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 proposal is step three 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 suggested agenda topics in November 1990. Subsequently two Staff Discussion Papers (SDPs) were issued.

The first, 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 to the SDP, an Advance Notice of Proposed Rulemaking (ANPRM) was developed and published in the **Federal Register** on August 24, 1994 (59 FR 26774). The responses to the ANPRM were of significant assistance to the Board in developing this NPRM.

Public Comments

Fourteen sets of public comments were received from government contractors, professional and industrial associations, Federal agencies, and accounting and consulting firms.

All three Government commenters supported the basic approach and format incorporated in the ANPRM. All the other commenters, with one exception, were clearly opposed to the basic approach adopted in the ANPRM., i.e., the no step-up, no step-down approach. One industry commenter, although critical of the ANPRM, did not reject its basic approach out of hand and reserved his most critical comments to the current FAR provision that, in effect, sanctions the use of "historical cost or fair value, whichever is lower" principle in cases of mergers or business combinations.

Irrespective of their support or opposition to the basic approach incorporated in the ANPRM, a number of commenters offered additional, detailed comments on the various specific provisions of the document. Some of these comments were clearly editorial while others were more substantive in nature.

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 ANPRM, 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 this NPRM, 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 NPRM 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 further reductions in the defense budget can be expected to lead to additional mergers and business combinations among defense contractors. 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 current subsection 9904.404–50(d) is deleted and is replaced by an amended section that prescribes:

(1) That for Federal contract costing purposes tangible capital assets following a business combination shall retain their net book value recognized prior to the business combination provided that the assets had previously generated costs that were charged either as direct or indirect costs to Federal government contracts subject to CAS.

(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 prior to the business combination did not generate costs that were charged either as direct or indirect costs to Federal contracts subject to CAS.

b. 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 proposal, and any associated rulemaking, because this proposal would impose 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 proposal on contractors and subcontractors is expected to be minor. As a result, the Board has determined that this ANPRM 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 proposal will not have a significant effect on a substantial number of small entities because small businesses are exempt