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DEPARTMENT OF DEFENSE

GENERAL SERVICES ADMINISTRATION

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

48 CFR Parts 31 and 52

[FAC 2005–04; FAR Case 2001–031; Item VII]

RIN 9000–AJ67

Federal Acquisition Regulation; Deferred Compensation and Postretirement Benefits Other Than Pensions

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

ACTION: Final rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) have agreed on a final rule amending the Federal Acquisition Regulation (FAR) by revising the cost principles for Deferred compensation other than pensions, and Postretirement benefits other than pensions. The related contract clause, Reversion or Adjustment of Plans for Postretirement Benefits (PRB) Other Than Pensions, is also revised. The rule revises the cost principle and contract clause by improving clarity and structure, and removing unnecessary and duplicative language. The revisions are intended to revise contract cost principles and procedures, in light of the evolution of Generally Accepted Accounting Principles (GAAP), the advent of Acquisition Reform, and experience gained from implementation of the cost principles in the FAR.

DATES: *Effective Date*: July 8, 2005.

FOR FURTHER INFORMATION CONTACT The FAR Secretariat at (202) 501–4755 for information pertaining to status or publication schedules. For clarification of content, contact Mr. Jeremy Olson, Procurement Analyst, at (202) 501–3221. Please cite FAC 2005–04, FAR case 2001–031.

SUPPLEMENTARY INFORMATION:

A. Background

DoD, GSA, and NASA published a proposed rule in the **Federal Register** at 68 FR 33326, June 3, 2003, with request for public comments. Four respondents submitted comments; a discussion of the comments is provided below. The Councils considered all comments and concluded that the proposed rule should be converted to a final rule, with changes to the proposed rule. Differences between the proposed rule and final rule are discussed in Section B, Comments 2, 5, 6, and Changes for Clarity, below.

B. Public Comments

Deferred compensation—Subsequent period awards

1. *Comment*: Revise proposed FAR 31.205–6(k)(2). One respondent commented that the word ''made'' could be misconstrued to mean ''paid'' versus when the award program is instituted. The sentence should be changed to read: ''Deferred compensation awards are unallowable if the award program is instituted in a period subsequent to the accounting period when the work being remunerated was performed.''

Councils' response: Nonconcur. The Councils believe that the proposed language (which is the same as the current language in the last sentence of paragraph (k)(1) and has been unchanged for many years) is clear. By definition, deferred compensation is an award ''made'' to compensate an employee in a future period, *i.e.*, the award is ''paid'' in the future. Therefore, the Councils do not believe it is likely that the word ''made'' will be misconstrued as ''paid.'' In addition, the respondent has provided no evidence that this language is being misinterpreted.

Furthermore, the respondent's proposed language would change the meaning of the provision and create an inappropriate result. Under that proposed language, the contractor could ''institute'' an award program in 1999, and award an employee in 2003 for work performed during 2000. The purpose of the FAR provision is to preclude such retroactive awards; the respondent's proposed revision would thwart this purpose.

Delayed recognition methodology for recognizing PRB past service costs

2. *Comment*: Revise proposed FAR 31.205–6(o)(2)(iii)(A). The respondent believes that the second sentence of the provision could be misinterpreted to mean that the entire amount of PRB costs attributable to the past service (transition obligation) is unallowable, not just the portion of the PRB costs in excess of the amount assignable under the delayed recognition methodology. The provision should be revised to read as follows:

''However, the portion of PRB costs attributable to past service (''transition obligation'') as defined in Financial Accounting Standards Board Statement 106, paragraph 110, that is in excess of the amount assignable under the delayed recognition methodology described in paragraphs 112 and 113 of Statement 106 is unallowable.''

Councils' response: Concur. The Councils agree that the language was intended to disallow only the excess amount, not the total amount. The Councils also agree that the respondent's proposed language, with some additional wording, is appropriate. Therefore, the Councils have revised the language to read as follows:

''However, the portion of PRB costs attributable to the transition obligation assigned to the current year that is in excess of the amount assignable under the delayed recognition methodology described in paragraphs 112 and 113 of Financial Accounting Standards Board Statement 106 is unallowable. The transition obligation is defined in Statement 106, paragraph 110.''

Refund of Government share of PRB costs which revert or inure to the contractor

3. *Comment*: Revise proposed FAR 31.205–6(o)(3). One respondent was concerned that, under the proposed language, the Government may be entitled to an equitable share of previously funded PRB costs when benefits are reduced but total costs are not. In the present environment, contractors may be required to reduce benefits to simply keep retiree health costs from increasing at an unsustainable level. The provision does not define what is meant by ''any amount of previously funded PRB costs which revert or inure to the contractor.'' The respondent recommends that the provision explicitly state that the Government is entitled to an equitable share of previously funded costs only when the costs are ultimately reduced.

Councils' response: Nonconcur. The Councils believe the respondent is misapplying the provision. Neither a reduction in PRB costs nor a reduction in PRB benefits alone entitles the Government to an equitable share of previously funded PRB costs under proposed FAR 31.205–6(o)(3) (FAR 31.205–6(o)(5) of the final rule) or FAR 52.215–18. The Government is entitled to an equitable share when previously funded PRB costs revert or inure to the contractor, for whatever reason. ''Inure'' is defined in Webster's College Dictionary as ''to come into use or operation,'' while ''revert'' means ''to return or go back.'' Thus, this language applies whenever assets return or go back to the contractor, or come into use

or operation (*i.e.*, are constructively received) by the contractor.

4. *Comment*: Revise proposed FAR 31.205–6(o)(3). Two respondents asserted that the provision is one-sided by entitling the Government to share in any proceeds resulting from over funding but shielding the Government from liability in the event of under funding. The respondents recommend that the provision require the Government to receive a pro-rata share of the unfunded liability that exists at the time of a segment closing, plan termination, or curtailment of benefits. In addition, the rule should be amended so that PRB plan closing adjustments operate the same way as pension plan closing adjustments.

Councils' response: Nonconcur. The assertion that the provision is one-sided is based on the assumption that this provision applies whenever the PRB plan is over funded. The provision at FAR 31.205–6(o)(3) of the proposed rule (FAR 31.205–6(o)(5) of the final rule) does not apply simply because a PRB plan is over funded. The provision applies only when the assets revert, inure, or are constructively received by the contractor.

The Councils do not believe that FAR 31.205–6(o)(3) should be revised to provide a segment closing adjustment for PRB costs. Unlike pension benefits, contractors generally reserve the right to reduce or eliminate PRB benefits. Therefore, the Councils do not believe an adjustment similar to the pension segment closing adjustment is appropriate for PRBs.

5. *Comment*: Revise proposed FAR 31.205–6(o)(3). Four respondents believe that the last sentence of the provision (that specifies the contractor shall credit the Government's share of previously funded PRB costs to the Government, either as a cost reduction or by cash refund, at the option of the Government) is inequitable and should be eliminated because it ignores the interest of the contractor, it is both unnecessary and undesirable, and it is unduly prescriptive. In addition, the respondents believe that explicitly dictating the required alternative methods of adjustment reduces the flexibility to negotiate an equitable adjustment that considers the unique facts relating to a particular situation. The provision should be revised to read as follows:

''When determining or agreeing on the method for treating the equitable share, the contracting parties should consider the following methods: cost reduction, amortizing the cost over a number of years, cash refund or some other agreed upon method.''

Councils' response: Partially concur. The Councils agree with the concept that the parties should attempt to negotiate the method of recovery for the Government's equitable share of PRB funds that inure or revert to the contractor. However, the rule must also address those instances where the parties fail to reach a settlement. While the contractor and the Government should attempt to negotiate a settlement, if the parties disagree, the Contracting Officer must designate the method for recovery of the equitable share. Therefore, to address this concern, the Councils deleted the last sentence of proposed 31.205–6(o)(3) and added the following language to the related contract clause at 52.215–18(b):

When determining or agreeing on the method for recovery of the Government's equitable share, the contracting parties should consider the following methods: cost reduction, amortizing the credit over a number of years (with appropriate interest), cash refund, or some other agreed upon method. Should the parties be unable to agree on the method for recovery of the Government's equitable share, through good faith negotiations, the Contracting Officer shall designate the method of recovery.

Reduced benefits for a PRB plan

6. *Comment*: Revise proposed FAR 52.215–18. One respondent asserted that the language in the first sentence of the contract clause, regarding what is meant by ''reduced benefits'' in a PRB plan, is ambiguous. A contractor might reduce benefits but, because of increased costs in other areas, the allocable costs of the PRB plan might stay steady or even increase. The respondent also believes that the language should focus on allocable costs and not on the level of benefits in the plan.

Councils' response: Partially concur. The Councils agree that the phrase ''reduce a PRB plan'' is ambiguous and has revised it to read ''reduce the benefits of a PRB plan.''

The Councils do not agree that the language should be revised to focus on allocable costs. The language requires the contractor to notify the contracting officer when there is a PRB termination or a reduction in benefits under the PRB plan. The purpose of this provision is to assure that the Government is promptly notified so that timely adjustments can be made for purposes of contract negotiations (forward pricing rate adjustments) and billing (billing rate adjustments). The purpose is also to assure that the Government receives its equitable share of any previously funded PRB costs which inure or revert to the contractor as a result of a plan termination or reduction in benefits, or for any other reason. In those cases where there is a reduction in benefits but it does not affect the amount of PRB costs allocable to Government contracts, no adjustments would be made to the forward pricing or billing rates. If no funds inure or revert to the contractor as a result of the reduction in benefits, there would also be no refund or credit due the Government under the provision. However, the contractor must still notify the Contracting Officer so that the Government has an opportunity to review any assertion that the reduction in benefits does not impact allocable costs or result in a refund or credit due the Government.

Changes for Clarity

For purposes of enhancing clarity and structure, the Councils have revised the language at FAR 31.205–6(o)(2) and (3). In addition, upon further review, the Councils have determined that the language at FAR 31.205–6(o)(3) applies to all of (o)(2), and not just (o)(2)(iii). Therefore, the language that was moved to FAR 31.205–6(o)(2)(iii)(D) in the proposed rule, has been moved back to FAR 31.205–6(o)(3) in the final rule.

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 Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration certify that this final rule will not 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 principle discussed in this rule.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the 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 31 and 52

Government procurement.

Dated: May 27, 2005.

Julia B. Wise,

Director, Contract Policy Division.

■ Therefore, DoD, GSA, and NASA amend 48 CFR parts 31 and 52 as set forth below:

■ 1. The authority citation for 48 CFR parts 31 and 52 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 31—CONTRACT COST PRINCIPLES AND PROCEDURES

■ 2. Amend section 31.205–6 by revising paragraphs (k), (o)(2), (o)(3), and (o)(5) to read as follows:

31.205–6 Compensation for personal services.

* * * * *

(k) *Deferred compensation other than pensions.* The costs of deferred compensation awards are allowable subject to the following limitations:

(1) The costs shall be measured, assigned, and allocated in accordance with 48 CFR 9904.415, Accounting for the Cost of Deferred Compensation.

(2) The costs of deferred compensation awards are unallowable if the awards are made in periods subsequent to the period when the work being remunerated was performed.

* * * * *

(o) *Postretirement benefits other than pensions (PRB).*

* * * * *

(2) To be allowable, PRB costs shall be incurred pursuant to law, employer-employee agreement, or an established policy of the contractor, and shall comply with paragraphs (o)(2)(i), (ii), or (iii) of this subsection.

(i) *Pay-as-you-go.* PRB costs are not accrued during the working lives of employees. Costs are assigned to the period in which—

(A) Benefits are actually provided; or

(B) The costs are paid to an insurer, provider, or other recipient for current year benefits or premiums.

(ii) *Terminal funding.* PRB costs are not accrued during the working lives of the employees.

(A) Terminal funding occurs when the entire PRB liability is paid in a lump sum upon the termination of employees (or upon conversion to such a terminal-funded plan) to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees.

(B) Terminal funded costs shall be amortized over a period of 15 years.

(iii) *Accrual basis.* PRB costs are accrued during the working lives of employees. Accrued PRB costs shall be—

(A) Measured and assigned in accordance with generally accepted accounting principles. However, the portion of PRB costs attributable to the transition obligation assigned to the current year that is in excess of the amount assignable under the delayed recognition methodology described in paragraphs 112 and 113 of Financial Accounting Standards Board Statement 106 is unallowable. The transition obligation is defined in Statement 106, paragraph 110;

(B) Paid to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees; and

(C) Calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

(3) To be allowable, PRB costs must be funded by the time set for filing the Federal income tax return or any extension thereof, or paid to an insurer, provider, or other recipient by the time set for filing the Federal income tax return or extension thereof. PRB costs assigned to the current year, but not funded, paid or otherwise liquidated by the tax return due date as extended are not allowable in any subsequent year.

* * * * *

(5) The Government shall receive an equitable share of any amount of previously funded PRB costs which revert or inure to the contractor. Such equitable share shall reflect the Government's previous participation in PRB costs through those contracts for which cost or pricing data were required or which were subject to Subpart 31.2.

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PART 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

■ 3. Revise section 52.215–18 to read as follows:

52.215–18 Reversion or Adjustment of Plans for Postretirement Benefits (PRB) Other Than Pensions.

As prescribed in 15.408(j), insert the following clause:

REVERSION OR ADJUSTMENT OF PLANS FOR POSTRETIREMENT BENEFITS (PRB) OTHER THAN PENSIONS (JUL 2005)

(a) The Contractor shall promptly notify the Contracting Officer in writing when the Contractor determines that it will terminate or reduce the benefits of a PRB plan.

(b) If PRB fund assets revert or inure to the Contractor, or are constructively received by it under a plan termination or otherwise, the Contractor shall make a refund or give a credit to the Government for its equitable share as required by 31.205–6(o)(5) of the Federal Acquisition Regulation (FAR). When determining or agreeing on the method for recovery of the Government's equitable share, the contracting parties should consider the following methods: cost reduction, amortizing the credit over a number of years (with appropriate interest), cash refund, or some other agreed upon method. Should the parties be unable to agree on the method for recovery of the Government's equitable share, through good faith negotiations, the Contracting Officer shall designate the method of recovery.

(c) The Contractor shall insert the substance of this clause in all subcontracts that meet the applicability requirements of FAR 15.408(j).

(End of clause)

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DEPARTMENT OF DEFENSE

GENERAL SERVICES ADMINISTRATION

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

48 CFR Part 31

[FAC 2005–04; FAR Case 2004–005; Item VIII]

RIN 9000–AJ93

Federal Acquisition Regulation; Gains and Losses

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

ACTION: Final rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) have agreed on a final rule amending the Federal Acquisition Regulation (FAR) by revising the contract cost principles for Gains and losses on disposition or impairment of depreciable property or other capital assets, Depreciation costs, and Rental costs. The final rule adds language to specifically address the gain or loss recognition of sale and leaseback transactions to be consistent with the date at which a contractor begins to incur an obligation for lease or rental costs. A date for recognition of gain or loss associated with sale and leaseback transactions was previously undefined within the cost principles. In addition, revised language is also added to recognize that an adjustment to the lease/rental cost limitations are required to ensure that the total costs associated with the use of the subject assets do not exceed the constructive costs of ownership.