



JUL 22 2004

MEMORANDUM FOR RONALD POUSSARD
DIRECTOR
DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM: RODNEY P. LANTIER, DIRECTOR
REGULATORY AND FEDERAL ASSISTANCE
PUBLICATIONS DIVISION

SUBJECT: FAR Case 2004-005, Gains and Losses

Attached are comments received on the subject FAR case published at 69 FR 29380; May 21, 2004. The comment closing date was July 20, 2004.

<u>Response Number</u>	<u>Date Received</u>	<u>Comment Date</u>	<u>Commenter</u>
2004-005-1	07/19/04	07/19/04	Lockheed Martin Corp.
2004-005-2	07/20/04	07/20/04	AIA(NDIA)
2004-005-3	06/21/04	06/21/04	Anthony P DeStefano

Attachments

Lockheed Martin Corporation
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E-mail: tony.dipasquale@lmco.com

2004-005-1

Anthony M. DiPasquale
Vice President
Government Financial Management

July 19, 2004

General Services Administration
FAR Secretariat (MVA)
ATTN: Laurie Duarte
1800 F Street, NW, Room 4035
Washington, DC 20405

RE: FAR Case 2004-005

Dear Ms. Duarte:

Lockheed Martin Corporation (LMC) appreciates the opportunity to submit comments concerning proposed revisions to FAR 31.205-16, "Gains and losses on disposition or impairment of depreciable property or other capital assets."

General

LMC greatly appreciates the Council's revisions from the previous proposal. Specifically, modifying the disposition date to the earlier date of the transaction "arrangement" will provide consistency with GAAP and equity for both the Government and the contractor. This is a major improvement. However, we believe that there are four areas that provide further opportunities for clarity and/or equity improvements. Following are LMC's suggested revisions.

"Fair Market Value" vs "Net Amount Realized"

Paragraph (b)(1) uses the term "fair market value" whereas paragraph (c) uses the existing term "net amount realized" to define the gain or loss. LMC firmly believes that only the existing term ("net amount realized") be used whenever referring to the measurement of the gain or loss.

"Fair market value" is a problematic concept and is currently an element in a \$95 million ASBCA case between LMC and the Government. At various times, DCAA contends that fair market value is the higher of either property tax value, insurable value, replacement value, or the value to a hypothetical buyer who needs the exact asset that is for sale. This is in direct conflict with the standard definition of the net proceeds that result from an arms length transaction between a willing seller and willing buyer, neither of which is forced into the transaction.

Combining Sale and Leaseback Transactions

LMC interprets the combined reading of proposed 31.205-16(a), (b), (c), and (d) with 31.205-11(m)(1) and 31.205-36(b)(2) to mean that a contractor must provide both depreciation recapture and limit future lease charges to what would have been the continuing ownership costs. This unclear and contentious area has long been an inequitable proposition. For example, a contractor sells a building for the original value. This results in a full depreciation recapture and means that the Government received goods and services free of any building costs. However, if the leaseback exceeds the previous ownership costs, then the contractor is forced to provide future facilitization at less than cost. This is clearly inequitable compared to other contractors who receive full recovery of their facility costs.

LMC suggests that a sale and leaseback transaction be limited to an “either or” negotiation. Either apply the depreciation recapture at the time of sale, or limit the lease cost for the period of time necessary to liquidate an amount equal to the depreciation recapture. This would be equitable whether there is a gain or loss and regardless of the lease cost since a reasonableness test must also be met.

“The Government and the Contractor”

The phrase “the Government and the contractor” appears six times in the proposed rule. LMC suggests that this phrase be eliminated and that the previous language be retained. The new phrase implies that both parties perform such duties as accounting entries when in reality FAR provides requirements that must be met by the contractor and approved by the contracting officer.

“Disposition Date is the Date of the Sale and Leaseback Arrangement”

The above phrase as used in proposed paragraph (b)(2) could be made more precise. LMC suggests that the disposition date should be the “effective” date of the transaction. For example, “arrangement” could be the date a sale is agreed to, whereas the “effective” date is the date the deal closes escrow and title passes from seller to buyer. The later date is the precise, unambiguous date that should be used.

Summary

Again, LMC appreciates the opportunity to comment on the proposed rule and we express appreciation for the improvements made since the prior proposal. However, we believe that further changes can be made for clarity and equity reasons.

Our four suggestions are: (1) use “net amount realized” in lieu of “fair market value”; (2) require depreciation recapture or lease cost limits, but not both for a sale-leaseback transaction; (3) eliminate the phrase “the Government and the contractor” and return to the prior language; and (4) establish the date of the transaction as the “effective” date rather than the “arrangement” date.

Please do not hesitate to contact me for further discussions or to answer any questions.

Sincerely,

Anthony M. DiPasquale

2004-005-2

**AEROSPACE INDUSTRIES ASSOCIATION
NATIONAL DEFENSE INDUSTRIAL ASSOCIATION**

July 20, 2004

General Services Administration
FAR Secretariat (MVA)
Attn: Laurie Duarte
1800 F Street, NW, Room 4035
Washington, DC 20405

Re: FAR Case 2004-005

Dear Ms Duarte:

The Aerospace Industries Association (AIA) and the National Defense Industrial Association (NDIA) are pleased to have the opportunity to comment on the proposed revision to the FAR cost principle 31.205-16, Gains or Losses on Disposition or Impairment of Depreciable Property or Other Capital Assets. Our member companies support the effort to streamline and add clarity to the cost principles contained in FAR Part 31 and appreciate your proposals to achieve that end.

We applaud the Councils' decision to delete the previously proposed concept for sale and leaseback arrangement, which would have determined the gain or loss on the date of the eventual end of the lease or vacating of the property whichever was later. As we, and others, pointed out in prior comments, this concept would have potentially led to inequitable and contentious conclusions. Withdrawal of the later disposition date removed a major concern that our member companies had with the previous draft.

We commented in our prior letter that we did not support the new language appearing in the draft, which states "the Government and the Contractor shall" take certain actions. This language appears in several paragraphs and we believe it would alter the long-standing relationship of the Government and Contractors in complying with provisions in the FAR. Although the current language in FAR 31.205-16 contains the word "shall," it does not suggest that the Government and the Contractor will take joint action. We recommend the current sentence structure be retained without change.

We continue to be concerned by the provisions of proposed paragraph (b). We believe the language is confusing and subjective in meaning and could result in the Government recouping depreciation in excess of actual contractor gains. We are particularly concerned with the introduction of the language referring to "fair market value," which is not defined and potentially subject to multiple interpretations. The following is an example of the inequities that could result from the application of explicit instructions of paragraph (b) in relation to sale/leaseback transactions where the actual sales price is below the original acquisition cost. Consider the following set of conditions.

<u>Facts of Sale</u>	<u>Gain/Loss Impacts</u>
- Original Acquisition Cost - \$10M	- Gain on Sale (\$12M - 7M) = \$5M
- Current Net Book Value - \$7M	- Depreciation recoupment to Government limited to \$3M (\$10M - 7M)
- Fair Market Value - \$12M	- Gain to the Seller (\$9M - 7M) = \$2M
- Sales Price - \$9M	

In this scenario, although the gain on the sale is \$5M, the amount the Government can recoup is limited by paragraph (d) to the accumulated depreciation of \$3M, \$10M original cost less the \$7M net book value. This limitation is adopted because the Government has shared in \$3M of depreciation while this asset has been held so the \$3M is the most it can share in the recoupment. Since the asset was sold for \$9M, the contractor's cash gain is \$2M but it has to give the Government a credit for 3M. This example demonstrates that the Fair Market Value concept is confusing at best and inequitable at worst. Therefore, we recommend that the proposed language of Fair Market Value be eliminated, and the existing language of net amount realized be added to paragraph (b) (1) instead.

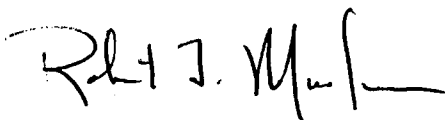
AIA agrees with the statement in (b) (2) that properly establishes the date for recognizing the gain or loss on the sale in a sale/leaseback transaction as the date of the sale/leaseback agreement. However, we suggest that the wording "sale and leaseback arrangement" could be subject to various interpretations. It seems alternative language, "The disposition date is the date the sale and leaseback agreement is effective," is more specific and unambiguous.

Notwithstanding our previous comments about the need for revisions in paragraph (b), we believe it could be eliminated by stating in the coverage statement in paragraph (a) that this principle also covers sale/leaseback transactions. A suggested new paragraph (a) is included herewith as Attachment A.

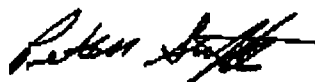
It is our opinion that our suggested changes do not alter the policy intentions of the Councils, and we believe their adoption in the drafting of a final rule will result in clearer and more concise provisions in the FAR 31.205-16 cost principle.

If you have any questions or would like to meet to discuss our comments and recommendations, please contact Dick Powers of AIA (703 358-1042) or Ruth Franklin of NDIA (703 247-2598).

Sincerely,



Mr. Robert T. Marlow
Vice President, Government Division
Aerospace Industries Association



Mr. Peter M. Steffes
Vice President, Government Policy
National Defense Industrial Association

Attachment

2004-005-2

FAR 31.205-16
Gains and Losses on Disposition or Impairment
Of Depreciable Property or Other Capital Assets

- (a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) of depreciable property, including property subject to the sale and leaseback limitations in 31.205-11(i)(1) or 31.205-36(b)(2), shall be included 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 (c) of this subsection). The disposition date in the case of a sale and leaseback arrangement is the date the agreement is effective. However, no gain or loss is recognized as a result of the transfer of assets in a business combination (see 31.205-52).
- (b) Gains and losses on disposition of tangible capital assets, including those acquired under capital leases (see 31.205-11(m)), shall be considered 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.
- (c) The gain recognized for contract costing purposes shall be limited 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) Special considerations

2004-005-3



Adestefano2@aol.com

06/21/2004 07:01 PM

To: farcase.2004-005@gsa.gov

cc:

Subject: Proposed Rule on Gains and Losses

Ladies and Gentlemen:

I apologize in advance, but I have to be blunt. I believe that this proposed rule on FAR 31.205-16 is a boon for government contractors and a bust for the government and the taxpayers. The rule in paragraph (d) clearly limits the amount of credit accruing to the government on a sale and leaseback arrangement, but has no limit on the losses that contractors can charge on other sale and leaseback arrangements. This is due to the fact that the limits in paragraph (c) are avoided in paragraph (b) which states that "Notwithstanding the provisions in paragraph (c) of this subsection ..." This rule would result in a flood of sale and leaseback arrangements allowing for "paper losses" charged to contracts and/or indirect expense groupings. And while one can reasonably argue that depreciable real property does not lose market value generally, one can also see that many other types of depreciable assets, including computer equipment, do in fact lose market value at rates that exceed their depreciation deductions. What's more, it is not clear how these market value determinations will be made in actual practice.

So I recommend a rewrite of paragraph (b) so that no loss can be recognized for government contract purposes on sale/leasebacks which are not arms-length transactions entered into between contractors and third parties.

Anthony P. DeStefano, CPA, CFCM
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