

from the application of the Cost Accounting Standards. Therefore, this proposed rule does not require a regulatory flexibility analysis under the Regulatory Flexibility Act of 1980.

E. Public Comments

This NPRM was developed after consideration of the public comments received in response to the Board's ANPRM published on May 24, 1994 (59 FR 26774). 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: Most non-Government commenters disagreed with the Board's proposed "no step-up, no step-down" approach. They opposed the exception from generally accepted accounting principles (GAAP) and expressed the opinion that the proposed approach does not represent sound accounting. They also pointed out that the proposed approach would lead to inconsistencies in the accounting practices applied in cases of CAS-covered contracts as contrasted with non-CAS-covered contracts. In general, the alternative approaches suggested involved either continuation of the "status quo", combined with proposals to rescind FAR 31.205-52, or suggestions to explore ways to insure that the government participates, when appropriate, in gains and losses recognized from assets involved in mergers or business combinations.

Response: 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 this SDP that the Board decided to proceed with the "no step-up, no step-down" approach.

The Board cannot agree with the suggestions that the status quo should be, in essence, maintained. The issues addressed in this proposal were first identified as significant issues by commenters in responses to the Board's request for suggested agenda topics in November 1990. Furthermore, the FAR 31.205-52 provisions, which are part of the current regulatory environment in this area, have been generally recognized as leading to inequitable

consequences from the perspective of contractors. One commenter stated: "* * * the FAR provision not only suffers from implementation and transition problems, but as written is patently unfair by using historical costs when the purchase method indicates increased asset values and using the purchase cost when it is lower than the historical values. This allows the government to choose the method of accounting which is most cost beneficial to it." Given these circumstances, the Board cannot agree that "no action" is the proper course to follow in this instance.

Comment: Several commenters discussed the need to solve the apparent conflict between the CAS allocability provisions and the Federal Acquisition Regulation (FAR) allowability provisions in this area. In particular, it was suggested the OFPP Administrator address any continuing conflict between the Cost Accounting Standards and FAR 31.205-52 pursuant to the authority conferred on the Administrator by 41 U.S.C. 422(j)(3).

Response: The Board is aware of the apparent conflict between the provisions of CAS 9904.404 and FAR 31.205-52. Once the proposed amendment to CAS has been promulgated, the OFPP Administrator will determine whether any changes may be necessary in the FAR cost principles to make them fully compatible with the amended CAS 9904.404 and 9904.409.

Comment: Several commenters stated that the proposed amendment is unfair to contractors as it would prevent them from recouping their investments through future contract prices. In particular, the contrast was drawn between the acquisition of individual assets through purchase and the acquisition of assets as part of a business combination. In one case, the GAAP rules regarding acquisition cost would be followed, whereas in the other, the new CAS rule would mandate adherence to historical cost.

Response: It is the intent of the Board to apply the proposed amendments to CAS 9904.404 and 9904.409 on a prospective basis only. Therefore, any assets acquired in business combinations that have been concluded prior to the promulgation of these amendments will not be affected by the proposed changes in CAS. As to business combination taking place after the promulgation of the amendments, it is assumed that the parties involved will take into account, while negotiating the merger agreement, that any future depreciation chargeable to Government contracts and corresponding cash flow

projections, will be based on the historical costs of the tangible capital assets being transferred in the course of the merger.

As to the treatment of purchased assets in contrast to assets acquired through a business combination, it should be pointed out that in cases of individual tangible capital assets acquired from a CAS-covered contractor, any gain or loss from such a sale would be subject to recapture by the Government in accordance with the provisions of CAS 9904.409-50(j). It is precisely because the Board concluded that such a recapture would be impractical in cases of business combinations that it decided to proceed with the "no step-up, no step-down" approach in the proposed amendments.

Comment: One commenter argued that any Government claim to a share in a gain resulting from changes in asset values due to price level changes cannot be justified on the basis of payment of cost of money as a government contract cost. The commenter argued that cost of money was introduced as an offset to profit and therefore should not have an impact on cost measurement.

Response: At the time the CASB separately recognized cost of money in CAS 9904.414 as an imputed contract cost, it clearly acknowledged that prior to the promulgation of that Standard, this cost element had been a "consideration in determining contract profit compensation." However, this acknowledgement did not imply that the Board regarded cost of money as being part of, or having the characteristics of profit. It clearly recognized pre-CAS 9904.414 cost of money as an element of cost that implicitly was recognized as part of profit. CAS 9904.414 merely turned an implicitly recognized cost into an explicitly recognized cost.

Comment: Several commenters suggested that some type of materiality or significance criterion should be introduced to deal with those instances where the acquired entity has allocated only immaterial amounts of assets costs to CAS-covered contracts prior to the business combination or where such allocations were not made during the cost accounting period immediately preceding the business combination although they may have been made in the course of earlier periods.

Response: CAS 9904.404 and 9904.409 apply only in the case of full CAS coverage. Therefore, after the recent changes in the applicability criteria, the threshold for full CAS coverage has been increased to \$25 million in contract awards during a cost accounting period. It is hard to conceive