

Statutory Date:

Outside Interest (Circle): IG OFPP OMB DCAA GAO Industry Other _____

Coordination/Comments (Circle): DDP MPI CPA CPF DSPS FC GC Other CAS Cmte

Action Scheduled Today: Discuss a draft final rule.

Attachments:

A. CP Cmte. Rept dtd. April 23, 1996

D. CPF Memo dtd Apr. 30, 1996

B. Federal Register notice (60 FR 64254)

C. CMR dtd Jan. 30, 1995 (New Case)

OSD Position:

CPF concurs with the rule. The memo also emphasizes CPF's position that the cost allowability rule is totally consistent with the Cost Accounting Standards.

The Chair of the CAS Cmte. concurs with the rule.

Discussions/Actions Taken:

CAM Update:

Agree to final rule

Director DARC



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH, DEVELOPMENT AND ACQUISITION
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

23 April 1996

FAR Case 95-003

MEMORANDUM FOR DIRECTOR, DEFENSE ACQUISITION REGULATIONS COUNCIL

SUBJECT: FAR Case 95-003, Impairment of Long-Lived Assets

I. PROBLEM

The Cost Principles Committee was tasked to review public comments received in response to the subject interim rule published in the *Federal Register* on 14 December 1995 and to draft a final rule.

II. RECOMMENDATION

That the interim rule be amended as shown in TAB A and adopted as a final rule.

III. BACKGROUND

The interim rule was intended to clarify that impairment losses recognized for financial accounting purposes under the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS), No. 121, *"Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets To Be Disposed Of,"* are not allowable for Government contract costing. The interim rule revised the existing language at FAR 31.205-11 and 31.205-16 to expressly state that for Government contracting purposes, any loss (including an impairment loss) is recognized only upon disposal of the asset. Until an impaired asset is disposed of, depreciation is limited to the amounts that would have been allowed before any impairment loss occurred.

SFAS No. 121, effective for company fiscal years beginning after 15 December 1995, addresses the impairment of long-lived assets (such as land, buildings, and equipment), certain identifiable intangibles, and related goodwill. The SFAS "requires that long-lived assets and certain identifiable intangibles to be held and used by an entity be reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable." Such events include a significant decrease in the market value of an asset, change in the extent or manner in which an asset is used, and adverse change in legal factors or business climate. If the company believes that the expected future cash flows from the use of the asset and eventual disposition are less than the carrying amount (usually net book value) of the asset, an impairment loss must be recognized.

For impaired assets expected to be held and used, the net book value is reduced to fair value (i.e., the current amount the asset could be bought or sold for between willing parties). Once an asset is written down due to an impairment loss, the asset cannot be written back up, even if the impairment is subsequently removed. Impaired assets to be disposed of are generally reported at the lower of the carrying amount or fair value less cost to sell.

IV. EVALUATION OF COMMENTS

Responses were received from the following four commentors: Sundstrand Aerospace, National Security Industrial Association (NSIA), Aerospace Industries Association (AIA), and the American Bar Association (ABA). All commentors oppose the rule and believe it is unnecessary. Essentially, they contend that the rule should be withdrawn because it (1) is contrary to Generally Accepted Accounting Principles (GAAP), (2) involves a subject matter beyond the authority of the Councils, and (3) is administratively burdensome. The Committee's analysis of the substantive issues raised by the commentors follows.

A. Contrary to GAAP

NSIA asserts that Government contract accounting should not depart from GAAP unless public policy or other special circumstances warrant deviation. AIA states that the interim rule is unwarranted and contrary to sound accounting theory. The commentors also state that the interim rule does not address why SFAS No. 121 should not be used for Government accounting.

Committee Comments

The interim rule does depart from GAAP, because in this instance, it is inadequate for Government contract costing. GAAP is required to be followed in the absence of contract rules to the contrary. However, when GAAP produces an inequitable result, the Government has the right and fiduciary responsibility to the U.S. taxpayers to prescribe another arrangement. The Committee continues to believe that the interim rule protects the Government's interests and provides for equitable treatment.

The relevance of GAAP for Government contracting purposes is perhaps best summarized by the American Institute of Certified Public Accountants (AICPA). The AICPA makes the following statement in Section 2.46 of the *Audit and Accounting Guide for Audits of Federal Government Contractors*:

"Generally accepted accounting principles (GAAP) are established for financial accounting purposes and provide little guidance for cost accounting purposes in the Government contracting industry. Consequently, GAAP is applied only when no guidance in FAR or CAS exists."

To illustrate the inequity of SFAS No. 121, consider assets such as land and buildings and how their values can change over time. If these types of assets become impaired, an estimated loss will be recognized under GAAP. The estimated one-time period loss could then be charged to Government contracts even though the assets are still being used by the company. Since the Government intends to reimburse the contractor its historical costs and the assets have not actually been disposed of, the contractor has not experienced a real out-of-pocket loss. The loss, if any, will be realized when the assets are ultimately disposed of at some future point. Also, the Government would not receive a credit if the impairment is subsequently removed because GAAP prohibits the restoration of a previously recognized impairment loss.

B. Involves a Subject Matter Beyond the Authority of the Councils

The commentators believe that the interim rule addresses the measurement or allocation of cost which is within the exclusive statutory authority of the CAS Board (CASB). The commentators quote 41 U.S.C. 422(j)(4) which gives the CASB exclusive authority with respect to the measurement, assignment, or allocation of costs subject to CAS. The basic concern is summarized in the following ABA comment:

"Although the Section acknowledges the role of the Defense Acquisition Regulations Council and the Civilian Agency Acquisition Council with respect to cost allowability matters, matters of public policy, it is clear from both the nature of the Interim Rule, as well as the Background discussion, that the Councils have chosen to address a matter involving a government contract cost accounting practice--a matter beyond their authority. Rulemaking and regulatory guidance in this area should appropriately be issued by the CAS Board."

Committee Comments

This issue is fundamental to the case. The Committee agrees that the CASB has sole authority over the measurement, assignment, and allocation of costs for CAS-covered contracts. However, not all Government contracts are subject to CAS. Further, CAS 404 and 409 do not address the measurement, assignment, or allocation associated with intangible capital assets.

The CASB acknowledges that cost allowability is a contract administration matter. The CASB makes the following comments in its Statement of Objectives, Policies and Concepts:

"While the Board has exclusive authority for establishing Standards governing the measurement, assignment and allocation of costs, it does not determine the allowability of categories of individual items of costs.

* * * * *

The use of Cost Accounting Standards has no direct bearing on the allowability of those individual items of cost which are subject to limitations or exclusions set forth in the contract or which are otherwise specified as unallowable by the Government."

In addition, recognition of the concept of "allowability" is found in the following quote from the Boeing SERP Case Appeal (Court of Appeals for the Federal Circuit (CAFC) Case No. 86-927, October 1, 1986):

"Since the allowability of a cost remains the province of the procuring agencies, the DOD may limit costs based upon rational procurement policies and not all costs are deemed reasonable just because they have been incurred and measured, allocated and assigned in accordance with CAS requirements."

While the CAS could be similarly amended or interpreted in a way that would conclude that recognition of asset impairments for Government contracting is inappropriate, it is not likely this will occur in the near future. In the meantime, U.S. taxpayers could end up paying for estimated losses recognized for financial accounting purposes that will not actually be realized for years, if at all - a clearly inequitable result. However, to further clarify that the cost principle is an "allowability", and not a "measurement or allocability" rule with respect to CAS-covered contracts, we have rephrased the interim rule. In addition, we have added a sentence to 31.205-11(o) to ensure there is no conflict with CAS 409.50(i) by clarifying that changes in depreciation may result from other permissible causes.

C. Administratively Burdensome

The commentators allege that the rule is administratively burdensome because it will necessitate keeping an extra set of fixed asset records.

Committee Comments

We disagree. Contractors are already required to segregate unallowable costs for Government contracting purposes (e.g., treatment of gains or losses subsequent to mergers or business combinations) and to maintain fixed asset records. Moreover, contractors may already have to keep more than one set of fixed assets records, regardless of the cost principle, because of differences in depreciation methods required by GAAP, state, and/or Federal tax returns.

V. COLLATERALS

A. Regulatory Flexibility Act

This final rule is not expected to have a significant impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., because most contracts awarded to small entities are awarded on a competitive, fixed price basis and the cost principles do not apply.

B. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the changes to the FAR do not impose record keeping or information collection requirements, or collections of information from offerors, contractors, or members of the public which require the approval of the Office of Management and Budget under 44 U.S.C. 3501 et seq.

VI. SUMMARY

All Committee members below concur in the contents of this report.



Clarence M. Belton
Chairman, Cost Principles Committee

DOD Members

Paul A. Schill, Air Force
James Bozzard, Army
Stephen T. Larkin, DCAA
Glenn Gulden, DLA
Chris Werner, OSD

Non-DOD Members

Bill Childs, NASA
Bill Dunn, EPA
Jerry Olson, GSA
Terry Sheppard, DOE

TAB A--Committee Recommended Final Rule

TAB A
RECOMMENDED COMMITTEE LANGUAGE

The baseline language is the interim rule published in the *Federal Register* on December 14, 1995. Changes are represented by [bold print in brackets] for new language and ~~strikeout~~ for deleted language.

31.205-11 Depreciation

* * * * *

(o) In the event of a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances, [allowable] depreciation of the impaired assets shall ~~not exceed~~ [be limited to] the amounts [that would have been allowed had the assets not been] ~~established on depreciation schedules in use prior to the write-down~~ [written down] (see 31.205-16(g)). [However, this does not preclude a change in depreciation resulting from other causes such as permissible changes in estimates of service life, consumption of services or residual value.]

31.205-16 Gains and losses on disposition or impairment of depreciable property or other capital assets

* * * * *

(g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be ~~recognized~~ [allowed] for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damage, idle facilities arising from a declining business base, etc.). [If depreciable property or other capital assets have been written down from carrying value to fair value due to impairments, gains or losses upon disposition shall be the amounts that would have been allowed had the assets not been written down.] ~~Depreciation or amortization on pre-write down carrying value of impaired assets not yet disposed of shall continue to be recoverable under established depreciation or amortization schedules to the extent it is not otherwise unallowable under other provisions of the FAR.~~

**CLEAN VERSION OF
RECOMMENDED COMMITTEE LANGUAGE**

31.205-11 Depreciation

* * * * *

(o) In the event of a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances, allowable depreciation of the impaired assets shall be the amounts that would have been allowed had the assets not been written-down (see 31.205-16(g)). However, this does not preclude a change in depreciation resulting from other causes such as permissible changes in estimates of service life, consumption of services or residual value.

31.205-16 Gains and losses on disposition or impairment of depreciable property or other capital assets

* * * * *

(g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be allowed for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damage, idle facilities arising from a declining business base, etc.). If depreciable property or other capital assets have been written down from carrying value to fair value due to impairments, gains or losses upon disposition shall be the amounts that would have been allowed had the assets not been written down.

DEPARTMENT OF DEFENSE**GENERAL SERVICES
ADMINISTRATION****NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION****48 CFR Part 31**

[FAC 90-35; FAR Case 95-003]

RIN 9000-AG73

**Federal Acquisition Regulation;
Impairment of Long-Lived Assets**

AGENCIES: Department of Defense (DOD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Interim rule, with request for comments.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council have agreed to an interim rule to clarify the allowability of losses recognized when carrying values of impaired assets are written down for financial reporting purposes. This regulatory action was not subject to Office of Management and Budget review under Executive Order 12866, dated September 30, 1993.

DATES: *Effective Date:* December 14, 1995.

Comment Due Date: To be considered in the formulation of a final rule, comments should be submitted to the address given below on or before February 12, 1996.

ADDRESSES: Comments should be submitted to: General Services Administration, FAR Secretariat, 18th & F Streets NW., Room 4037, Washington, DC 20405.

FOR FURTHER INFORMATION CONTACT: Mr. Jeremy F. Olson at (202) 501-3775 in reference to this FAR case. For general information, contact the FAR Secretariat, Room 4037, GS Building, Washington, DC 20405 (202) 501-4755. Please cite FAC 90-35, FAR Case 95-003.

SUPPLEMENTARY INFORMATION:**A. Background**

This interim rule is intended to clarify cost allowability rules concerning the recognition of gains and losses related to long-lived assets. The rule addresses a cost category which is the subject of a Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS), No. 121, dated March 1995, entitled "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets To Be Disposed Of."

The SFAS applies to long-lived assets (such as land, buildings, and equipment), identifiable intangibles, and related goodwill, and establishes guidance to recognize and measure impairment losses. If impaired assets are to be held for use, the SFAS requires a write-down to fair value when events or circumstances (e.g., environmental damage, idle facilities arising from declining business, etc.) indicate that carrying values may not be fully recoverable.

Impaired assets that are to be disposed of, however, would be reported (with certain exceptions) at the lower of cost or fair value less cost to sell. Once written down, the previous carrying amount of an impaired asset could not be restored if the impairment was subsequently removed.

In contrast to the SFAS provisions, Cost Accounting Standard (CAS) 9904.409, "Depreciation of Tangible Capital Assets", provides quite different criteria and guidance to recognize gains and losses for Government contract purposes. The language at 9904.409-40 (a)(4) and (b)(4), 9904.409-50(j), and related Promulgation Comment 10, "Gain or Loss," makes it clear that gains and losses are recognized only upon asset disposal; no other circumstances trigger such recognition.

FAR 31.205-16 reflects the CAS provisions that an asset be disposed of in order to recognize a gain or loss. The FAR rule applies to both CAS and non-CAS covered contracts. Consequently, for Government contract purposes, an impairment loss is recognized only upon disposal of the impaired asset. Like other losses, it is measured as the difference between the net amount realized and the impaired asset's undepreciated balance. Government contractors, therefore, recover the carrying values of impaired assets held for use by retaining pre-write-down depreciation or amortization schedules as though no impairment had occurred. The rule addresses the treatment of losses for impaired assets by adding a new paragraph (o) at 31.205-11, and revising the title and adding a new paragraph (g) at 31.205.16.

B. Regulatory Flexibility Act

The interim rule is not expected to have significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* because most contracts awarded to small entities are awarded on a competitive fixed-price basis and the cost principles do not apply. An Initial Regulatory Flexibility Analysis has, therefore, not been performed.

Comments are invited from small businesses and other interested parties. Comments from small entities concerning the affected FAR parts will also be considered in accordance with 5 U.S.C. 610. Such comments must be submitted separately and cite 5 U.S.C. 601, *et seq.* (FAC 90-35, Far case 95-003) in correspondence.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the rule does not impose any reporting or record keeping requirements which require the approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.*

D. Determination To Issue an Interim Rule

A determination has been made under authority of the Secretary of Defense (DOD), the Administrator of General Services (GSA), and the Administrator of the National Aeronautics and Space Administration (NASA) that, pursuant to 41 U.S.C. 418b, urgent and compelling reasons exist to publish an interim rule prior to affording the public an opportunity to comment. This action is necessary because the Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, dated March 1995, requires all publicly owned firms to recognize impairment losses in their financial statements for fiscal years beginning after December 15, 1995. It is likely that Government contractors whose 1996 fiscal year begins after December 15, 1995, will recognize impairment losses for financial reporting and claim a portion of such losses either on current contracts or on those awarded after December 15, 1995. In order to ensure that contractors' impairment losses are not paid by the Federal Government, it is necessary to issue this clarification of existing cost principles expeditiously. However, pursuant to Public Law 98-577 and FAR 1.501, public comments received in response to this interim rule will be considered in formulating the final rule.

List of Subjects in 48 CFR Part 31

Government procurement.

Dated: December 8, 1995.

Edward C. Loeb,

Acting Director, Office of Federal Acquisition Policy.

Federal Acquisition Circular

Number 90-35

Federal Acquisition Circular (FAC) 90-35 is issued under the authority of the Secretary of Defense, the Administrator of General

Services, and the Administrator for the National Aeronautics and Space Administration.

Unless otherwise specified, all Federal Acquisition Regulation (FAR) and other directive material contained in FAC 90-35 is effective December 14, 1995.

Dated: December 1, 1995.

Eleanor R. Spector,
Director, Defense Procurement.

Dated: December 6, 1995.

Ida M. Ustad,
Associate Administrator, for Acquisition Policy.

Dated: December 7, 1995.

Tom Luedtke,
Deputy Associate Administrator for Procurement, NASA.

Therefore, 48 CFR Part 31 is amended as set forth below:

PART 31—CONTRACT COST PRINCIPLES AND PROCEDURES

1. The authority citation for 48 CFR Part 31 continues to read as follows:

Authority: 40 U.S.C. 486(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

2. Section 31.205-11 is amended at the end of paragraph (e) by adding the parenthetical "(but see paragraph (o) of this subsection)."; and by adding paragraph (o) to read as follows:

31.205-11 Depreciation.

(o) In the event of a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances, depreciation of the impaired assets shall not exceed the amounts established on depreciation

schedules in use prior to the write-down (see 31.205-16(g)).

3. Section 31.205-16 is amended by revising the section heading and adding paragraph (g) to read as follows:

31.205-16 Gains and losses on disposition or impairment of depreciable property or other capital assets.

(g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be recognized for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damage, idle facilities arising from a declining business base, etc.). Depreciation or amortization on pre-write-down carrying value of impaired assets not yet disposed of shall continue to be recoverable under established depreciation or amortization schedules to the extent it is not otherwise unallowable under other provisions of the FAR.

[FR Doc. 95-30442 Filed 12-13-95; 8:45 am]
BILLING CODE 6820-EP-M

48 CFR Part 31

[Federal Acquisition Circular 90-35]

Federal Acquisition Regulation; Rates of Inflation

AGENCIES: Department of Defense (DOD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Annual notice of rates of inflation.

The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council have agreed to publish as an information item, the rates of inflation which are used in conjunction with other factors to determine the allowability of IR&D/B&P costs for major contractors under 31.205-18(c)(2)(i)(C)(2) during the first three contractor fiscal years beginning on or after October 1, 1992. The following rates of inflation are effective immediately, and shall remain in effect until superseded by the next publication, which is anticipated in January 1996:

Fiscal year	Annual percent-age rate
1994	2.5
1995	2.9
1996	3.0
1997	3.0

The above rates are the Price Escalation Indices for the Research, Development, Test & Evaluation (RDT&E) Account, Total Obligation Authority (TOA), issued by the Principal Deputy Under Secretary of Defense (Comptroller) on January 10, 1995. These rates of inflation supersede those published in FAC 90-23, Item XI—Annual Notice of Rates of Inflation, in the Federal Register on December 28, 1994.

Dated: December 8, 1995.

Edward C. Loeb,
Acting Director, Office of Federal Acquisition Policy.

[FR Doc. 95-30443 Filed 12-13-95; 8:45 am]
BILLING CODE 6820-EP-M

Case Management Record

Discussion Handout

FAR Case 95-003		Date January 30, 1995	
Title Impairment of Long-Lived Assets			
Priority 1	Submitted By Ladd		Originator Code O
Case Manager Mens		Case References	
FAR Cites		DFARS Cites	
Cognizant Committees Cost Principles and CAS			
Coordination CPF			
Recommendation Discuss: <u>02/15/95</u>			

This is a new case initiated at the request of the Director of Defense Procurement to revise the FAR to implement a new Financial Accounting Standards Board (FASB) rule that will require publicly-held firms to recognize asset impairment losses resulting from certain events or changes in circumstances when recovery of carrying values is improbable.

CPF has already developed a proposed rule and staffed it with selected members of the Cost Principles and CAS Committees. Please do whatever staffing you need to do within your agency so that we might discuss the draft language and reach agreement on a fast-track basis.



ACQUISITION AND
TECHNOLOGY

DP/CPF

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

JAN 23 1995



MEMORANDUM FOR DEPUTY DIRECTOR, DEFENSE ACQUISITION REGULATIONS
SYSTEM

SUBJECT: Accounting for Impairment of Long-Lived Assets

The Financial Accounting Standards Board plans to issue a new rule in February that will require publicly-held firms to recognize asset impairment losses resulting from certain events or changes in circumstances (e.g., environmental damage) when recovery of carrying values is improbable. Once written down, the previous carrying amount of an asset cannot be restored if the impairment is subsequently removed. The rule will apply to financial statements for fiscal years beginning after June 15, 1995.

Under current CAS and FAR provisions, impairment losses on assets held for use cannot be recognized for Government contracting. Nonetheless, uncertainty and potential controversy might be avoided if an appropriate FAR change is implemented to clarify existing policy on the subject.

CPF has staffed the issue with selected members of the Cost Principles and CAS committees, and drafted a proposed change to FAR 31.205-16 with collaterals (Attachment). Given the short lead time available to us, I would like this case to receive top priority. Please establish a case number and process the case as quickly as possible.

Eleanor R. Spector
Director, Defense Procurement

Attachment



DAR Case 95-XX
Baseline: FAR posted through FAC 94-20

Proposed change shown in [brackets].

PART 31--CONTRACT COST PRINCIPLES AND PROCEDURES

* * * *

31.205-16 Gains and losses on disposition of depreciable property or other capital assets.

(a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation or amortization applicable to those assets was included (but see paragraph (d) of this subsection). However, no gain or loss shall be recognized as a result of the transfer of assets in a business combination (see 31.205-52). [Moreover, with respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be recognized for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damage, idle facilities arising from a declining business base, etc.). Depreciation or amortization on pre-write-down carrying values of impaired assets not yet disposed of shall continue to be recoverable under established depreciation or amortization schedules to the extent it is not otherwise unallowable under other provisions of the FAR.]

* * * *

Attachment

PROPOSED FEDERAL REGISTER NOTICE

DEPARTMENT OF DEFENSE
GENERAL SERVICES ADMINISTRATION
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

48 CFR Part 31

Federal Acquisition Regulation (FAR); Impaired Assets.

AGENCIES: Department of Defense (DoD); General Services Administration (GSA); and National Aeronautics and Space Administration (NASA).

ACTION: Request for comment on proposed rule.

COMMENTS: Comments should be submitted to the FAR Secretariat at the address shown below on or before (60 days from publication), to be considered in the formulation of a final rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council are considering *revising to* ~~revising~~ FAR 31.205-16 to *clarify* ~~set forth a clarification of~~ existing rules regarding the allowability of losses recognized when carrying values of impaired assets are written down for financial reporting.

ADDRESS: Interested parties should submit written comments to: General Services Administration, FAR Secretariat (VRS), 18th & F Streets, N.W., Room 4041, Washington, DC 20405. Please cite FAR Case 95-XX in all correspondence related to these issues.

EFFECTIVE DATE:

FOR FURTHER INFORMATION CONTACT: Ms. Beverly Fayson, FAR Secretariat, telephone (202) ⁵⁰¹⁻⁴⁷⁸⁶ ~~523-4755~~. Please cite FAR Case 95-XX.

SUPPLEMENTARY INFORMATION:

A. Background

The ~~revision~~^{rule} proposed ~~by the councils~~ is intended to clarify extant cost allowability rules regarding recognition of gains and losses related to long-lived assets. This ~~proposed~~^a rule addresses a cost category which is the subject of a Financial Accounting Standards Board proposed Statement of Financial Accounting Standards (SFAS), No. 132-B, dated November 29, 1993, and entitled "Accounting for the Impairment of Long-Lived Assets." // The SFAS applies to long-lived assets (such as land, buildings, and equipment), identifiable intangibles, and related goodwill, and establishes guidance to recognize and measure impairment losses. If impaired assets are to be held for use, the SFAS requires a write-down to fair value when events or circumstances (e.g., environmental damage, idle facilities arising from declining business, etc.) indicate that carrying values may not be fully recoverable. Impaired assets that are to be disposed of, however, would be reported (with certain exceptions) at the lower of cost or fair value less cost to sell. Once written down, the previous carrying amount of an impaired asset could not be restored if the impairment was subsequently removed. The final SFAS, which is virtually unchanged from the proposed rule (except for certain utility company provisions), is scheduled to be issued on February 15, 1995. The SFAS will apply to all financial statements issued for fiscal years beginning after June 15, 1995. In contrast to the SFAS provisions, Cost Accounting

Standard (CAS) 9904.409, "Depreciation of Tangible Capital Assets," provides quite different criteria and guidance to recognize gains and losses for Government contracting purposes. The language at 9904.409-40(a)(4) and (b)(4), 9904.409-50(j), and related Promulgation Comment 10, "Gain or Loss," makes it clear that gains and losses are recognized only upon asset disposal; no other circumstances trigger such recognition. FAR 31.205-16, "Gains and losses on disposition of depreciable property and other capital assets," reflects the CAS provision that an asset be disposed of in order to recognize a gain or loss. The FAR rule applies to both CAS and non-CAS covered contracts. Consequently, for Government contracting purposes, an impairment loss is recognized only upon disposal of the impaired asset and, like other losses, it is measured as the difference between the net amount realized and the impaired asset's undepreciated balance. Government contractors, therefore, recover the carrying values of impaired assets held for use by retaining pre-write-down depreciation or amortization schedules as though no impairment had occurred. ~~In order to clarify the existing cost allowability rule, both councils have agreed to proceed with publication of this proposed rule.~~

B. Regulatory Flexibility Act

This proposed rule is not expected to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq., because most contracts awarded to small entities

are awarded on a competitive fixed-price basis and ^{the} cost principles do not apply. An Initial Regulatory Flexibility Analysis has, therefore, not been performed. Comments from small entities concerning the affected FAR subpart will be considered in accordance with 5 U.S.C. 610. Such comments must be submitted separately and should cite 5 U.S.C. 601, et seq. (FAR case 95-⁰⁰³~~XX~~), in correspondence.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the proposed change to the FAR does not impose record keeping or information collection requirements, or collections of information from offerors, contractors, or members of the public which require the approval of the Office of Management and Budget under 44 U.S.C. 3501, et seq.

List of Subjects in 48 CFR Part 31:

Government procurement.

Dated:

Office of Cost, Pricing, & Finance

-----Memo-----

April 30, 1996

TO: Captain D. S. Parry, DARS

SUBJECT: Impairment of Long-Lived Assets (FAR Case 95-003)

In accordance with your request of April 26, I have reviewed the proposed rule, the committee report, and the public comments. I offer the following comment:

- In the committee comments on substantive issues raised by commentators, I believe the committee failed to make one very necessary point when discussing Comment B--"Involves a Subject Matter Beyond the Authority of the Councils." The commentators stated that the interim rule addresses the measurement or allocation of cost, which is within the exclusive statutory authority of the CAS Board. Unfortunately, the committee neglected to set forth the Government's strongest argument: that the cost allowability rule is totally consistent with the cost accounting standards. Pertinent CAS coverage is at 9904.409-50(i) (which permits changes in asset depreciation only for changes in asset services consumption, estimated service life, and residual value), and 9904.409-50(j) (which permits a gain or loss in asset value to be recognized only upon disposal of the asset), and the proposed final rule is consistent with those provisions.

Carol F. Covey
Deputy Director
Cost, Pricing, & Finance

CASE MANAGEMENT RECORD

DISCUSSION H/O

FAR Case 95-003		Date 17 APRIL 1996	
Title IMPAIRMENT OF LONG-LIVED ASSETS			
Priority 1	Submitted By N-1		Originator Code
Case Manager: S. HABERLIN		Case References:	
FAR Cites:		DFARS Cites:	
Cognizant Committee(s): COST PRINICIPLES			
Coordination:			
Recommendation: DISCUSS: 5/1			
Remarks: THIS IS THE COST PRINICIPLES COMMITTEE REPORT SETTING FORTH THE COMMITTEE'S RECOMMENDED FINAL RULE. THE COMMITTEE RECOMMENDS MINOR CHANGES FROM THE PROPOSED RULE BASED ON THE PUBLIC COMMENTS RECEIVED.			

APR 24 1996



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH, DEVELOPMENT AND ACQUISITION
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

23 April 1996

FAR Case 95-003

MEMORANDUM FOR DIRECTOR, DEFENSE ACQUISITION REGULATIONS COUNCIL

SUBJECT: FAR Case 95-003, Impairment of Long-Lived Assets

I. PROBLEM

The Cost Principles Committee was tasked to review public comments received in response to the subject interim rule published in the *Federal Register* on 14 December 1995 and to draft a final rule.

II. RECOMMENDATION

That the interim rule be amended as shown in TAB A and adopted as a final rule.

III. BACKGROUND

The interim rule was intended to clarify that impairment losses recognized for financial accounting purposes under the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS), No. 121, "*Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets To Be Disposed Of*," are not allowable for Government contract costing. The interim rule revised the existing language at FAR 31.205-11 and 31.205-16 to expressly state that for Government contracting purposes, any loss (including an impairment loss) is recognized only upon disposal of the asset. Until an impaired asset is disposed of, depreciation is limited to the amounts that would have been allowed before any impairment loss occurred.

SFAS No. 121, effective for company fiscal years beginning after 15 December 1995, addresses the impairment of long-lived assets (such as land, buildings, and equipment), certain identifiable intangibles, and related goodwill. The SFAS "requires that long-lived assets and certain identifiable intangibles to be held and used by an entity be reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable." Such events include a significant decrease in the market value of an asset, change in the extent or manner in which an asset is used, and adverse change in legal factors or business climate. If the company believes that the expected future cash flows from the use of the asset and eventual disposition are less than the carrying amount (usually net book value) of the asset, an impairment loss must be recognized.

For impaired assets expected to be held and used, the net book value is reduced to fair value (i.e., the current amount the asset could be bought or sold for between willing parties). Once an asset is written down due to an impairment loss, the asset cannot be written back up, even if the impairment is subsequently removed. Impaired assets to be disposed of are generally reported at the lower of the carrying amount or fair value less cost to sell.

IV. EVALUATION OF COMMENTS

Responses were received from the following four commentors: Sundstrand Aerospace, National Security Industrial Association (NSIA), Aerospace Industries Association (AIA), and the American Bar Association (ABA). All commentors oppose the rule and believe it is unnecessary. Essentially, they contend that the rule should be withdrawn because it (1) is contrary to Generally Accepted Accounting Principles (GAAP), (2) involves a subject matter beyond the authority of the Councils, and (3) is administratively burdensome. The Committee's analysis of the substantive issues raised by the commentors follows.

A. Contrary to GAAP

NSIA asserts that Government contract accounting should not depart from GAAP unless public policy or other special circumstances warrant deviation. AIA states that the interim rule is unwarranted and contrary to sound accounting theory. The commentors also state that the interim rule does not address why SFAS No. 121 should not be used for Government accounting.

Committee Comments

The interim rule does depart from GAAP, because in this instance, it is inadequate for Government contract costing. GAAP is required to be followed in the absence of contract rules to the contrary. However, when GAAP produces an inequitable result, the Government has the right and fiduciary responsibility to the U.S. taxpayers to prescribe another arrangement. The Committee continues to believe that the interim rule protects the Government's interests and provides for equitable treatment.

The relevance of GAAP for Government contracting purposes is perhaps best summarized by the American Institute of Certified Public Accountants (AICPA). The AICPA makes the following statement in Section 2.46 of the *Audit and Accounting Guide for Audits of Federal Government Contractors*:

"Generally accepted accounting principles (GAAP) are established for financial accounting purposes and provide little guidance for cost accounting purposes in the Government contracting industry. Consequently, GAAP is applied only when no guidance in FAR or CAS exists."

To illustrate the inequity of SFAS No. 121, consider assets such as land and buildings and how their values can change over time. If these types of assets become impaired, an estimated loss will be recognized under GAAP. The estimated one-time period loss could then be charged to Government contracts even though the assets are still being used by the company. Since the Government intends to reimburse the contractor its historical costs and the assets have not actually been disposed of, the contractor has not experienced a real out-of-pocket loss. The loss, if any, will be realized when the assets are ultimately disposed of at some future point. Also, the Government would not receive a credit if the impairment is subsequently removed because GAAP prohibits the restoration of a previously recognized impairment loss.

B. Involves a Subject Matter Beyond the Authority of the Councils

The commentators believe that the interim rule addresses the measurement or allocation of cost which is within the exclusive statutory authority of the CAS Board (CASB). The commentators quote 41 U.S.C. 422(j)(4) which gives the CASB exclusive authority with respect to the measurement, assignment, or allocation of costs subject to CAS. The basic concern is summarized in the following ABA comment:

"Although the Section acknowledges the role of the Defense Acquisition Regulations Council and the Civilian Agency Acquisition Council with respect to cost allowability matters, matters of public policy, it is clear from both the nature of the Interim Rule, as well as the Background discussion, that the Councils have chosen to address a matter involving a government contract cost accounting practice--a matter beyond their authority. Rulemaking and regulatory guidance in this area should appropriately be issued by the CAS Board."

Committee Comments

This issue is fundamental to the case. The Committee agrees that the CASB has sole authority over the measurement, assignment, and allocation of costs for CAS-covered contracts. However, not all Government contracts are subject to CAS. Further, CAS 404 and 409 do not address the measurement, assignment, or allocation associated with intangible capital assets.

The CASB acknowledges that cost allowability is a contract administration matter. The CASB makes the following comments in its Statement of Objectives, Policies and Concepts:

"While the Board has exclusive authority for establishing Standards governing the measurement, assignment and allocation of costs, it does not determine the allowability of categories of individual items of costs.

* * * * *

The use of Cost Accounting Standards has no direct bearing on the allowability of those individual items of cost which are subject to limitations or exclusions set forth in the contract or which are otherwise specified as unallowable by the Government."

In addition, recognition of the concept of "allowability" is found in the following quote from the Boeing SERP Case Appeal (Court of Appeals for the Federal Circuit (CAFC) Case No. 86-927, October 1, 1986):

"Since the allowability of a cost remains the province of the procuring agencies, the DOD may limit costs based upon rational procurement policies and not all costs are deemed reasonable just because they have been incurred and measured, allocated and assigned in accordance with CAS requirements."

While the CAS could be similarly amended or interpreted in a way that would conclude that recognition of asset impairments for Government contracting is inappropriate, it is not likely this will occur in the near future. In the meantime, U.S. taxpayers could end up paying for estimated losses recognized for financial accounting purposes that will not actually be realized for years, if at all - a clearly inequitable result. However, to further clarify that the cost principle is an "allowability", and not a "measurement or allocability" rule with respect to CAS-covered contracts, we have rephrased the interim rule. In addition, we have added a sentence to 31.205-11(o) to ensure there is no conflict with CAS 409.50(i) by clarifying that changes in depreciation may result from other permissible causes.

C. Administratively Burdensome

The commentators allege that the rule is administratively burdensome because it will necessitate keeping an extra set of fixed asset records.

Committee Comments

We disagree. Contractors are already required to segregate unallowable costs for Government contracting purposes (e.g., treatment of gains or losses subsequent to mergers or business combinations) and to maintain fixed asset records. Moreover, contractors may already have to keep more than one set of fixed assets records, regardless of the cost principle, because of differences in depreciation methods required by GAAP, state, and/or Federal tax returns.

V. COLLATERALS

A. Regulatory Flexibility Act

This final rule is not expected to have a significant impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.*, because most contracts awarded to small entities are awarded on a competitive, fixed price basis and the cost principles do not apply.

B. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the changes to the FAR do not impose record keeping or information collection requirements, or collections of information from offerors, contractors, or members of the public which require the approval of the Office of Management and Budget under 44 U.S.C. 3501 *et seq.*

VI. SUMMARY

All Committee members below concur in the contents of this report.



Clarence M. Belton
Chairman, Cost Principles Committee

DOD Members

Paul A. Schill, Air Force
James Bozzard, Army
Stephen T. Larkin, DCAA
Glenn Gulden, DLA
Chris Werner, OSD

Non-DOD Members

Bill Childs, NASA
Bill Dunn, EPA
Jerry Olson, GSA
Terry Sheppard, DOE

TAB A--Committee Recommended Final Rule

TAB A
RECOMMENDED COMMITTEE LANGUAGE

The baseline language is the interim rule published in the *Federal Register* on December 14, 1995. Changes are represented by **[bold print in brackets]** for new language and ~~strikeout~~ for deleted language.

31.205-11 Depreciation

* * * * *

(o) In the event of a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances, **[allowable]** depreciation of the impaired assets shall ~~not exceed~~ **[be limited to]** the amounts **[that would have been allowed had the assets not been]** ~~established on depreciation schedules in use prior to the write-down~~ **[written down]** (see 31.205-16(g)). **[However, this does not preclude a change in depreciation resulting from other causes such as permissible changes in estimates of service life, consumption of services or residual value.]**

31.205-16 Gains and losses on disposition or impairment of depreciable property or other capital assets

* * * * *

(g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be ~~recognized~~ **[allowed]** for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damage, idle facilities arising from a declining business base, etc.). **[If depreciable property or other capital assets have been written down from carrying value to fair value due to impairments, gains or losses upon disposition shall be the amounts that would have been allowed had the assets not been written down.]** ~~Depreciation or amortization on pre-write down carrying value of impaired assets not yet disposed of shall continue to be recoverable under established depreciation or amortization schedules to the extent it is not otherwise unallowable under other provisions of the FAR.~~

**CLEAN VERSION OF
RECOMMENDED COMMITTEE LANGUAGE**

31.205-11 Depreciation

* * * * *

(o) In the event of a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances, allowable depreciation of the impaired assets shall be the amounts that would have been allowed had the assets not been written-down (see 31.205-16(g)). However, this does not preclude a change in depreciation resulting from other causes such as permissible changes in estimates of service life, consumption of services or residual value.

31.205-16 Gains and losses on disposition or impairment of depreciable property or other capital assets

* * * * *

(g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be allowed for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damage, idle facilities arising from a declining business base, etc.). If depreciable property or other capital assets have been written down from carrying value to fair value due to impairments, gains or losses upon disposition shall be the amounts that would have been allowed had the assets not been written down.

Case Management Record

Discussion Handout


FAR Case 95-003		Date March 6, 1996
Title Impairment of Long-Lived Assets		
Priority 1	Submitted By Haberlin	Originator Code O
Case Manager Haberlin		Case References
FAR Cites 31.205-16		DFARS Cites
Cognizant Committees Cost Principles		
Coordination CPF		
Recommendation Have CCP Cmte. review the additional public comment and include in the Cmte. report due on 3/20/96.		
<p>We published an interim FAR rule in the Federal Register on December 14, 1995 (60 FR 64254) and forwarded public comments to the Cost Principles Cmte.</p> <p>Attached is one late response from the American Bar Association who concludes that the subject matter of this interim rule is within the jurisdiction of the Cost Accounting Standards Board, and, accordingly, the interim rule should be withdrawn.</p> <p>An advance copy of ABA's comments was forwarded to the CP Cmte. Chairman on March 1.</p> <p>MAR 06 1996</p>		



General Services Administration
Office of Acquisition Policy
Washington, DC 20405

FEB 27 1996

MEMORANDUM FOR CAPTAIN D.S. PARRY, SC, USN
DIRECTOR
DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM: BEVERLY FAYSON
FAR SECRETARIAT 

SUBJECT: FAR Case 95-003, Impairment of Long-Lived Assets

Attached is a late comment and a request to remove comment No. 1 (Treasury, Bureau of Engraving and Printing) from your previous listing because it actually belongs with FAR Case 95-305. Comments on this case were transmitted on February 15, 1996.

<u>RESPONSE NUMBER</u>	<u>DATE RECEIVED</u>	<u>COMMENT DATE</u>	<u>COMMENTS</u>	<u>REMARKS</u>
95-003-05	02/28/96	01/30/96	ABA	

We recommend:

X That the DARC analyze public comments, draft final rule language, and provide it to the CAAC for review and consideration; or that DARC ask one of its committees to analyze public comments and to submit a committee report, including final rule language, for review and consideration by both Councils.

 That the CAAC or the FAR Staff analyze public comments, draft final rule language, and provide it to DoD for review and consideration; or that the CAAC task one of its committees to analyze public comments and to submit a committee report, including final rule language, for review and consideration by both Councils.

 That the Councils agree on final rule language without further deliberation.

Attachment

cc: Ralph DeStefano, Acting CAAC Chairman
Jeremy Olson, FAR Staff Analyst



1995-1996

AMERICAN BAR ASSOCIATION

Section of Public Contract Law

Writer's Address and Telephone

6801 Rockledge Drive
Bethesda, MD 20817
(301) 897-6125



February 16, 1996

General Services Administration
FAR Secretariat (VRS)
18th and F Streets, N.W.
Room 4037
Washington, D.C. 20405

Attention: Mr. Jeremy F. Olson

Re: FAR Case 95-003; Interim Rule Regarding
Impairment of Long-Lived Assets

Dear Mr. Olson:

On behalf of the Section of Public Contract Law ("the Section") of the American Bar Association ("the Association"), I am submitting comments on the above-referenced Interim Rule. The Section consists of attorneys and associated professionals in private practice, industry and Government service. The Section's governing Council and substantive committees contain a balance of members representing these three segments to ensure that all points of view are considered. In this manner, the Section seeks to improve the process of public contracting for needed supplies, services and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or by the Board of Governors of the American Bar Association, and, therefore, should not be construed as representing the policy of the American Bar Association.

Introduction

The "Background" discussion accompanying publication of the Interim Rule makes it clear that the rule is intended to address the treatment of costs resulting from a contractor's compliance with the rules of accounting for long-lived assets whose value has been impaired and is not recoverable as described in the March 1995 Financial Accounting Standards Board's Statement of Financial Accounting Standards ("SFAS") No. 121 ("Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of"). Promulgations of the Financial

FEB 16 1996

8

CHAIR
Frank H. Menaker, Jr.
6801 Rockledge Drive, MP200-9
Bethesda, MD 20817
301/897-6125

CHAIR-ELECT
James F. Hinchman
441 G Street, NW, Suite 7802
Washington, DC 20548
202/512-5600

VICE-CHAIR
John T. Kuelbs
1100 Wilson Blvd., 20th Floor
Arlington, VA 22209
703/284-4355

SECRETARY
Marcia G. Madson
Suite 800 North
1800 M Street, NW
Washington, DC 20036
202/467-7067

BUDGET AND FINANCE OFFICER
Lynda Troutman O'Sullivan
Suite 800
1001 Pennsylvania Avenue, NW
Washington, DC 20004-2505
202/639-7056

SECTION DELEGATE
Marshall J. Doka, Jr.
5700 Bank One Center
1717 Main Street
Dallas, TX 75201
214/746-5701

IMMEDIATE AND PREVIOUS
PAST CHAIRS
John B. Miller
P.O. Box 786
Winchester, MA 01890-4286
617/729-2219

Donald J. Kinlin
2000 Courthouse Plaza, NE
Dayton, OH 45402
513/443-6922

COUNCIL MEMBERS
Jose Aguirre
900 Commodore Drive
San Bruno, CA 94066-2402

Richard J. Bednar
1001 Pennsylvania Avenue, NW
Washington, DC 20004-2595

Daniel S. Bishop
360 North Crescent Drive
Beverly Hills, CA 90210

Theodore J. Collins
P.O. Box 3707, MS 13-08
Seattle, WA 98124-2207

Agnes P. Dover
309 Rucker Place
Alexandria, VA 22301

Lester Edelman
6330 Cavalier Corridor
Falls Church, VA 22044

Kurt L. Frazier
777 San Marin Drive
Novato, CA 94998

Anthony H. Gamboa
840 Cumberstone Road
Hanwood, MD 20776

Michael A. Hordell
1747 Pennsylvania Avenue, NW
Washington, DC 20006

Laura K. Kennedy
815 Connecticut Avenue, NW
Washington, DC 20006

Michael K. Love
1227 25th Street, NW, 7th Floor
Washington, DC 20037

David M. Prorichick
2433 McClintic Court
Vienna, VA 22180

EDITOR, PUBLIC CONTRACT
LAW JOURNAL
Carl L. Vacketta
Washington, DC

EDITOR, THE PROCUREMENT
LAWYER
Patricia H. Wittie
Washington, DC

BOARD OF GOVERNORS LIAISON
Allan J. Joseph
San Francisco, CA

YOUNG LAWYERS LIAISON
Nanci S. Redman
Washington, DC

LAW STUDENT LIAISON
Kathleen L. Hammock
St. Charles, MO

SECTION MANAGER
Marilyn Neforas
750 North Lake Shore Drive
Chicago, IL 60611-4497
312/968-5596 - FAX: 312/968-5688

SECTION ASSISTANT
Carol S. Simmons
312/968-5699 - FAX: 312/968-5688

Mr. Jeremy Olson
February 16, 1996
Page 2

95 003-5

Accounting Standards Board define preferred accounting practices for financial (public reporting) purposes.

SFAS No. 121, specifically, describes the method of accounting for assets whose value is impaired due to events or changes in circumstances which indicate the carrying value of an asset may not be recoverable. Where assets are retained, but their value is not recoverable, SFAS No. 121 requires that the value of the asset be written down to fair value. Impaired assets that are to be sold are to be reported at the lower of cost or fair value, less the cost to sell. SFAS No. 121 clearly distinguishes impairment and recoverability from depreciation policies and estimates.

In the Background discussion, the drafters of the Interim Rule contrasted the treatment of impaired assets in SFAS No. 121 to the current treatment of gains and losses in CAS 409, in Promulgation Comment No. 10 to the Standard, and in FAR § 31.205-16, which is described as permitting the recognition of a loss only on disposition of an asset.

**The Subject Matter Of The Interim Rule Is Within The Exclusive
Statutory Authority Of The Cost Accounting Standards Board.**

41 U.S.C. § 422(j)(4) states that "[c]osts which are the subject of cost accounting standards promulgated under this section *shall not be subject to regulations that are established by another executive agency* that differ from such standards with respect to the measurement, assignment, or allocation of such costs." (emphasis added). The rules for the measurement of the cost of depreciation of tangible capital assets for CAS-covered contracts is the subject of CAS 409, FAR § 9904.409.

CAS 409 specifically addresses the establishment of an asset's service life and the effect of "[c]hanges in expected physical usefulness" and "[c]hanges in expected economic usefulness." See FAR §§ 9904.409-50(e)(1)(i) and (ii). It is clear that the subject matter of the Interim Rule and SFAS No. 121 relate to impairment and recoverability of an asset and not the establishment or adjustment of service lives and, therefore, is an issue of recognition of gains and losses. CAS 409-40(b)(4) and Promulgation Comment No. 10 discuss the subject of asset gains and losses. It is apparent, therefore, that CAS 409 addresses the very subject covered by the Interim Rule. Even if it is argued that the existing CAS does not already address the subsidiary issue of asset impairment covered by the Interim Rule, the Interim Rule, at a minimum, effectively serves to interpret CAS 409 and the referenced Promulgation Comment.

The Section believes that whether and to what extent CAS 409 addresses impairment loss as part of its treatment of gains and losses is a matter entirely within

Mr. Jeremy Olson
February 16, 1996
Page 3

PA/003-5
95-003-5

the jurisdiction of the CAS Board. As such, if an interpretation or revision is considered appropriate, this should be accomplished by the CAS Board in accordance with its exclusive statutory rulemaking and/or interpretative authority. In light of the foregoing, the Section recommends the immediate withdrawal of the Interim Rule. If necessary, we also recommend that the CAS Board Chairman use his statutory authority to rescind the Interim Rule.

The Section remains concerned that government contract cost accounting issues be resolved in accordance with the statutory authority granted to the respective rulemaking agencies. Although the Section acknowledges the role of the Defense Acquisition Regulations Council and the Civilian Agency Acquisition Council with respect to cost *allowability* matters, matters of public policy, it is clear from both the nature of the Interim Rule, as well as the Background discussion, that the Councils have chosen to address a matter involving a government contract *cost accounting practice* -- a matter beyond their authority. Rulemaking and regulatory guidance in this area should appropriately be issued by the CAS Board.

Conclusion

The Section appreciates the opportunity to provide these comments and is available to answer any questions they may raise.

Sincerely,



Frank H. Menaker, Jr.
Chair,
Section of Public Contract Law

cc: James F. Hinchman
John T. Kuelbs
Marcia C. Madsen
Lynda Troutman O'Sullivan
Marschall J. Doke, Jr.
John B. Miller
Donald J. Kinlin
Council Members
Chair and Vice Chairs of the
Accounting, Costs & Pricing Committee
Laura K. Kennedy

CASE MANAGEMENT RECORD

INFORMATION H/O

FAR Case 95-003		Date 28 FEBRUARY 1996	
Title IMPAIRMENT OF LONG-LIVED ASSETS			
Priority 1	Submitted By N-1		Originator Code
Case Manager: S. HABERLIN		Case References:	
FAR Cites		DFARS Cites	
Cognizant Committees: COST PRINCIPLES			
Coordination			
Recommendation NONE -- FOR INFORMATION ONLY			
<p>COPY OF NAVY TASKING TO THE COST PRINCIPLES COMMITTEE TO REVIEW THE PUBLIC COMMENTS AND PREPARE A DRAFT FINAL RULE.</p> <p>R/D: <u>20 MAR 1996</u></p> <p>FEB 28 1996</p>			



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH, DEVELOPMENT AND ACQUISITION
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

23 February 1996

MEMORANDUM FOR MR. CLARENCE BELTON, CHAIR, COST PRINCIPLES
COMMITTEE

Subj: FAR CASE 95-003; IMPAIRMENT OF LONG-LIVED ASSETS

Encl: (1) CMR dated February 22, 1996, with enclosures

A proposed rule under the subject FAR case was published on 14 December 1995. The public comment period has now ended and comments have been received from three sources. (A fourth public comment, comment 95-003-1, forwarded by the FAR Secretariat clearly applies to another case and should be ignored.) On behalf of the DAR Council, therefore, I am requesting that your Committee review and analyze the public comments (enclosure (1)) and develop a draft final FAR rule as appropriate.

Your Committee's recommendations with respect to disposition of the public comments and a final rule are due by 20 March 1996, and should be submitted as part of a Committee report that includes:

- (i) a statement of the problem/reason the report has been prepared;
- (ii) recommendations;
- (iii) a discussion of the Committee's analysis of each comment and the rationale for its proposed final rule;
- (iv) a detailed statement regarding the applicability of the Regulatory Flexibility Act, the Paperwork Reduction Act, and Federal Register publication requirements to any FAR changes proposed by the Committee; and
- (v) a matrix identifying each generic public comment received and who submitted the comment.

In conjunction with its report, the committee should also submit the text of any changed portions of the FAR that would result from the Committee's recommendations, both in hard copy and on either a floppy disk (in "Word 6.0" format, if possible) or as a computer file attached to an E-mail message sent directly to the case manager (haberlsg@acq.osd.mil).

Please keep me informed regarding the status of the Committee's efforts.


Sidney A. Tronic
Navy Policy Representative
DAR Council

Case Management Record

Discussion Handout

FARS Case 95-003		Date February 22, 1996
Title Impairment of Long-Lived Assets		
Priority 1	Submitted By Haberlin	Originator Code O
Case Manager Haberlin		Case References
FAR Cites 31.205-16		DFARS Cites
Cognizant Committees Cost Principles		
Coordination CPF		
Recommendation Task the CP Cmte. to review the public comments. CP Cmte. R/D <u>3/20</u> .		
<p>We published an interim FAR rule in the Federal Register on December 14, 1995 (60 FR 64254). We received public comments from four respondents.</p>		

FEB 22 1996



General Services Administration
Office of Acquisition Policy
Washington, DC 20405

FEB 15 1996

MEMORANDUM FOR CAPTAIN D.S. PARRY, SC, USN
DIRECTOR
DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM:

BEVERLY FAYSON
FAR SECRETARIAT

SUBJECT: FAR Case 95-003, Impairment of Long-Lived Assets

Attached are comments received on the subject FAR case published at 60 FR 64254; December 14, 1995. The comment closing date was February 12, 1996.

<u>RESPONSE NUMBER</u>	<u>DATE RECEIVED</u>	<u>COMMENT DATE</u>	<u>COMMENTER</u>	<u>REMARKS</u>
95-003-01	12/22/95	12/22/95	TREASURY/BEP	
95-003-02	02/28/96	01/30/96	SUNDSTRAND	
95-003-03	02/13/96	02/09/96	NSIA	
95-003-04	02/13/96	02/12/96	AIA	

We recommend:

X That the DARC analyze public comments, draft final rule language, and provide it to the CAAC for review and consideration; or that DARC ask one of its committees to analyze public comments and to submit a committee report, including final rule language, for review and consideration by both Councils.

 That the CAAC or the FAR Staff analyze public comments, draft final rule language, and provide it to DoD for review and consideration; or that the CAAC task one of its committees to analyze public comments and to submit a committee report, including final rule language, for review and consideration by both Councils.

 That the Councils agree on final rule language without further deliberation.

Attachments

cc: Ralph DeStefano, Acting CAAC Chairman
Jeremy Olson, FAR Staff Analyst





DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING

WASHINGTON, D. C. 20228

95-003-1

95-305

MEMORANDUM FOR KEVIN N. WHITFIELD
PROCUREMENT ANALYST

FROM:

Carol Seegars, Chief
Office of Procurement

Carol F. Seegars

SUBJECT:

Request for Comments on FAR Interim Rule

DATE:

December 22, 1995

Per your request dated December 4, 1995, the BEP offers the following comments with respect to the FAR Interim Rule under FAR case 95-3:

The introduction of a requirement to include new environmental certification and clause requirements in all competed contracts in excess of \$100,000 (including options), is in direct contradiction to the stated intent of FASA to streamline contract functions and eliminate paperwork burdens (where able) in accordance with the Paperwork Reduction Act. Companies who fall under the reporting requirements, are already required to report on toxic chemicals released to the environment under EPA's "The Emergency Planning and Community Right-To-Know Act of 1986 (EPCRA)". In March 1995, the House passed bill HR 1022 that required regulatory agencies to weigh the benefits of a new regulation against the costs it would impose on businesses. In February 1995, the House passed a bill that temporarily froze the implementation of new regulations. Given the current climate regarding streamlining procurement and eliminating paperwork burdens, the Government should find new methods of enforcing EPA regulations.

The proposed change to FAR Part 23 adds the following troubling guidance for any member of a professional procurement team:

1) Prior to making a determination to omit the certification and clause in a solicitation in excess of \$500,000 (including options), the agency **SHALL** consult with EPA.

NOTE: What is the requirement prior to making a determination to omit the certification and clause in any solicitation between \$100,000 and \$500,000?

2) The Contracting Officer **SHALL** cooperate with EPA representatives and provide advice and assistance to aid EPA in the performance of responsibilities; and

95-003-1

3) EPA MAY recommend Termination for Convenience of any existing agency contract if it is determined that the Contractor is not filing the necessary forms or incomplete information. This guidance provides great potential for EPA's interference and/or stoppage of the BEP's ability to procure equipment and supplies required. The requirement for inclusion of the proposed clause and certification includes all SIC codes between 20 and 39; this covers most, if not all, of the items procured in the Stamp Contracts Division. Since foreign companies are exempt from these requirements, it seems that this action would further widen the gap between our ability to award to American companies and drive us further into the arms of foreign contractors not liable for many of our regulatory practices. Any EPA involvement in agency contracting could conceivably lead to serious conflict between satisfying agency needs and helping EPA perform their job. Possibly a better solution to assist EPA in enforcing this requirement would be to put some teeth in the regulation by increasing the fines involved for those companies who disregard EPCRA.

Note: The Background information conflicts with the statement of the proposed clause; the former states that this rule does not apply to subcontractors beyond the first tier, while the latter talks about subcontractors and does not identify the requirements as applying to only first tier subcontractors.

If you need any additional information, please contact Linda B. Washington of my staff at 874-3151.

cc: T. K. Brown
Office of Environmental Protection



95-003

4747 HARRISON AVENUE • P.O. BOX 7002 • ROCKFORD, IL 61125-7002
(815) 226-6000 • FAX 226-7488 • TWX 910-631-4255 • TELEX 25-7440

January 30, 1996

L957-196-0071

General Services Administration
FAR Secretariat (VRS)
18th and F Streets
NW
Room 4037
Washington, D.C. 20405

SUBJECT: WRITTEN COMMENTS REGARDING THE FAR INTERIM
PROPOSED RULE: IMPAIRMENT OF LONG-LIVED ASSETS AS
CITED IN THE *FEDERAL REGISTER*, VOL. 60, NO. 240,
DECEMBER 14, 1995

REFERENCE: FAR CASE 95-003

Gentlemen:

Thank you for the opportunity to review the above interim rule and comment on it. We have reviewed the interim rule and believe that it is not necessary. It places an undue administrative burden upon contractors who experience write-downs due to the impairment of long-lived assets since it would require contractors to maintain a separate set of records to depreciate the written-down assets as if they had not been written down. Since the current government movement is toward the adoption of commercial practices, enacting a rule that is contrary to current commercial practice seems to diverge from this endeavor.

If you have any questions, please feel free to contact me at (815) 226-5226.

Sincerely,

Arthur R. Charles, Vice President
Aerospace Contracts, Compliance and Management Services

ARC/gp

FEB 8 1996

3



National Security Industrial Association

95-003-2

1025 Connecticut Ave., NW, #300
Washington, DC 20036
(202) 775-1440
Fax (202) 775-1309

Office of the President

February 9, 1996

Mr. Jeremy F. Olson
General Services Administration
FAR Secretariat
18th & F Streets, NW, Room 4037
Washington, DC 20405

Subject: FAC 90-35, FAR Case 95-003

Dear Mr. Olson:

The National Security Industrial Association (NSIA) appreciates the opportunity to comment on the interim rules in FAR 31.205-11 and FAR 31.205-16 addressing impairment of Long-Lived Assets for government contract costing purposes. The following are our comments:

We firmly believe that government contract accounting should not depart from generally accepted accounting principles (GAAP) unless public policy or other special circumstances warrant deviation. The interim rules deviate from GAAP and require treatment diametrically opposed to SFAS 121. The interim rule did not address why SFAS 121 should not be used for government accounting other than the fact that CAS 409-40(a)(4) and 405-50(j) contain language which deals with the unrelated subject of asset disposals. The result of this departure from GAAP is increased administrative costs associated with performing government contracts by requiring an additional set of asset records and depreciation/amortization schedules.

NSIA also believes that the charters of the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council do not include addressing allocation issues in the FAR Cost Principles when such issues are currently addressed in the Cost Accounting Standards. The interim rule amendments to FAR 31.205-11 and 31.205-16 are addressing when costs are assigned to cost accounting periods. The assignment of cost to cost accounting periods is properly an issue for consideration by the Cost Accounting Standards Board (CASB) and should not be addressed through changes in the cost principles. The issue of changes in circumstances, which would include impairment of assets, is covered in CAS 409-50(i). If changes in this section are needed, the CASB is the appropriate government entity to revise its coverage. Therefore, it is inappropriate to issue these interim rules in the FAR.

FEB 13 1996

4

John R. Woodhull
Chairman
Board of Trustees

Arthur E. Johnson
Vice Chairman, Board of Trustees
Chairman, Executive Committee

Marilyn W. Andrulis, Ph.D.
Vice Chairman
Executive Committee

Thomas C. Richards
President

95-003-3


Mr. Olson
Page 2

The Federal Register notice stated that the interim rules are clarifications to cost allowability rules. While we agree that clarifications to existing rules can properly be issued as interim rules, we do not agree that new concepts or issues that have not been previously addressed in the cost principles should be issued as interim rules. New FAR cost principles and changes to existing FAR cost principles, unless mandated by law, should be processed through the normal procedure for new rules.

In summary, NSIA recommends that the government withdraw these rules because they are inappropriate and contrary to generally accepted accounting principles (GAAP).

If you would like further information on this subject, please contact Ed Schiff, NSIA Director for Procurement, at (202) 496-3297.

Sincerely,


Thomas C. Richards
General, USAF (Ret)
President

TCR:as

5



**Aerospace
Industries
Association**



95-003-4

February 12, 1996

General Services Administration
FAR Secretariat (VRS)
Attn: Mr. Jeremy F. Olson
18th and F Streets, N.W.
Room 4037
Washington, D.C. 20405

Reference: FAR Case 95-003

Dear Mr. Olson:

The Aerospace Industries Association (AIA) is pleased to provide its comments on interim amendments to FAR 31.205-11 and FAR 31.205-16, prohibiting a change in the methodology for depreciating impaired long-lived assets for government contract costing purposes. In accordance with the interim amendments, any changes in depreciation resulting in the write-down of an impaired long-lived asset will be recognized only upon disposition of the asset.

AIA strongly believes that the interim rules are unwarranted and contrary to sound accounting theory and existing Cost Accounting Standards (CAS) governing the allocation of costs to final cost objectives. Accordingly, AIA recommends that the interim rule be withdrawn. Detailed support for the AIA position is shown below.

The Statement of Financial Accounting Standards (hereinafter called the "Statement") No. 121, Accounting for the Impairment of Long-lived Assets, issued by the Financial Accounting Standards Board (FASB) in March 1995 established principles for the accounting treatment of impaired long-lived assets to be held and used, and impaired long-lived assets identified for disposal. The Statement requires that long-lived assets used by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. It also requires an immediate write-down of assets being disposed of to their fair market value (less cost to sell), if lower than the current carrying value. This Statement is effective for financial statements for fiscal years beginning after December 15, 1995.

Pursuant to FAR 31.201-2, Determining Allowability, generally accepted accounting principles (GAAP) are to be employed in accounting for costs of government contracts unless superseded

Aerospace Industries Association of America, Inc.
1250 Eye Street, N.W., Washington, D.C. 20005-3922 (202) 371-8400

FEB 13 1996

by specific Cost Accounting Standards or limitations found in FAR cost principles. The sound accounting principle/theory implicit in the SFAS 121 pronouncement is that long-lived assets, such as plant and equipment, are generally recorded at cost, i.e., fair value of the asset on the date of acquisition. The original cost is then reduced, or depreciated, over the periods in which the asset is used or consumed. However, when an asset has been determined to be impaired, under the accounting principle of "conservatism," it should be written down to its realizable value, if less than the current carrying value, and a one-time period loss recognized. The SFAS 121 pronouncement does not eliminate the possibility of a gain or loss upon the actual disposition of the asset; it only minimizes the cost write-off that is subsequently expected to occur.

The DoD position that impairment losses are not to be recognized for government contract costing purposes is contrary to this sound accounting theory as well as the basic concepts found in FAR 31.201-3, Determining Reasonableness. Moreover, the DoD position is inconsistent with basic accounting theory found in CAS 409, Depreciation of Tangible Capital Assets, FAR 31.205-11, Depreciation, and FAR 31.205-16, Gains and Losses on Disposition of Depreciable Property or Capital Assets.

The basic thrust of CAS 409 is to recognize in the accounting period the costs related to the consumption of physical assets. The Standard is based on the concept that depreciation costs identified with cost accounting periods should be a reasonable measure of the expiration of service potential of the tangible assets subject to depreciation. Consistent with the requirements in SFAS 121, CAS 409.50(h)(1) recognizes the ability to revise "estimates of service life, consumption of services, and residual value ... whenever circumstances change significantly." Similarly, CAS 409.50(e)(5) provides the flexibility to use advance agreements for shorter service lives when the asset has a unique purpose or other special circumstances that warrant a shorter estimated service life. Lastly, CAS 409.50(j)(3) provides that "the contracting parties may account for gains and losses arising from mass or extraordinary dispositions in a manner which will result in treatment equitable to all parties."

Likewise, FAR 31.205-11(a), Depreciation, states that depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a

95-003-4

Mr. Jeremy F. Olson
February 12, 1996
Page Three

framework in SFAS 121, FAR 31.205-16(e), Gains and Losses on Disposition of Depreciable Property or Capital Assets, provides an accounting framework acknowledging that "losses arising from mass or extraordinary sales, retirements, or other disposition... shall be considered on a case-by-case basis."

Further, contrary to the position articulated in the background discussion accompanying the interim rule, CAS 409.40 (a)(4) and (b)(4), CAS 409.50 (j) (and the related Promulgation Comment 10, Gain or Loss), and FAR 31.205-16 do not preclude recognition of asset gains or losses such as those required by SFAS 121. The provisions of those standards/regulations address only those situations where the disposition of an asset has actually occurred and do not in any way establish or restrict the accounting practices to be followed for recognizing other asset gains or losses.

A major result of the interim rule is that the inconsistencies between GAAP and the regulations governing the costing of government contracts will, once again, increase the administrative costs associated with performing government's contracts. Industry continues to be concerned with government's gradual movement away from the tenants of sound accounting theory (GAAP) and fundamental concepts in recently proposed changes in procurement regulations and in this interim rule. Further, we fail to see the need for the government's action. It appears that the government's objective in proposing this rule is to preclude potential financial harm caused by required adjustments to contract costs resulting from losses sustained by contractors from the write-down of impaired assets. The government's concern is unfounded and not supported in today's environment. Due to competitive and fixed-price contracting and affordability issues, adjustments in an asset's value that potentially represent increased costs to the government will not always be passed on to the government.

We believe that the interim regulation does not represent a clarification to existing regulations, nor is it equitable to industry. A formal promulgation process has been established, and is legally mandated for all proposed changes in FAR. This promulgation process provides an opportunity for both the government and contractor community to identify concerns and comment on proposed rules before they become final. The process also ensures that the final rules issued by the government are equitable to all parties. Bypassing this process by coloring the proposed changes as clarifications does not comport with the intent of federal procurement regulations or recent acquisition reform initiatives.

S

95-003-4

Mr. Jeremy F. Olson
February 12, 1996
Page Four

In summary, for the reasons outlined in this comment draft, AIA encourages the government to reconsider the position contained in the interim regulation and to withdraw this rule.

If you have any question regarding AIA's position on this subject, please contact Dick Powers of my staff at (202) 371-8526.

Sincerely,


Leroy J. Haugh

9

Case Management Record

Discussion Handout

FARS Case 95-003		Date February 22, 1996
Title Impairment of Long-Lived Assets		
Priority 1	Submitted By Haberlin	Originator Code O
Case Manager Haberlin		Case References
FAR Cites 31.205-16		DFARS Cites
Cognizant Committees Cost Principles		
Coordination CPF		
Recommendation Task the CP Cmte. to review the public comments. CP Cmte. R/D <u>3/20</u>		
<p>We published an interim FAR rule in the Federal Register on December 14, 1995 (60 FR 64254). We received public comments from four respondents.</p> <p><i>Told DARC that 1st comment belongs to a different case.</i></p> <p style="text-align: right;">FEB 22 1996</p>		



General Services Administration
Office of Acquisition Policy
Washington, DC 20405

FEB 15 1996

MEMORANDUM FOR CAPTAIN D.S. PARRY, SC, USN
DIRECTOR
DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM:

BEVERLY FAYSON
FAR SECRETARIAT

SUBJECT:

FAR Case 95-003, Impairment of Long-Lived Assets

Attached are comments received on the subject FAR case published at 60 FR 64254; December 14, 1995. The comment closing date was February 12, 1996.

<u>RESPONSE NUMBER</u>	<u>DATE RECEIVED</u>	<u>COMMENT DATE</u>	<u>COMMENTS</u>	<u>REMARKS</u>
95-003-01	12/22/95	12/22/95	TREASURY/BEP	
95-003-02	02/28/96	01/30/96	SUNDSTRAND	
95-003-03	02/13/96	02/09/96	NSIA	
95-003-04	02/13/96	02/12/96	AIA	

We recommend:

X That the DARC analyze public comments, draft final rule language, and provide it to the CAAC for review and consideration; or that DARC ask one of its committees to analyze public comments and to submit a committee report, including final rule language, for review and consideration by both Councils.

____ That the CAAC or the FAR Staff analyze public comments, draft final rule language, and provide it to DoD for review and consideration; or that the CAAC task one of its committees to analyze public comments and to submit a committee report, including final rule language, for review and consideration by both Councils.

____ That the Councils agree on final rule language without further deliberation.

Attachments

cc: Ralph DeStefano, Acting CAAC Chairman
Jeremy Olson, FAR Staff Analyst





DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING

WASHINGTON, D. C. 20228

95-003-1

MEMORANDUM FOR KEVIN N. WHITFIELD
PROCUREMENT ANALYST

FROM: Carol Seegars, Chief Office of Procurement *Carol L. Seegars*

SUBJECT: Request for Comments on FAR Interim Rule

DATE: December 22, 1995

Per your request dated December 4, 1995, the BEP offers the following comments with respect to the FAR Interim Rule under FAR case 95-3:

The introduction of a requirement to include new environmental certification and clause requirements in all competed contracts in excess of \$100,000 (including options), is in direct contradiction to the stated intent of FASA to streamline contract functions and eliminate paperwork burdens (where able) in accordance with the Paperwork Reduction Act. Companies who fall under the reporting requirements, are already required to report on toxic chemicals released to the environment under EPA's "The Emergency Planning and Community Right-To-Know Act of 1986 (EPCRA)". In March 1995, the House passed bill HR 1022 that required regulatory agencies to weigh the benefits of a new regulation against the costs it would impose on businesses. In February 1995, the House passed a bill that temporarily froze the implementation of new regulations. Given the current climate regarding streamlining procurement and eliminating paperwork burdens, the Government should find new methods of enforcing EPA regulations.

The proposed change to FAR Part 23 adds the following troubling guidance for any member of a professional procurement team:

1) Prior to making a determination to omit the certification and clause in a solicitation in excess of \$500,000 (including options), the agency **SHALL** consult with EPA.

NOTE: What is the requirement prior to making a determination to omit the certification and clause in any solicitation between \$100,000 and \$500,000?

2) The Contracting Officer **SHALL** cooperate with EPA representatives and provide advice and assistance to aid EPA in the performance of responsibilities; and

95-003-1

3) EPA MAY recommend Termination for Convenience of any existing agency contract if it is determined that the Contractor is not filing the necessary forms or incomplete information. This guidance provides great potential for EPA's interference and/or stoppage of the BEP's ability to procure equipment and supplies required. The requirement for inclusion of the proposed clause and certification includes all SIC codes between 20 and 39; this covers most, if not all, of the items procured in the Stamp Contracts Division. Since foreign companies are exempt from these requirements, it seems that this action would further widen the gap between our ability to award to American companies and drive us further into the arms of foreign contractors not liable for many of our regulatory practices. Any EPA involvement in agency contracting could conceivably lead to serious conflict between satisfying agency needs and helping EPA perform their job. Possibly a better solution to assist EPA in enforcing this requirement would be to put some teeth in the regulation by increasing the fines involved for those companies who disregard EPCRA.

Note: The Background information conflicts with the statement of the proposed clause; the former states that this rule does not apply to subcontractors beyond the first tier, while the latter talks about subcontractors and does not identify the requirements as applying to only first tier subcontractors.

If you need any additional information, please contact Linda B. Washington of my staff at 874-3151.

cc: T. K. Brown
Office of Environmental Protection



4747 HARRISON AVENUE • P.O. BOX 7002 • ROCKFORD, IL 61125-7002
(815) 226-6000 • FAX 226-7488 • TWX 910-631-4255 • TELEX 25-7440

January 30, 1996

L957-196-0071

General Services Administration
FAR Secretariat (VRS)
18th and F Streets
NW
Room 4037
Washington, D.C. 20405

SUBJECT: WRITTEN COMMENTS REGARDING THE FAR INTERIM
PROPOSED RULE: IMPAIRMENT OF LONG-LIVED ASSETS AS
CITED IN THE *FEDERAL REGISTER*, VOL. 60, NO. 240,
DECEMBER 14, 1995

REFERENCE: FAR CASE 95-003

Gentlemen:

Thank you for the opportunity to review the above interim rule and comment on it. We have reviewed the interim rule and believe that it is not necessary. It places an undue administrative burden upon contractors who experience write-downs due to the impairment of long-lived assets since it would require contractors to maintain a separate set of records to depreciate the written-down assets as if they had not been written down. Since the current government movement is toward the adoption of commercial practices, enacting a rule that is contrary to current commercial practice seems to diverge from this endeavor.

If you have any questions, please feel free to contact me at (815) 226-5226.

Sincerely,

Arthur R. Charles, Vice President
Aerospace Contracts, Compliance and Management Services

ARC/gp

FEB 8 1996

3



National Security Industrial Association

95-003-2

1025 Connecticut Ave., NW, #300
Washington, DC 20036
(202) 775-1440
Fax (202) 775-1309

Office of the President

February 9, 1996

Mr. Jeremy F. Olson
General Services Administration
FAR Secretariat
18th & F Streets, NW, Room 4037
Washington, DC 20405

Subject: FAC 90-35, FAR Case 95-003

Dear Mr. Olson:

The National Security Industrial Association (NSIA) appreciates the opportunity to comment on the interim rules in FAR 31.205-11 and FAR 31.205-16 addressing impairment of Long-Lived Assets for government contract costing purposes. The following are our comments:

We firmly believe that government contract accounting should not depart from generally accepted accounting principles (GAAP) unless public policy or other special circumstances warrant deviation. The interim rules deviate from GAAP and require treatment diametrically opposed to SFAS 121. The interim rule did not address why SFAS 121 should not be used for government accounting other than the fact that CAS 409-40(a)(4) and 405-50(j) contain language which deals with the unrelated subject of asset disposals. The result of this departure from GAAP is increased administrative costs associated with performing government contracts by requiring an additional set of asset records and depreciation/amortization schedules.

NSIA also believes that the charters of the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council do not include addressing allocation issues in the FAR Cost Principles when such issues are currently addressed in the Cost Accounting Standards. The interim rule amendments to FAR 31.205-11 and 31.205-16 are addressing when costs are assigned to cost accounting periods. The assignment of cost to cost accounting periods is properly an issue for consideration by the Cost Accounting Standards Board (CASB) and should not be addressed through changes in the cost principles. The issue of changes in circumstances, which would include impairment of assets, is covered in CAS 409-50(i). If changes in this section are needed, the CASB is the appropriate government entity to revise its coverage. Therefore, it is inappropriate to issue these interim rules in the FAR.

FEB 13 1996

4

John R. Woodhull
Chairman
Board of Trustees

Arthur E. Johnson
Vice Chairman, Board of Trustees
Chairman, Executive Committee

Marilyn W. Andrulis, Ph.D.
Vice Chairman
Executive Committee

Thomas C. Richards
President

95-003-3

Mr. Olson
Page 2

The Federal Register notice stated that the interim rules are clarifications to cost allowability rules. While we agree that clarifications to existing rules can properly be issued as interim rules, we do not agree that new concepts or issues that have not been previously addressed in the cost principles should be issued as interim rules. New FAR cost principles and changes to existing FAR cost principles, unless mandated by law, should be processed through the normal procedure for new rules.

In summary, NSIA recommends that the government withdraw these rules because they are inappropriate and contrary to generally accepted accounting principles (GAAP).

If you would like further information on this subject, please contact Ed Schiff, NSIA Director for Procurement, at (202) 496-3297.

Sincerely,



Thomas C. Richards
General, USAF (Ret)
President

TCR:as

5



**Aerospace
Industries
Association**

95-003-4



February 12, 1996

General Services Administration
FAR Secretariat (VRS)
Attn: Mr. Jeremy F. Olson
18th and F Streets, N.W.
Room 4037
Washington, D.C. 20405

Reference: FAR Case 95-003

Dear Mr. Olson:

The Aerospace Industries Association (AIA) is pleased to provide its comments on interim amendments to FAR 31.205-11 and FAR 31.205-16, prohibiting a change in the methodology for depreciating impaired long-lived assets for government contract costing purposes. In accordance with the interim amendments, any changes in depreciation resulting in the write-down of an impaired long-lived asset will be recognized only upon disposition of the asset.

AIA strongly believes that the interim rules are unwarranted and contrary to sound accounting theory and existing Cost Accounting Standards (CAS) governing the allocation of costs to final cost objectives. Accordingly, AIA recommends that the interim rule be withdrawn. Detailed support for the AIA position is shown below.

The Statement of Financial Accounting Standards (hereinafter called the "Statement") No. 121, Accounting for the Impairment of Long-lived Assets, issued by the Financial Accounting Standards Board (FASB) in March 1995 established principles for the accounting treatment of impaired long-lived assets to be held and used, and impaired long-lived assets identified for disposal. The Statement requires that long-lived assets used by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. It also requires an immediate write-down of assets being disposed of to their fair market value (less cost to sell), if lower than the current carrying value. This Statement is effective for financial statements for fiscal years beginning after December 15, 1995.

Pursuant to FAR 31.201-2, Determining Allowability, generally accepted accounting principles (GAAP) are to be employed in accounting for costs of government contracts unless superseded

Aerospace Industries Association of America, Inc.
1250 Eye Street, N.W., Washington, D.C. 20005-3922 (202) 371-8400

FEB 13 1996

by specific Cost Accounting Standards or limitations found in FAR cost principles. The sound accounting principle/theory implicit in the SFAS 121 pronouncement is that long-lived assets, such as plant and equipment, are generally recorded at cost, i.e., fair value of the asset on the date of acquisition. The original cost is then reduced, or depreciated, over the periods in which the asset is used or consumed. However, when an asset has been determined to be impaired, under the accounting principle of "conservatism," it should be written down to its realizable value, if less than the current carrying value, and a one-time period loss recognized. The SFAS 121 pronouncement does not eliminate the possibility of a gain or loss upon the actual disposition of the asset; it only minimizes the cost write-off that is subsequently expected to occur.

The DoD position that impairment losses are not to be recognized for government contract costing purposes is contrary to this sound accounting theory as well as the basic concepts found in FAR 31.201-3, Determining Reasonableness. Moreover, the DoD position is inconsistent with basic accounting theory found in CAS 409, Depreciation of Tangible Capital Assets, FAR 31.205-11, Depreciation, and FAR 31.205-16, Gains and Losses on Disposition of Depreciable Property or Capital Assets.

The basic thrust of CAS 409 is to recognize in the accounting period the costs related to the consumption of physical assets. The Standard is based on the concept that depreciation costs identified with cost accounting periods should be a reasonable measure of the expiration of service potential of the tangible assets subject to depreciation. Consistent with the requirements in SFAS 121, CAS 409.50(h)(1) recognizes the ability to revise "estimates of service life, consumption of services, and residual value ... whenever circumstances change significantly." Similarly, CAS 409.50(e)(5) provides the flexibility to use advance agreements for shorter service lives when the asset has a unique purpose or other special circumstances that warrant a shorter estimated service life. Lastly, CAS 409.50(j)(3) provides that "the contracting parties may account for gains and losses arising from mass or extraordinary dispositions in a manner which will result in treatment equitable to all parties."

Likewise, FAR 31.205-11(a), Depreciation, states that depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a

95-003-4

Mr. Jeremy F. Olson
February 12, 1996
Page Three

framework in SFAS 121, FAR 31.205-16(e), Gains and Losses on Disposition of Depreciable Property or Capital Assets, provides an accounting framework acknowledging that "losses arising from mass or extraordinary sales, retirements, or other disposition... shall be considered on a case-by-case basis."

Further, contrary to the position articulated in the background discussion accompanying the interim rule, CAS 409.40 (a)4) and (b) (4), CAS 409.50 (j) (and the related Promulgation Comment 10, Gain or Loss), and FAR 31.205-16 do not preclude recognition of asset gains or losses such as those required by SFAS 121. The provisions of those standards/regulations address only those situations where the disposition of an asset has actually occurred and do not in any way establish or restrict the accounting practices to be followed for recognizing other asset gains or losses.

A major result of the interim rule is that the inconsistencies between GAAP and the regulations governing the costing of government contracts will, once again, increase the administrative costs associated with performing government's contracts. Industry continues to be concerned with government's gradual movement away from the tenants of sound accounting theory (GAAP) and fundamental concepts in recently proposed changes in procurement regulations and in this interim rule. Further, we fail to see the need for the government's action. It appears that the government's objective in proposing this rule is to preclude potential financial harm caused by required adjustments to contract costs resulting from losses sustained by contractors from the write-down of impaired assets. The government's concern is unfounded and not supported in today's environment. Due to competitive and fixed-price contracting and affordability issues, adjustments in an asset's value that potentially represent increased costs to the government will not always be passed on to the government.

We believe that the interim regulation does not represent a clarification to existing regulations, nor is it equitable to industry. A formal promulgation process has been established, and is legally mandated for all proposed changes in FAR. This promulgation process provides an opportunity for both the government and contractor community to identify concerns and comment on proposed rules before they become final. The process also ensures that the final rules issued by the government are equitable to all parties. Bypassing this process by coloring the proposed changes as clarifications does not comport with the intent of federal procurement regulations or recent acquisition reform initiatives.

8

95-003-4

Mr. Jeremy F. Olson
February 12, 1996
Page Four

In summary, for the reasons outlined in this comment draft, AIA encourages the government to reconsider the position contained in the interim regulation and to withdraw this rule.

If you have any question regarding AIA's position on this subject, please contact Dick Powers of my staff at (202) 371-8526.

Sincerely,


for Leroy J. Haugh

9

Case Management Record

*Navy: No problems
with language.
Agreed to draft
proposed rule.*

Discussion Handout

FAR Case 95-003		Date August 2, 1995
Title Impairment of Long-Lived Assets		
Priority 1	Submitted By Neilson	Originator Code O
Case Manager Fenk		Case References
FAR Cites 31.205-16		DFARS Cites
Cognizant Committees Cost Principles		
Coordination CPF		
Recommendation Agree to CAAC recommendation, as revised.		
<p><i>Reclama 8/7 COB</i></p> <p>The CAAC recommends revisions to our draft proposed rule to correct an inconsistency between 31.205-11, which indicates that the depreciation of an asset cannot exceed the amount used for book and statement purposes, and the change at 31.205-16, that states that asset write-downs from book value will not be recognized for contract cost purposes.</p> <p>The CAAC revision solves this problem by making an exception to the depreciation rule, limiting depreciation to the amounts already established on depreciation schedules prior to the write-down.</p> <p>CPF agrees with the revision, except the CAAC located it in the wrong place, where it applies only to non-CAS covered contracts. We suggest instead that the fix be located in a new paragraph (o) at the end of 31.205-11.</p>		

AUG 02 1995



General Services Administration
Office of Acquisition Policy
Washington, DC 20405

JUL 25 1995

D.S. Parry
CAPT, SC, USN
Director, Defense Acquisition
Regulations Council
ATTN: IMD 3D139
OUSD(A&T)
3062 Defense, Pentagon
Washington, DC 20301-3062

Re: FAR Case 95-003, Impairment of long-lived Assets

Dear CAPT Parry:

The DARC approved a proposed rule to add allowable cost criteria to the cost principle at FAR 31.205-16 concerning the recognition of gains and losses related to long-lived assets. The CAAC concurs with the proposed rule approved by the DARC except that the CAAC also believes additional changes are necessary in the cost principle covering depreciation expense, 31.205-11. The further changes approved by the CAAC are shown in the attached amended proposed rule.

This further change in the proposed rule is necessary because, if a contractor writes down the value of an asset per the new SFAS, the depreciation expense charged for that asset will necessarily be reduced to reflect the lower value of the asset. That reduced depreciation schedule will be reflected on the contractor's books and records. However, FAR 31.205-11(e) states that depreciation expenses charged to a contract cannot exceed the depreciation expense on the contractor's books and records. This means that, if the change to 31.205-16 recommended by the DARC is made and if FAR 31.205-11(e) is left unchanged, contractors would be unable to recoup the write down amount under Government contracts. Accordingly, the depreciation cost criteria must be changed to permit a contractor to use the old depreciation schedule if the value of an asset is written down per the new SFAS in order to let contractors continue to make full recovery.

If the DARC agrees with these further changes, we will publish the rule in the Federal Register for public comment.

Sincerely,

C. ALLEN OLSON
Chairman
Civilian Agency
Acquisition Council



**PROPOSED RULE APPROVED BY CAAC
FAR CASE 95-003, IMPAIRMENT OF LONG-LIVED ASSETS**

Changes in bold inside brackets [**like this**] are changes recommended by the DARC and concurred in by the CAAC. Text shown in bold italics inside brackets [*like this*] are the additional changes approved by the CAAC.

31.205-11 Depreciation.

(a) Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life refers to the prospective period of economic usefulness in a particular contractor's operations as distinguished from physical life; it is evidenced by the actual or estimated retirement and replacement practice of the contractor.

(b) Contractors having contracts subject to 48 CFR 9904.409, Depreciation of Tangible Capital Assets, must adhere to the requirement of that standard for all fully CAS-covered contracts and may elect to adopt the standard for all other contracts. All requirements of 48 CFR 9904.409 are applicable if the election is made, and its requirements supersede any conflicting requirements of this cost principle. Once electing to adopt 48 CFR 9904.409 for all contracts, contractors must continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts. Paragraphs (c) through (e) below apply to contracts to which 48 CFR 9904.409 is not applied.

(c) Normal depreciation on a contractor's plant, equipment, and other capital facilities is an allowable contract cost, if the contractor is able to demonstrate that it is reasonable and allocable (but see paragraph (i) below).

(d) Depreciation shall be considered reasonable if the contractor follows policies and procedures that are—

(1) Consistent with those followed in the same cost center for business other than Government;

(2) Reflected in the contractor's books of accounts and financial statements; and

(3) Both used and acceptable for Federal income tax purposes.

(e) When the depreciation reflected on a contractor's books of accounts and financial statements differs from that used and acceptable for Federal income tax purposes, reimbursement shall be based on the asset cost amortized over the estimated useful life of the property using depreciation methods (straight line, sum of the years' digits, etc.) acceptable for income tax purposes. Allowable depreciation shall not exceed the amounts used for book and statement purposes and shall be determined in a manner consistent with the depreciation policies and procedures followed in the same cost center on non-Government business, ***except that, in the event of a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances, depreciation of the impaired assets shall not exceed the amounts established on depreciation schedules in use prior to the write-down (see 31.205-16(g)).***

(f) Depreciation for reimbursement purposes in the case of tax-exempt organizations shall be determined on the basis described in paragraph (e) immediately above.

(g) Special considerations are required for assets acquired before the effective date of this cost principle if, on that date, the undepreciated balance of these assets resulting from depreciation policies and procedures used previously for Government contracts and subcontracts is different from the undepreciated balance on the books and financial statements. The undepreciated balance for contract cost purposes shall be depreciated over the remaining life using the methods and lives followed for book purposes. The aggregate depreciation of any asset allowable after the effective date of this 31.205-11 shall not exceed the cost basis of the asset less any depreciation allowed or allowable under prior acquisition regulations.

(h) Depreciation should usually be allocated to the contract and other work as an indirect cost. The amount of depreciation allowed in any accounting period may, consistent with the basic objectives in paragraph (a) above, vary with volume of production or use of multishift operations.

(i) In the case of emergency facilities covered by certificates of necessity, a contractor may elect to use normal depreciation without requesting a determination of "true depreciation," or may elect to use either normal or "true depreciation" after a determination of "true depreciation" has been made by an Emergency Facilities Depreciation Board (EFDB). The method elected must be followed consistently throughout the life of the emergency facility. When an election is made to use normal depreciation, the criteria in paragraphs (c), (d), (e), and (f) above shall apply for both the emergency period and the post-emergency period. When an election is made to use "true depreciation", the amount allowable as depreciation—

(1) With respect to the emergency period (five years), shall be computed in accordance with the determination of the EFDB and allocated ratably over the full five year emergency period; *provided* no other allowance is made which would duplicate the factors, such as extraordinary obsolescence, covered by the Board's determination; and

(2) After the end of the emergency period, shall be computed by distributing the remaining undepreciated portion of the cost of the emergency facility over the balance of its useful life provided the remaining undepreciated portion of such cost shall not include any amount of unrecovered "true depreciation."

(j) No depreciation, rental, or use charge shall be allowed on property acquired at no cost from the Government by the contractor or by any division, subsidiary, or affiliate of the contractor under common control.

(k) The depreciation on any item which meets the criteria for allowance at a "price" under 31.205-26(e) may be based on that price, provided the same policies and procedures are used for costing all business of the using division, subsidiary, or organization under common control.

(l) No depreciation or rental shall be allowed on property fully depreciated by the contractor or by any division, subsidiary, or affiliate of the contractor under common control. However, a reasonable charge for using fully depreciated property may be agreed upon and allowed (but see 31.109(h)(2)). In determining the charge, consideration shall be given to cost, total estimated useful life at the time of negotiations, effect of any increased maintenance charges or decreased efficiency due to age, and the amount of depreciation previously charged to Government contracts or subcontracts.

(m) 48 CFR 9904.404, Capitalization of Tangible Assets, applies to assets acquired by a "capital lease" as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board (FASB). Compliance with 48 CFR 9904.404 and FAS-13 requires that such leased assets (capital leases) be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the leased life as amortization charges as appropriate. Assets whose leases are classified as capital leases under FAS-13 are subject to the requirements of 31.205-11 while assets acquired under leases classified as operating leases are subject to the requirements on rental costs in 31.205-36. The standards of financial accounting and reporting prescribed by FAS-13 are incorporated into this principle and shall govern its application, except as provided in subparagraphs (1), (2), and (3) below.

(1) Rental costs under a sale and leaseback arrangement shall be allowable up to the amount that would have been allowed had the contractor retained title to the property.

(2) Capital leases, as defined in FAS-13, for all real and personal property, between any related parties are subject to the requirements of this subparagraph 31.205-11(m). If it is determined that the terms of the lease have been significantly affected by the fact that the lessee and lessor are related, depreciation charges shall not be allowed in excess of those which would have occurred if the lease contained terms consistent with those found in a lease between unrelated parties.

(3) Assets acquired under leases that the contractor must capitalize under FAS-13 shall not be treated as purchased assets for contract purposes if the leases are covered by 31.205-36(b)(4).

(n) Whether or not the contract is otherwise subject to CAS, the requirements of 31.205-52, which limit the allowability of depreciation, shall be observed.

* * * * *

31.205-16 Gains and losses on disposition [or impairment] of depreciable property or other capital assets.

(a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation or amortization applicable to those assets was included (but see paragraph (d) of this subsection). However, no gain or loss shall be recognized as a result of the transfer of assets in a business combination (see 31.205-52).

(b) Gains and losses on disposition of tangible capital assets, including those acquired under capital leases (see 31.205-11(m)), shall be considered as adjustments of depreciation costs previously recognized. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds from involuntary conversions, and its undepreciated balance. The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost (or for assets acquired under a capital lease, the value at which the leased asset is capitalized) of the asset and its undepreciated balance (except see subdivisions (c)(2)(i) or (ii) of this section).

(c) Special considerations apply to an involuntary conversion which occurs when a contractor's property is destroyed by events over which the owner has no control, such as fire, windstorm, flood, accident, theft, etc., and an insurance award is recovered. The following govern involuntary conversions:

(1) When there is a cash award and the converted asset is not replaced, gain or loss shall be recognized in the period of disposition. The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost of the asset and its undepreciated balance.

(2) When the converted asset is replaced, the contractor shall either—

(i) Adjust the depreciable basis of the new asset by the amount of the total realized gain or loss; or

(ii) Recognize the gain or loss in the period of disposition, in which case the Government shall participate to the same extent as outlined in subparagraph (c)(1) above.

(d) Gains and losses on the disposition of depreciable property shall not be recognized as a separate charge or credit when—

(1) Gains and losses are processed through the depreciation reserve account and reflected in the depreciation allowable under 31.205-11; or

(2) The property is exchanged as part of the purchase price of a similar item, and the gain or loss is taken into consideration in the depreciation cost basis of the new item.

(e) Gains and losses arising from mass or extraordinary sales, retirements, or other disposition other than through business combinations shall be considered on a case-by-case basis.

(f) Gains and losses of any nature arising from the sale or exchange of capital assets other than depreciable property shall be excluded in computing contract costs.

[(g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be recognized for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damage, idle facilities arising from a declining business base, etc.). Depreciation or amortization on pre-write-down carrying value of impaired assets not yet disposed of shall continue to be recoverable under established depreciation or amortization schedules to the extent it is not otherwise unallowable under other provisions of the FAR.]

Case Management Record

INFORMATION Handout

FAR Case 95-003		Date March 1, 1995
Title Impairment of Long-Lived Assets		
Priority	Submitted By Holcombe	Originator Code
Case Manager Holcombe		Case References
FAR Cites 31.205-16(g)	DFARS Cites	
Cognizant Committees Cost Principles and CAS		
Coordination CPF		
Recommendation File - Information Only		

During DAR Council discussions of this case on February 15, 1995, the case manager was tasked to seek CPF's agreement to use the terms "net book value" in lieu of "carrying value" and "fair market value" in lieu of "fair value." We have talked with CPF and with the Chair of the Cost Principles Committee. Both have indicated that the terms are not synonymous and should remain as written since these are the terms used in the Financial Accounting Standard being implemented.

In addition, the DAR Council posed the question, "Why are we allowing higher write-off for depreciation than would otherwise be allowed if written-down?" CPF has clarified that this is less expensive for the Government. It is a matter of the timing for sharing those costs.

We will continue to process the proposed rule agreed to by the DAR Council on February 15, 1995.

Post-It™ brand fax transmittal memo 7671		# of pages ▾ 1
To DAR COUNCIL	From LINDA HOLCOMBE	
Co.	Co.	
Dept.	Phone #	
Fax #	Fax #	

Official Case Record

Date:

February 15, 1995

FAR Case: 95-003

Case Title:

Impairment of Long-Lived Assets

Originator:

O

Sponsor:

Committee:

Case Manager:

Mens

FAR/DFARS:

31.205-16

Statute:

Statutory Date:

Outside Interest (Circle): IG OFPP OMB DCAA GAO Industry Other _____

Coordination/Comments (Circle): DDP MPI CPA CPF DSPS FC GC Other _____

Action Scheduled Today:

Discuss proposed FAR rule drafted by CPF.

OSD Position:

The proposed FAR rule clarifies that losses associated with contractor write-downs of long-lived tangible assets and identifiable intangible assets, from carrying to fair market values, due to impairment of the assets resulting from certain events or changes in circumstances (e.g. loss of business base, etc.), are unallowable costs under Government contracts. The Cost Principles Committee reviewed CPF's draft rule and recommends that the title of 31.205-16 be revised to include the term "impairment" and that the text be set out as a separate new paragraph (g). I agree with the Committee's recommendation.

Discussions/Actions Taken:

Agree to rule as revised by Cost Principles
Case Mgr to contact CPF + make sure they agree and
ask if they agree. Also see if they can agree to "Net
book value" versus carrying value + "fair market" value versus
fair rule.

CAM Update:

Agreed to proposed rule

CASE MANAGEMENT RECORD

Discussion H/O

FAR Case 95-003		Date February 15, 1995
Title: Impairment of Long-Lived Assets		
Priority	Submitted By N-1	Originator Code
Case Manager: Mens		Case References:
FAR Cites	DFARS Cites	
Cognizant Committees: Cost Principles and CAS		
Coordination CPF		
Recommendation: Discuss _____		
<p>Although not tasked to coordinate on the proposed change to the cost principle at FAR 31.205-16, the Cost Principles Committee has provided the attached comments for DAR Council consideration. The Committee's recommended revisions are meant to highlight and clarify.</p>		

FEB 18 1995



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

January 9, 1995

MEMORANDUM FOR NAVY POLICY REPRESENTATIVE

Subj: FAR CASE 95-003, IMPAIRMENT OF LONG-LIVED ASSETS

This is in reference to the Case Management Record of January 30, 1995 on the subject FAR case. It is noted that the Cost Principles Committee was not requested to coordinate on the proposed change to the cost principle at FAR 31.205-16. However, the Committee would like to submit the following comments for DAR Council consideration.

The Cost Principles Committee concurs with the conclusion that impairment losses should be unallowable for government contracting purposes. We also do not take exception to the proposed new language which sets forth the Government's policy regarding this issue. However, we believe that the word "impairment" should be added to the heading of the cost principle to highlight that the allowability of asset impairment costs are also being addressed. Also, from a stylistic point of view and for better clarity, we believe that the coverage on asset impairments should not be added to paragraph (a) which addresses disposition (sale, retirement, etc.) of depreciable property. Since impairment is different from disposition, the Cost Principles Committee believes that it is more appropriate to have separate paragraphs addressing the allowability of the two distinct costs. Therefore, we recommend that the cost principle be revised as follows:

31.205-16 Gains or losses on disposition [or impairment] of depreciable property or other capital assets.

* * * * *

[(g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be recognized for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g. environmental damage, idle facilities arising from a declining business base, etc.). Depreciation or amortization on pre-write-down carrying values of impaired assets not yet disposed of shall continue to be recoverable under established depreciation or amortization schedules to the extent it is not otherwise unallowable under other provisions of the FAR.]

I am available to discuss this issue if you like.

Clarence M. Belton
Chairman, Cost Principles Committee

2/9/95

I spoke with Don Sawyer regarding this approach.
Don indicated that he does not object to our revision.
CTB

12/20

Call Don
Sanger
Will Cost
Principles
Committee has
a chance to
conduct
on this

MINUTES OF JOINT COMMITTEE MEETING
ON ACCOUNTING FOR
IMPAIRMENT OF LONG-LIVED ASSETS

* * * * *

A joint meeting of the Cost Principles and Cost Accounting Standards (CAS) committees was held on November 30, 1994. The purpose of the meeting was to: (i) discuss provisions of the Statement of Financial Accounting Standards (SFAS) entitled "Accounting for the Impairment of Long-Lived Assets;" (ii) determine what, if any, relevance the SFAS has to Government contract pricing and cost accounting; (iii) review appropriate Federal Acquisition Regulation (FAR) and CAS provisions; and (iv) recommend appropriate policy to protect the Government's interests while providing equitable treatment to contractors. Invited staff members of the CAS Board and Department of Defense Inspector General's Audit Policy and Oversight office attended the meeting.

SFAS PROVISIONS:

The SFAS addresses accounting for impairment of long-lived assets (such as land, buildings, and facilities), identifiable intangibles, and related goodwill. It provides guidance to recognize and measure impairment losses due to events or changes in circumstances (e.g., environmental damage, idle facilities arising from declining business, etc.) and requires the carrying amount of affected assets to be reduced to fair value whenever their carrying amounts may not be recoverable. The SFAS will apply to financial statements of publicly-held firms for fiscal years beginning after December 15, 1994.

METHODOLOGY:

Recognizing that cost accounting rules, regulations, and standards which apply to Government contract pricing and costing do not always coincide with financial and tax accounting requirements, the joint committee agreed that the most productive discussion approach would be to analyze the effects of recognizing SFAS for Government contracting versus the effects of non-recognition.

Minutes of Joint Committee Meeting
on Accounting for Impairment of
Long-Lived Assets 11/30/94

DISCUSSION:

Recognition versus Non-recognition.

An impaired asset write-down is essentially an extraordinary event that normally would be charged off as a period expense. Depending upon business and contract mix, recognition of write-downs could provide enhanced cash flow to contractors and significant cost increases to the Government in write-down periods, unless the Government required impairment losses to be amortized over remaining periods of impaired asset use. Moreover, for pricing purposes, a contractor might be able to control the timing of an impaired asset write-down for maximum effect.

The potential for "gaming" would necessitate a cost rule with sufficient safeguards to preclude abuses. Consequently, the rule likely would be complex and contain requirements that imposed a considerable administrative burden. For example, oversight and review of write-downs on a case-by-case basis might be necessary to protect the Government's interests. Accordingly, the group was unable to discern a compelling reason for the Government to recognize impaired asset write-downs for contracting purposes.

Conversely, a non-recognition policy toward impaired asset write-downs is consistent with current FAR provisions and provides equitable treatment for both contractors and Government, to wit:

- open flexibly priced contracts are unaffected;
- amortization schedules need not be changed;
- contractor's current cash flow is unaffected;
- contractors continue to price/cost depreciation on pre-write-down carrying values and, thereby, recover the full amount;
- cost records can be maintained via memo entries to asset accounts and entail no administrative burden;
- costs are more predictable;
- minimal FAR changes are required;
- treatment of loss is consistent with that of disposal gains and asset write-ups related to business combinations per [FAR 31.205-16(a) and FAR 31.205-52 respectively];

Minutes of Joint Committee Meeting
on Accounting for Impairment of
Long-Lived Assets 11/30/94

- treatment of loss is consistent with current restructuring policy;
- treatment of remediation costs for environmental cleanup is unaffected;
- treatment of loss is consistent with idle facilities and idle capacity cost rule [FAR 31.205-17]; and
- resolves defense industry concerns regarding potential inequities due to the "no reversal" provision of the SFAS.

Other Considerations.

The joint committee also noted that mechanisms already exist to deal with asset impairments, such as:

- contractual provisions;
- advance agreements;
- contract termination provisions;
- FAR Part 50 [P.L. 85-804, Extraordinary Contractual Actions];
- CAS 9904.409 [changes in asset estimated service life and residual value, and loss recognition upon disposal];
- restructuring policy [impairment losses might be part of proposed costs related to asset dispositions resulting from internal or external restructuring activities];

CONCLUSION:

The joint committee (eight attendees) unanimously agreed that impairment losses should not be recognized for Government contracting. In essence, an impairment loss is the equivalent of accelerated depreciation; it simply changes the timing for recovery of asset carrying values. Under current FAR provisions, defense contractors will continue to recover the full amount of pre-write-down carrying values. Accordingly, there is no objective reason to recognize SFAS-mandated impairment losses for Government contracting purposes.

Minutes of Joint Committee Meeting
on Accounting for Impairment of
Long-Lived Assets 11/30/94

RECOMMENDATION:

The joint committee recommends issuing a FAR interim rule stating that impairment losses are not allowable for Government contracting purposes. The language should emphasize that asset carrying values shall continue to be fully recoverable to the extent they are not otherwise unallowable under other provisions of FAR. The group also recommends a policy memorandum be issued to the Services and Agencies recommending that, pending publication of a FAR change, advance agreements should be negotiated with contractors contemplating asset write-downs within the next calendar year.

Prepared by: DSawyer/PDUSD(A&T)DP(CPF)/2Dec94/(703)695-7197

Case Management Record

Discussion Handout

FAR Case 95-003		Date January 30, 1995	
Title Impairment of Long-Lived Assets			
Priority 1	Submitted By Ladd		Originator Code O
Case Manager Mens		Case References	
FAR Cites		DFARS Cites	
Cognizant Committees Cost Principles and CAS			
Coordination CPF			
Recommendation Discuss: <u>FEB 15, 1995</u>			
<p>This is a new case initiated at the request of the Director of Defense Procurement to revise the FAR to implement a new Financial Accounting Standards Board (FASB) rule that will require publicly-held firms to recognize asset impairment losses resulting from certain events or changes in circumstances when recovery of carrying values is improbable. <i>See OFR for correct synopsis</i></p> <p>CPF has already developed a proposed rule and staffed it with selected members of the Cost Principles and CAS Committees. Please do whatever staffing you need to do within your agency so that we might discuss the draft language and reach agreement on a fast-track basis.</p>			

JAN 31 1995



ACQUISITION AND
TECHNOLOGY

DP/CPF

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

JAN 23 1995



MEMORANDUM FOR DEPUTY DIRECTOR, DEFENSE ACQUISITION REGULATIONS
SYSTEM

SUBJECT: Accounting for Impairment of Long-Lived Assets

The Financial Accounting Standards Board plans to issue a new rule in February that will require publicly-held firms to recognize asset impairment losses resulting from certain events or changes in circumstances (e.g., environmental damage) when recovery of carrying values is improbable. Once written down, the previous carrying amount of an asset cannot be restored if the impairment is subsequently removed. The rule will apply to financial statements for fiscal years beginning after June 15, 1995.

Under current CAS and FAR provisions, impairment losses on assets held for use cannot be recognized for Government contracting. Nonetheless, uncertainty and potential controversy might be avoided if an appropriate FAR change is implemented to clarify existing policy on the subject.

CPF has staffed the issue with selected members of the Cost Principles and CAS committees, and drafted a proposed change to FAR 31.205-16 with collaterals (Attachment). Given the short lead time available to us, I would like this case to receive top priority. Please establish a case number and process the case as quickly as possible.

Eleanor R. Spector
Director, Defense Procurement

Attachment



DAR Case 95-XX
Baseline: FAR posted through FAC 94-20

Proposed change shown in [brackets].

PART 31--CONTRACT COST PRINCIPLES AND PROCEDURES

* * * *

31.205-16 Gains and losses on disposition of depreciable property or other capital assets.

(a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation or amortization applicable to those assets was included (but see paragraph (d) of this subsection). However, no gain or loss shall be recognized as a result of the transfer of assets in a business combination (see 31.205-52). [Moreover, with respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be recognized for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damage, idle facilities arising from a declining business base, etc.). Depreciation or amortization on pre-write-down carrying values of impaired assets not yet disposed of shall continue to be recoverable under established depreciation or amortization schedules to the extent it is not otherwise unallowable under other provisions of the FAR.]

* * * *

Attachment

PROPOSED FEDERAL REGISTER NOTICE

DEPARTMENT OF DEFENSE
GENERAL SERVICES ADMINISTRATION
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

48 CFR Part 31

Federal Acquisition Regulation (FAR); Impaired Assets.

AGENCIES: Department of Defense (DoD); General Services Administration (GSA); and National Aeronautics and Space Administration (NASA).

ACTION: Request for comment on proposed rule.

COMMENTS: Comments should be submitted to the FAR Secretariat at the address shown below on or before (60 days from publication), to be considered in the formulation of a final rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council are considering revising FAR 31.205-16 to set forth a clarification of existing rules regarding the allowability of losses recognized when carrying values of impaired assets are written down for financial reporting.

ADDRESS: Interested parties should submit written comments to: General Services Administration, FAR Secretariat (VRS), 18th & F Streets, N.W., Room 4041, Washington, DC 20405. Please cite FAR Case 95-XX in all correspondence related to these issues.

EFFECTIVE DATE:

FOR FURTHER INFORMATION CONTACT: Ms. Beverly Fayson, FAR Secretariat, telephone (202) 523-4755. Please cite FAR Case 95-XX.

SUPPLEMENTARY INFORMATION:

A. Background

The revision proposed by the councils is intended to clarify extant cost allowability rules regarding recognition of gains and losses related to long-lived assets. This proposed rule addresses a cost category which is the subject of a Financial Accounting Standards Board proposed Statement of Financial Accounting Standards (SFAS), No. 132-B, dated November 29, 1993, and entitled "Accounting for the Impairment of Long-Lived Assets. The SFAS applies to long-lived assets (such as land, buildings, and equipment), identifiable intangibles, and related goodwill, and establishes guidance to recognize and measure impairment losses. If impaired assets are to be held for use, the SFAS requires a write-down to fair value when events or circumstances (e.g., environmental damage, idle facilities arising from declining business, etc.) indicate that carrying values may not be fully recoverable. Impaired assets that are to be disposed of, however, would be reported (with certain exceptions) at the lower of cost or fair value less cost to sell. Once written down, the previous carrying amount of an impaired asset could not be restored if the impairment was subsequently removed. The final SFAS, which is virtually unchanged from the proposed rule (except for certain utility company provisions), is scheduled to be issued on February 15, 1995. The SFAS will apply to all financial statements issued for fiscal years beginning after June 15, 1995. In contrast to the SFAS provisions, Cost Accounting

Standard (CAS) 9904.409, "Depreciation of Tangible Capital Assets," provides quite different criteria and guidance to recognize gains and losses for Government contracting purposes. The language at 9904.409-40(a)(4) and (b)(4), 9904.409-50(j), and related Promulgation Comment 10, "Gain or Loss," makes it clear that gains and losses are recognized only upon asset disposal; no other circumstances trigger such recognition. FAR 31.205-16, "Gains and losses on disposition of depreciable property and other capital assets," reflects the CAS provision that an asset be disposed of in order to recognize a gain or loss. The FAR rule applies to both CAS and non-CAS covered contracts. Consequently, for Government contracting purposes, an impairment loss is recognized only upon disposal of the impaired asset and, like other losses, it is measured as the difference between the net amount realized and the impaired asset's undepreciated balance. Government contractors, therefore, recover the carrying values of impaired assets held for use by retaining pre-write-down depreciation or amortization schedules as though no impairment had occurred. In order to clarify the existing cost allowability rule, both councils have agreed to proceed with publication of this proposed rule.

B. Regulatory Flexibility Act

This proposed rule is not expected to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq., because most contracts awarded to small entities

are awarded on a competitive fixed-price basis and cost principles do not apply. An Initial Regulatory Flexibility Analysis has, therefore, not been performed. Comments from small entities concerning the affected FAR subpart will be considered in accordance with 5 U.S.C. 610. Such comments must be submitted separately and should cite 5 U.S.C. 601, et seq. (FAR case 95-XX), in correspondence.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the proposed change to the FAR does not impose record keeping or information collection requirements, or collections of information from offerors, contractors, or members of the public which require the approval of the Office of Management and Budget under 44 U.S.C. 3501, et seq.

List of Subjects in 48 CFR Part 31:

Government procurement.

Dated: