



# Federal Register

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**Thursday,  
January 30, 2003**

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**Part VI**

**Department of Defense  
General Services  
Administration**

**National Aeronautics and  
Space Administration**

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**48 CFR Parts 2 and 31  
Federal Acquisition Regulation;  
Depreciation Cost Principle; Proposed  
Rule**

**DEPARTMENT OF DEFENSE****GENERAL SERVICES  
ADMINISTRATION****NATIONAL AERONAUTICS AND  
SPACE ADMINISTRATION****48 CFR Parts 2 and 31****[FAR Case 2001–026]****RIN 9000–AJ56****Federal Acquisition Regulation;  
Depreciation Cost Principle**

**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) to revise the depreciation cost principle.

**DATES:** Interested parties should submit comments in writing on or before March 31, 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.2001-026@gsa.gov](mailto:farcase.2001-026@gsa.gov).

Please submit comments only and cite FAR case 2001–026 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 Mr. Ralph De Stefano at (202) 501–1758. Please cite FAR case 2001–026.

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

The Councils performed a comprehensive review of the cost principle at FAR 31.205–11, Depreciation, to evaluate the need for each specific requirement. As a result of the review, the Councils are proposing to revise the cost principle as follows:

1. *Definition of depreciation.* The language currently at FAR 31.205–11(a) is a definition for the term “depreciation.” Since the term is used throughout the FAR, the definition was moved to FAR 2.101, Definitions.

2. *Residual values.* The depreciation cost principle is more restrictive than

cost accounting standards (CAS) because it requires a contractor to use residual values in establishing depreciation costs, while the cost accounting standard for depreciation of tangible capital assets at 48 CFR 9904.409–50(h) allows contractors to ignore residual values under 10 percent for tangible personal property. The rule adds language at FAR 31.205–11(a) to make the policy on residual values consistent with CAS.

3. *Depreciation claimed for tax purposes.* Currently, FAR 31.205–11(e) limits allowable depreciation to the lesser of the depreciation used for Federal income tax purposes or for financial statements. This policy encourages contractors to use the same depreciation for both tax and financial reporting purposes. The Councils have eliminated all references to Federal income tax accounting since it is unnecessary to tie allowable depreciation to depreciation claimed for tax purposes, and to penalize contractors because they use an acceptable depreciation method for tax purposes that is different from that used for financial purposes.

4. *Write-down due to business combinations/impaired assets.* The Councils added “except as indicated in paragraphs (g) and (h) of this subsection” to FAR 31.205–11(c) of the proposed rule to eliminate any potential inequity caused among these paragraphs. In the proposed rule, the language currently in paragraphs FAR 31.205–11(n) and (o) are moved to new paragraphs (g) and (h) to specifically disallow the effect on depreciation when contractors are involved in the write-down of assets from carrying value to fair market value as a result of business combinations or impairments. In effect, these paragraphs require contractors to continue to use their depreciation schedules as if the business combination (paragraph (g)) or impaired asset write-down (paragraph (h)) never occurred. However, if there is an asset write-down due to either of these events, the depreciation calculated based on generally accepted accounting principles (GAAP) will be lower than the depreciation generated by the use of the contractor’s previous depreciation schedule. Without a stated exception to the general rule in the proposed paragraph (c) that allowable depreciation cannot exceed the amount calculated based on GAAP, one might misinterpret the cost principle and inappropriately disallow the depreciation in excess of GAAP when a write-down of an asset due to a business combination or impairment occurs.

5. *Emergency facilities.* The current paragraph at FAR 31.205–11(i) has been deleted since the Councils are not aware of any existing contracts supporting the operation of emergency facilities covered by certificates of necessity.

6. The rule makes other changes to clarify, improve the structure, and remove redundancies throughout the cost principle.

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 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 2001–026), 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 2 and 31**

Government procurement.

Dated: January 23, 2003.

**Al Matera,**

*Director, Acquisition Policy Division.*

Therefore, DoD, GSA, and NASA propose amending 48 CFR parts 2 and 31 as set forth below:

1. The authority citation for 48 CFR parts 2 and 31 continues to read as follows:

**Authority:** 40 U.S.C. 486(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

## PART 2—DEFINITIONS OF WORDS AND TERMS

2. Amend section 2.101 in paragraph (b) by adding, in alphabetical order, the definition “Depreciation” to read as follows:

### 2.101 Definitions.

\* \* \* \* \*

*Depreciation* means a charge to current operations that distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life refers to the prospective period of economic usefulness in a particular contractor’s operations as distinguished from physical life; it is evidenced by the actual or estimated retirement and replacement practice of the contractor.

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## PART 31—CONTRACT COST PRINCIPLES AND PROCEDURES

3. Revise section 31.205–11 to read as follows:

### 31.205–11 Depreciation.

(a) Depreciation on a contractor’s plant, equipment, and other capital facilities is an allowable contract cost, subject to the limitations contained in this cost principle. For tangible personal property, only estimated residual values that exceed 10 percent of the capitalized cost of the asset shall be used in establishing depreciable costs.

Depreciation cost that would reduce the book value of a tangible capital asset below its residual value is unallowable.

(b) Contractors having contracts subject to 48 CFR 9904.409, Depreciation of Tangible Capital Assets, shall adhere to the requirement of that standard for all fully CAS-covered contracts and may elect to adopt the standard for all other contracts. All requirements of 48 CFR 9904.409 are applicable if the election is made, and contractors shall continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts.

(c) For contracts to which 48 CFR 9904.409 is not applied: Except as indicated in paragraphs (g) and (h) of this subsection, allowable depreciation shall not exceed the amount used for financial accounting purposes and shall be determined in a manner consistent

with the depreciation policies and procedures followed in the same segment on non-Government business.

(d) Depreciation, rental, or use charges are unallowable on property acquired from the Government at no cost by the contractor or by any division, subsidiary, or affiliate of the contractor under common control.

(e) The depreciation on any item that meets the criteria for allowance at price under 31.205–26(e) may be based on that price, provided the same policies and procedures are used for costing all business of the using division, subsidiary, or organization under common control.

(f) No depreciation or rental is allowed on property fully depreciated by the contractor or by any division, subsidiary, or affiliate of the contractor under common control. However, a reasonable charge for using fully depreciated property may be agreed upon and allowed (but see 31.109(h)(2)). In determining the charge, the contractor shall consider cost, total estimated useful life at the time of negotiations, effect of any increased maintenance charges or decreased efficiency due to age, and the amount of depreciation previously charged to Government contracts or subcontracts.

(g) Whether or not the contract is otherwise subject to CAS, the contractor shall comply with the requirements of 31.205–52, which limit the allowability of depreciation.

(h) In the event of a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances, allowable depreciation of the impaired assets is limited to the amounts that would have been allowed had the assets not been written down (see 31.205–16(g)). However, this does not preclude a change in depreciation resulting from other causes such as permissible changes in estimates of service life, consumption of services, or residual value.

(i) A “capital lease” as defined in Statement of Financial Accounting Standard No. 13 (FAS–13), Accounting for Leases, is subject to the requirements of this cost principle. FAS–13 requires that capital leases be treated as purchased assets; *i.e.*, be capitalized, and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the leased life as amortization charges, as appropriate. Capital leases under FAS–

13 are subject to the requirements of 31.205–11. Operating leases are subject to the requirements of 31.205–36. The standards of financial accounting and reporting prescribed by FAS–13 are incorporated into this principle and govern its application, except as follows:

(1) Rental costs under a sale and leaseback arrangement are allowable up to the amount that would have been allowed had the contractor retained title to the asset.

(2) If it is determined that the terms of the capital lease have been significantly affected by the fact that the lessee and lessor are related, depreciation charges are not allowable in excess of those that would have occurred if the lease contained terms consistent with those found in a lease between unrelated parties.

(j) The undepreciated balance of assets acquired before the effective date of this cost principle need not be retroactively adjusted if the assets were properly depreciated on Government contracts at the time the depreciation was charged. However, the remaining undepreciated balance as of the effective date of this cost principle shall be depreciated using the same method as used for financial statement purposes.

### 31.205–16 [Amended]

4. Amend section 31.205–16 in the first sentence of paragraph (b) by removing “31.205–11(m)” and adding “31.205–11(i)” in its place.

5. Amend section 31.205–36 by revising paragraph (a); and removing paragraph (b)(4) to read as follows:

### 31.205–36 Rental costs.

(a) This subsection is applicable to the cost of renting or leasing real or personal property acquired under “operating leases” as defined in Statement of Financial Accounting Standards No. 13 (FAS–13), Accounting for Leases. Compliance with 31.205–11(i) requires that assets acquired by means of capital leases, as defined in FAS–13, be treated as purchased assets; *i.e.*, be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the lease term as amortization charges, as appropriate.

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[FR Doc. 03–1962 Filed 1–29–03; 8:45 am]

BILLING CODE 6820–EP–P