

**DEPARTMENT OF DEFENSE****GENERAL SERVICES  
ADMINISTRATION****NATIONAL AERONAUTICS AND  
SPACE ADMINISTRATION****48 CFR Parts 15 and 31**

[FAR Case 2002-008]

RIN 9000-AJ69

**Federal Acquisition Regulation; Gains  
and Losses, Maintenance and Repair  
Costs, and Material Costs**

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

**ACTION:** Proposed rule.

**SUMMARY:** The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) are proposing to amend the Federal Acquisition Regulation (FAR) by deleting the cost principle regarding maintenance and repair costs, revising the cost principles regarding gains and losses on disposition or impairment of depreciable property or other capital assets, and by revising the language concerning material costs.

**DATES:** Interested parties should submit comments in writing on or before September 5, 2003 to be considered in the formulation of a final rule.

**ADDRESSES:** Submit written comments to—General Services Administration, FAR Secretariat (MVA), 1800 F Street, NW., Room 4035, ATTN: Laurie Duarte, Washington, DC 20405.

Submit electronic comments via the Internet to—[farcase.2002-008@gsa.gov](mailto:farcase.2002-008@gsa.gov).

Please submit comments only and cite FAR case 2002-008 in all correspondence related to this case.

**FOR FURTHER INFORMATION CONTACT:** The FAR Secretariat, Room 4035, GS Building, Washington, DC, 20405, at (202) 501-4755 for information pertaining to status or publication schedules. For clarification of content, contact Edward Loeb, Procurement Analyst, at (202) 501-0650. Please cite FAR case 2002-008.

**SUPPLEMENTARY INFORMATION:****A. Background**

The DoD Director of Defense Procurement established a special interagency Ad Hoc Committee to perform a comprehensive review of policies and procedures in FAR Part 31, Contract Cost Principles and Procedures, relating to cost measurement, assignment, and

allocation. The Director announced a series of public meetings in the **Federal Register** notice at 66 FR 13712, March 7, 2001, (with a “correction to notice” published in the **Federal Register** at 66 FR 16186, March 23, 2001). Attendees at the public meetings (held on April 19, 2001, May 10–11, 2001, and June 12, 2001) included representatives from industry, Government, and other interested parties who provided views on potential areas for revision in FAR Part 31. The Ad Hoc Committee reviewed the cost principles and procedures and the public comments; identified potential changes to the FAR; and submitted several reports, including draft proposed rules for consideration by the Councils.

The Councils reviewed the reports related to FAR 31.205-16, Gains and losses on disposition or impairment of depreciable property or other capital assets, FAR 31.205-24, Maintenance and repair costs, and FAR 31.205-26, Material costs, and proposed the following revisions:

1. *FAR 31.205-16.* Add a new paragraph (b) that addresses the method and timing for determining the gain and loss associated with a sale and leaseback arrangement. The Councils believe that (a) a contractor should not benefit or be penalized for entering into a sale and leaseback arrangement; (b) the Government should reimburse the contractor the same amount for the subject asset as if the contractor had retained title; and (c) the Government would be precluded from recovering the financing costs that were imbedded in the sales price should the gain be recognized at the date of the sale and leaseback arrangement. For these reasons, the Councils are recommending that the gain or loss be determined at the end of the lease term or when the contractor no longer occupies the property (whichever date is later), rather than the date of the sale and leaseback arrangement. Implementation of adequate agency guidance and tracking controls (e.g., maintenance of permanent files on contractors by auditors) should assure that the Government properly computes its share of the gain or loss at the date of disposition.

The Councils do not believe the impairment language currently in paragraph (f) of the cost principle should be revised because 48 CFR 9904.404—Capitalization of Tangible Assets, and 48 CFR 9904.409—Cost Accounting Standard—Depreciation of Tangible Capital Assets, do not address the issue of asset impairments.

2. *FAR 31.205-24.* Delete this cost principle which addresses the

assignment of maintenance and repair costs to cost accounting periods. The Councils believe that 48 CFR 9904—Cost Accounting Standards adequately addresses these costs for contracts subject to full CAS coverage. For business units with no contracts subject to full CAS coverage, Generally Accepted Accounting Principles (GAAP) would apply to all of the contracts in the business unit subject to FAR Part 31. GAAP, which include criteria for determining whether a cost should be expensed or capitalized, adequately address this issue. For business units that have contracts subject to full CAS coverage and contracts that are not, the contractor would be required to apply a method that was consistent with GAAP for the contracts that are not subject to full CAS coverage (this method could be the same as the method used by the business unit for contracts subject to full CAS coverage).

3. *FAR 31.205-26.* Delete the current paragraph (c) and the last sentence of the current paragraph (d). Paragraph (c) requires that adjustments for differences in physical and book inventories relate to the period of contract performance. The Councils recommend deleting this provision, and, thereby, relying upon GAAP.

The Councils also recommend deleting the last sentence of the current paragraph (d). This sentence provides specific methods for estimating material costs. Since FAR 31 focuses on criteria regarding the allowability of costs rather than the methods used to estimate costs, this sentence has been deleted.

4. Make related editorial changes.

This is not a significant regulatory action and, therefore, was not subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

**B. Regulatory Flexibility Act**

The Councils do not expect this proposed rule 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 use simplified acquisition procedures or are awarded on a competitive, fixed-price basis, and do not require application of the cost principles discussed in this rule. An Initial Regulatory Flexibility Analysis has, therefore, not been performed. We invite comments from small businesses and other interested parties. The Councils will consider comments from small entities

concerning the affected FAR Parts 15 and 31 in accordance with 5 U.S.C. 610. Interested parties must submit such comments separately and should cite 5 U.S.C. 601, *et seq.* (FAR case 2002-008), in correspondence.

### C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the proposed changes to the FAR do not impose information collection requirements that require the approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.*

### List of Subjects in 48 CFR Parts 15 and 31

Government procurement.

Dated: June 26, 2003.

Laura G. Smith,

Director, Acquisition Policy Division.

Therefore, DoD, GSA, and NASA propose amending 48 CFR parts 15 and 32 as set forth below:

1. The authority citation for 48 CFR parts 15 and 31 is revised to read as follows:

**Authority:** 40 U.S.C. 121(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

### PART 15—CONTRACTING BY NEGOTIATION

#### 15.208 [Amended]

2. In section 15.408, amend Table 15-2, which follows paragraph (m)(4), by removing from paragraph A.(1) of Item II, Cost Elements, "31.205-26(e)" and adding "31.205-26(c)" in its place.

### PART 31—CONTRACT COST PRINCIPLES AND PROCEDURES

3. In section 31.205-7, revise the last sentence in paragraph (c)(2) to read as follows:

#### 31.205-7 Contingencies.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \* (See, for example, 31.205-6(g) and 31.205-19).

\* \* \* \* \*

#### 31.205-11 [Amended]

4. Amend section 31.205-11 in paragraph (k) by removing "31.205-26(e)" and adding "31.205-26(c)" in its place.

5. Amend section 31.205-16 as follows:

- a. Revise paragraph (a);
- b. Redesignate paragraphs (b) through (g) as (c) through (h), respectively;
- c. Add a new paragraph (b);
- d. Revise the newly designated paragraphs (c), (d)(1), (e), and (f);
- e. Amend the newly designated paragraph (d)(2)(ii) by removing

"subparagraph (c)(1)" and adding "paragraph (d)(1)" in its place;

f. Amend the newly designated paragraph (g) by removing "shall be" and adding "is" in its place; and

g. Amend the first sentence of the newly designated paragraph (h) by removing "shall be" and adding "is" in its place. The added and revised text reads as follows:

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

(a) The Government and the contractor shall include gains and losses from the sale, retirement, or other disposition (but see 31-205.19) of depreciable property 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 (e) of this subsection). However, no gain or loss is recognized as a result of the transfer of assets in a business combination (*see* 31.205-52).

(b) Notwithstanding the provisions in paragraph (c) of this subsection, when costs of depreciable property are subject to the sale and leaseback limitations in 31.205-11(m)(1) or 31.205-36(b)(2)—

(1) The gain or loss is the difference between the fair market value on the disposition date and the adjusted asset value at the time of disposition (as defined in paragraph (b)(3) of this subsection);

(2) The disposition date is the later of—

(i) The latest ending date of the lease term, including any extensions and renewals; or

(ii) The date the contractor vacates the property; and

(3) The adjusted asset value at the time of disposition is the contractor's original asset cost less the sum of—

(i) The allowable depreciation costs for the period prior to the date of the sale and leaseback; and

(ii) The depreciation costs that would have been allowed had the contractor retained title to the property from the date of the sale and leaseback until the disposition date.

(c) The Government and the contractor consider gains and losses on disposition of tangible capital assets including those acquired under capital leases (*see* 31.205-11(m)) 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 Government and the contractor shall limit the gain

recognized for contract costing purposes 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* paragraph (d)(2)(i) or (ii) of this subsection).

(d) \* \* \*

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

\* \* \* \* \*

(e) The Government and the contractor shall not recognize gains or losses on the disposition of depreciable property as a separate charge or credit when the contractor—

(1) Processes the gains and losses through the depreciation reserve account and reflects them in the depreciation allowable under 31.205-11; or

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

(f) The Government and the contractor shall consider gains and losses arising from mass or extraordinary sales, retirements, or other disposition other than through business combinations on a case-by-case basis.

\* \* \* \* \*

#### 31.205-24 [Removed & Reserved]

6. Remove and reserve section 31.205-24.

7. Revise section 31.205-26 to read as follows:

#### 31.205-26 Material costs.

(a) Material costs include the costs of such items as raw materials, parts, subassemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and intransit insurance. In computing material costs, the contractor shall consider reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work).

(b) The contractor shall—

(1) Adjust the costs of material for income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts,

and credits for scrap, salvage, and material returned to vendors; and

(2) Credit such income and other credits either directly to the cost of the material or allocate such income and other credits as a credit to indirect costs. When the contractor can demonstrate that failure to take cash discounts was reasonable, the contractor does not need to credit lost discounts.

(c) When materials are purchased specifically for and are identifiable solely with performance under a contract, the actual purchase cost of those materials should be charged to the contract. If material is issued from stores, any generally recognized method of pricing such material is acceptable if

that method is consistently applied and the results are equitable.

(d) Allowance for all materials, supplies and services that are sold or transferred between any divisions, subdivisions, subsidiaries or affiliates of the contractor under a common control shall be on the basis of cost incurred in accordance with this subpart. However, allowance may be at price when—

(1) It is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary or affiliate of the contractor under a common control; and

(2) The item being transferred qualifies for an exception under 15.403–

1(b) and the contracting officer has not determined the price to be unreasonable.

(e) When a commercial item under paragraph (c) of this subsection is transferred at a price based on a catalog or market price, the contractor—

(1) Should adjust the price to reflect the quantities being acquired; and

(2) May adjust the price to reflect the actual cost of any modifications necessary because of contract requirements.

**31.205–44 [Amended]**

8. Amend section 31.205–44 in paragraph (f) by removing “31.205–24”.

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