

state or imply Governmental endorsement of a product, service or position which the contractor represents.

**1403.570-3 Contract clause.**

CO's shall include the clause at 48 CFR 1452.203-70, Restriction on Endorsements, in all solicitations, contracts and agreements which are not executed in accordance with SAT procedures.

3. Part 1425 is amended by removing Sections 1425.202 and 1425.204.

4. Part 1452 is amended by adding new Section 1452.203-70 to read as follows:

**PART 1452—SOLICITATION PROVISIONS AND CONTRACT CLAUSES**

**1452.203-70 Restriction on endorsements.**

As prescribed in 48 CFR 1403.570-3, insert the following clause in all solicitations, contracts and agreements which are expected to exceed the simplified acquisition threshold.

Restriction on Endorsements—Department of the Interior (Nov 1995)

The contractor shall not refer to contracts awarded by the Department of the Interior in commercial advertising, as defined in FAR 31.205-1, in a manner which states or implies that the product or service provided is approved or endorsed by the Government, or is considered by the Government to be superior to other products or services. This restriction is intended to avoid the appearance of preference by the Government toward any product or service. The contractor may request a determination as to the propriety of promotional material from the CO.

(End of Clause)

[FR Doc. 96-3205 Filed 2-12-96; 8:45 am]

BILLING CODE 4310-RF-M

**OFFICE OF MANAGEMENT AND BUDGET**

**Office of Federal Procurement Policy**

**48 CFR Part 9904**

**Cost Accounting Standards Board; Treatment of Gains or Losses Subsequent to Mergers or Business Combinations by Government Contractors; Increase in Minimum Acquisition Cost Criterion for Capitalization of Tangible Capital Assets**

**AGENCY:** Cost Accounting Standards Board, Office of Federal Procurement Policy, OMB.

**ACTION:** Final rule.

**SUMMARY:** The Office of Federal Procurement Policy, Cost Accounting Standards Board (CASB), hereby amends the Cost Accounting Standards (CAS) relating to the treatment of gains or losses attributable to tangible capital assets subsequent to mergers or business combinations by government contractors, and relating to the minimum acquisition cost criterion for capitalization of tangible capital assets by raising the prescribed criterion from \$1,500 to \$5,000.

To resolve the problems that have been identified in this area, the Board hereby amends CAS 9904.404, "Capitalization of Tangible Assets" and CAS 9904.409, "Depreciation of Tangible Capital Assets". These amendments are based on an approach involving a "no step-up, no step-down" of asset bases and no recognition of gain or loss on a transfer of assets following a business combination by contractors subject to CAS.

Section 26(g)(1) of the Office of Federal Procurement Policy Act requires that the Board, prior to the promulgation of any new or revised Cost Accounting Standard, publish a final rule. This final rule addresses the Board's proposal to amend CAS 9904.404 and CAS 9904.409 to deal with the issue of gains and losses subsequent to a merger or business combination.

**EFFECTIVE DATE:** This rule is effective April 15, 1996.

**FOR FURTHER INFORMATION CONTACT:** Dr. Rein Abel, Director of Research, Cost Accounting Standards Board (telephone 202-395-3254).

**SUPPLEMENTARY INFORMATION:**

**A. Regulatory Process**

The Cost Accounting Standards Board's rules and regulations are codified at 48 CFR Chapter 99. Section 26(g)(1) of the Office of Federal Procurement Policy Act, 41 U.S.C. § 422(g)(1), requires that the Board, prior to the establishment of any new or revised Cost Accounting Standard, complete a prescribed rulemaking process. This process consists of the following four steps:

1. Consult with interested persons concerning the advantages, disadvantages and improvements anticipated in the pricing and administration of government contracts as a result of a proposed Standard.
2. Promulgate an Advance Notice of Proposed Rulemaking.
3. Promulgate a Notice of Proposed Rulemaking.
4. Promulgate a final rule.

This final rule is step four in the four step process.

**B. Background**

*Prior Promulgations*

The issues addressed in this proposal were first identified by commenters in response to the Board's request for agenda topics in November 1990. Subsequently, two Staff Discussion Papers (SDPs) were issued.

The first SDP, dated August 26, 1991 and titled "Recognition and Pricing of Changing Capital Asset Values Resulting from Mergers and Business Combination by Government Contractors," (56 FR 42079) raised broad issues such as the scope of the proposed project, the basis for any Government claim to gains or losses resulting from a business combination and the likely economic consequences of a policy that would prohibit revaluation of assets following a merger.

The responses to this SDP were used by the Board as the basis for discussing the basic issues involved in this case. As a result of this discussion, the Board decided to issue a second SDP dealing with a series of questions concerning the specific procedures needed to deal effectively with the recognition, allocation and recovery of the gain or loss subsequent to a merger or business combination. The second SDP, entitled "Treatment of Gains or Losses Subsequent to Mergers or Business Combinations by Government Contractors," was issued on November 4, 1993 (58 FR 58882). On the basis of comments received in response to that SDP, an Advance Notice of Proposed Rulemaking (ANPRM) was developed and published in the Federal Register on May 24, 1994 (59 FR 26774). The responses to the ANPRM were of significant assistance to the Board in developing a Notice of Proposed Rulemaking (NPRM). The NPRM was published in the Federal Register on March 8, 1995 (60 FR 12725).

*Public Comments*

Ten sets of public comments were received in response to the NPRM from government contractors, professional and industrial associations, law firms and Federal agencies.

The views expressed by the various parties were, in essence, consistent with the views expressed by the same parties earlier when the ANPRM was published. The basic no step-up, no step-down approach was supported by the Government commenters and it was generally opposed by other commenters although some of these other

commenters did not explicitly express their views on this basic issue.

Besides expressing their views on the proposed approach outlined in the NPRM and the Board's arguments supporting this chosen approach, many commenters offered editorial as well as more substantive detailed comments on the various specific provisions of the document.

These comments are discussed below in greater detail, under Section E., Public Comments. The Board and the CASB staff express their appreciation for the generally constructive and thoughtful responses provided by the commenters.

#### Benefits

After consideration of all the comments received in response to the NPRM, the Board continues to believe that amendments to CAS 9904.404, "Capitalization of Tangible Assets," and CAS 9904.409, "Depreciation of Tangible Capital Assets," as set forth in the ANPRM and essentially restated in the NPRM, and this final rule, will significantly improve and clarify the implementation of CAS and related procurement regulations in accounting for tangible capital assets after completion of a merger or business combination. In particular, the Board continues to believe that the proposal embodied in this final rule will clarify the current ambiguities in this area and thus should lead to reductions in negotiations and litigation. This point is of particular significance in the current economic and budgetary environment where the need to realize economies in the defense budget can be expected to lead to mergers, business combinations and restructurings among contractors. It is also anticipated that increasing the capitalization criterion for tangible capital assets in CAS 9904.404 from \$1,500 to \$5,000, will significantly reduce record keeping burden in many instances. The Board believes that the potential benefit to the audit, negotiation, and general contract administration processes accruing from the added clarity and uniformity in the measurement of the cost of depreciation and cost of money subsequent to a business combination will be substantial and will greatly outweigh any added costs.

#### Summary of Proposed Amendments

A brief description of the proposed amendments follows:

a. The capitalization criterion for tangible capital assets in subsection 9904.404-40(b)(1) is increased from \$1,500 to \$5,000.

b. The current subsection 9904.404-50(d) is deleted and is replaced by an amended section that prescribes:

(1) That for contract costing purposes, tangible capital assets following a business combination shall retain their net book value recognized during the most recent cost accounting period prior to the business combination provided that the assets generated either depreciation expense or cost of money charges that were allocated during the period either as direct or indirect costs to Federal government contracts and subcontracts negotiated on the basis of cost.

(2) That the cost of tangible capital assets shall be restated after the business combination at a figure not to exceed the fair value at the date of the acquisition pursuant to a business combination where the assets during the most recent cost accounting period prior to the business combination did not generate either depreciation expense or cost of money charges that were allocated either as direct or indirect costs to Federal government contracts negotiated on the basis of cost.

c. A new subparagraph 9904.409-50(j)(5), is added to current subsection 9904.409-50(j). The purpose of this new subparagraph is to make it clear that the CAS 9904.409 provisions dealing with the recapture of gains and losses on disposition of tangible capital assets should not apply when assets are transferred subsequent to a business combination.

#### C. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96-511, does not apply to this rulemaking, because this rule imposes no paperwork burden on offerors, affected contractors and subcontractors, or members of the public which require the approval of OMB under 44 U.S.C. 3501, *et seq.*

#### D. Executive Order 12866 and the Regulatory Flexibility Act

The economic impact of this rule on contractors and subcontractors is expected to be minor. As a result, the Board has determined that this final rule will not result in the promulgation of a "major rule" under the provisions of Executive Order 12866, and that a regulatory impact analysis will not be required. Furthermore, this final rule will not have a significant effect on a substantial number of small entities because small businesses are exempt from the application of the Cost Accounting Standards. Therefore, this final rule does not require a regulatory flexibility analysis under the Regulatory Flexibility Act of 1980.

#### E. Public Comments

This final rule was developed after consideration of the public comments received in response to the Board's NPRM published on March 8, 1995 (60 FR 12725). The comments have provided valuable input to the Board's rulemaking process. The comments received and the action taken by the Board are summarized in the paragraphs that follow:

*Comment:* Several commenters indicated that the final rule should make it clear that this revised rule is to be applied on a prospective basis only. One commenter suggested that the language in 9904.404-63 and 9904.409-63 be supplemented to reflect the requirements of paragraph (a)(3) of the contract clause at 9903.201-4(a) which requires the receipt of a new CAS-covered contract for a new CAS requirement to be applicable.

*Response:* Sections 9904.404-63 and 9904.409-63 have been supplemented to make it clear that these revisions are to be applied prospectively.

*Comment:* Several commenters stressed once more that they believe there is a conflict between the CAS allocability provisions and the Federal Acquisition Regulation (FAR) allowability provisions in this area. It was suggested again, as in earlier comments, that the OFPP Administrator should address this issue.

*Response:* The Board is aware that there is an appearance of conflict between the provisions of CAS 9904.404 and FAR 31.205-52. As stated in the proposed rulemakings, the OFPP Administrator will determine whether any changes may be necessary in the FAR cost principles to make them fully compatible with amended CAS 9904.404 and 9904.409.

*Comment:* One commenter pointed out the apparent inconsistency in the language between sections 9904.404-50(d) (1) and (2) when describing the scope of the two paragraphs. In one paragraph the reference is to costs charged to "Federal Government contracts", while in the other, the reference is to "Federal Government contracts subject to CAS". In addition, another commenter pointed out that these references did not make clear whether contractors subject to modified CAS coverage are affected by this amendment.

*Response:* In order to make clear that the amendment applies to those tangible capital assets that were charged to Federal government contracts and subcontracts negotiated on the basis of cost before the business combination, the phrase "subject to CAS" has been

eliminated. This should make it clear that this revised rule applies to tangible capital assets that generated costs allocated to Federal government contracts and subcontracts negotiated on the basis of cost, where such costs were allocated to contracts and subcontracts by the seller during the most recent cost accounting period prior to the business combination.

*Comment:* Several suggestions were received dealing with different aspects of materiality in applying this revision. First, several contractors and industry associations suggested that specific materiality criteria be introduced, such as total dollar value of assets acquired or the percentage of commercial or competitively awarded fixed-priced contracts in relation to total sales. One Government commenter suggested that the coverage of the amendment should be extended also to those tangible capital assets that generated relevant costs chargeable to CAS-covered contracts "anytime during the three accounting periods prior to the business combination".

*Response:* The Board does not believe that the introduction of additional materiality criteria is advisable at this time. By its very nature, under full CAS coverage, the amended Standard's requirements apply to major contractors that perform significant amounts of CAS-covered work.

CAS 9904.404-50(d) has been revised to clearly state that the costs of tangible capital assets acquired from a seller (whether CAS-covered or non-CAS covered) which generated depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts shall not be written up by the buyer. The primary issue is whether or not a material amount of asset costs have been charged to Federal government contracts and subcontracts that were negotiated on the basis of cost, where such costs were allocated to contracts and subcontracts during the most recent cost accounting period prior to the acquisition date, not the amount of CAS-covered effort performed by the seller.

*Comment:* One commenter suggested that the acquisition cost criterion in section 9904.404 be raised from \$1,500 to \$5,000.

*Response:* The Board accepts this suggestion and therefore section 9904.404-40(b)(1) is modified to increase the minimum acquisition cost criterion from \$1,500 to \$5,000.

*Comment:* One Government commenter expressed the view that the provisions of the amendment should also be extended to non-CAS-covered contractors: "The proposed rule does

not provide uniformity or consistency since it provides for different treatment for acquired assets of CAS-covered from non-CAS-covered contractors".

*Response:* CAS 9904.404-50(d) has been revised to clearly establish that the acquired tangible capital asset valuations shall be determined in a consistent manner. As revised, application of the prescribed techniques in 9904.404-50(d)(1) and 9904.404-50(d)(2) is dependant upon whether or not the acquired assets were previously utilized in the performance of either CAS-covered and/or non-CAS covered Federal contracts that were negotiated on the basis of cost.

*Comment:* Several commenters expressed their disagreement with the abandonment of GAAP principles in this revision to CAS 9904.404. The view was expressed that the CASB should deviate from GAAP only in exceptional cases and, in the view of these commenters, such an approach is not warranted in the present case.

*Response:* The Board has pointed out in its Statement of Objectives, Policies and Concepts that it will make every reasonable effort to avoid conflict or disagreement with other bodies having similar responsibilities. However, it also pointed out that the nature of the Board's authority and its mission is such that it must retain and exercise full responsibility for meeting its objectives.

As stated in previous discussions, the Board adopted the "no step-up, no step-down" approach after extensive consideration of the possible alternative approaches. In particular, the issues associated with the recognition, allocation and recovery of the gain or loss subsequent to a merger or business combination were extensively explored in a Staff Discussion Paper (SDP) entitled "Treatment of Gains or Losses Subsequent to Mergers or Business Combinations by Government Contractors." It was only after careful consideration of the responses to the SDP that the Board decided to proceed with the "no step-up, no step-down" approach thereby establishing a cost accounting practice that diverges from the corresponding practice recognized for GAAP purposes.

*Comment:* Several commenters pointed out that since this issue has been under review by the CAS Board, there have been significant changes in the statutes and regulations covering mergers and business combinations by Government contractors. The Government, in order to encourage contractors to consolidate, has recognized "external restructuring" which allows, in certain circumstances, contractors' restructuring costs to be

charged to Government contracts to the extent that the restructuring results in savings that exceed the costs. The commenters argued that the same rationale should be applied to increased depreciation associated with the revaluation of a purchased company's assets if the business combination is regarded as an "external restructuring", and, that it would be inequitable for the Government to benefit from all of the savings resulting from restructuring, while it is unwilling to recognize all of the costs needed to implement such restructuring.

*Response:* In issuing this revision, the Board does not intend to encourage or discourage contractors to consolidate or restructure their operations. Rather, the Board's intent, in accordance with its stated objectives, in promulgating this revision, is to increase the degree of uniformity and consistency in like circumstances in the cost accounting practices that are used by Government contractors to record tangible capital asset values subsequent to mergers or business combinations. The Board believes that this action will result in cost allocations that are fair and equitable.

*Comment:* Several commenters offered editorial comments to the proposed revisions.

*Response:* All of these comments were considered and, as a result, the essence of several of these comments were incorporated in the final rule.

#### List of Subjects in 48 CFR Part 9904

Cost accounting standards,  
Government procurement.

Richard C. Loeb,

*Executive Secretary, Cost Accounting Standards Board.*

For the reasons set forth in this preamble, chapter 99 of title 48 of the Code of Federal Regulations is amended as set forth below:

1. The authority citation for part 9904 continues to read as follows:

Authority: Public Law 100-679, 102 Stat. 4056, 41 U.S.C. 422.

#### **PART 9904—COST ACCOUNTING STANDARDS**

##### **9904.404 Capitalization of tangible assets.**

2. Section 9904.404-40 is amended by revising paragraph (b)(1) to read as follows:

##### **9904.404-40 Fundamental requirement.**

\* \* \* \* \*

(b) \* \* \*

(1) The contractor's policy shall designate a minimum service life criterion, which shall not exceed 2 years, but which may be a shorter

period. The policy shall also designate a minimum acquisition cost criterion which shall not exceed \$5,000, but which may be a smaller amount.

\* \* \* \* \*

3. Section 9904.404-50 is amended by revising paragraph (d) to read as follows:

**9904.404-50 Techniques for application.**

\* \* \* \* \*

(d) The capitalized values of tangible capital assets acquired in a business combination, accounted for under the "purchase method" of accounting, shall be assigned to these assets as follows:

(1) All the tangible capital assets of the acquired company that during the most recent cost accounting period prior to a business combination generated either depreciation expense or cost of money charges that were allocated to Federal government contracts or subcontracts negotiated on the basis of cost, shall be capitalized by the buyer at the net book value(s) of the asset(s) as reported by the seller at the time of the transaction.

(2) All the tangible capital asset(s) of the acquired company that during the most recent cost accounting period prior to a business combination did not generate either depreciation expense or cost of money charges that were allocated to Federal government

contracts or subcontracts negotiated on the basis of cost, shall be assigned a portion of the cost of the acquired company not to exceed their fair value(s) at the date of acquisition. When the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess.

\* \* \* \* \*

4. Section 9904.404-63 is revised to read as follows:

**9904.404-63 Effective date.**

(a) This Standard is effective April 15, 1996.

(b) This Standard shall be applied beginning with the contractor's next full cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow Standard 9904.404 in effect prior to April 15, 1996, until this Standard, effective April 15, 1996, becomes applicable after the receipt of a contract or subcontract to which this revised Standard applies.

5. Section 9904.409-50 is amended by adding a new paragraph (j)(5) to read as follows:

**9904.409-50 Techniques for application.**

\* \* \* \* \*

(j) \* \* \*

(5) The provisions of this subsection 9904.409-50(j) do not apply to business combinations. The carrying values of tangible capital assets acquired subsequent to a business combination shall be established in accordance with the provisions of subsection 9904.404-50(d).

\* \* \* \* \*

6. Section 9904.409-63 is revised to read as follows:

**9904.409-63 Effective date.**

(a) This Standard is effective April 15, 1996.

(b) This Standard shall be applied beginning with the contractor's next full cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow Standard 9904.409 in effect prior to April 15, 1996, until this Standard, effective April 15, 1996, becomes applicable after the receipt of a contract or subcontract to which this revised Standard applies.

[FR Doc. 96-3061 Filed 2-12-96; 8:45 am]

BILLING CODE 3110-01-P