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Dear Colleague:

On January 28, 1975 the Cost-Accounting Standards Board (CASB) published in the Federal Register a standard (#409) on depreciation of tangible capital assets for companies under contract with the Federal government.

This regulation is the first promulgated by CASB which has not been unanimously endorsed by its membership. Mr. Charles Dana of CASB has written an incisive and persuasive dissenting opinion which points out the serious shortcomings of the standard and the damage which its enforcement will cause both government contractors and the government itself.

In brief, the standard would require depreciation of capital assets to be based on the historical service life of those assets, rather than on the Internal Revenue Service depreciation guidelines as they are currently.

This seemingly modest regulation is open to criticism on a number of points. In the first place, CASB has been mandated "to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts." In fact, this standard will promote greater diversity in rates of depreciation, since the allowable rate of depreciation of assets for each company will forever be tied to its particular business and financial status at the time of implementation.

Secondly, CASB is required to take into account "the probable costs of implementation compared to the probable benefits." As pointed out above, the standard will not promote uniformity, yet it will require extensive and detailed record-keeping to determine the historical service lives of assets. Businesses do not currently keep records of this scope, and the implementation and maintenance of such record-keeping will impose substantial non-productive costs on the contractors.

The foregoing criticisms of the regulation are made within the terms of the authorizing legislation. Other, and perhaps more serious, criticisms come from considerations outside the legislation.

First, CASB is concerned only with accounting problems. It refuses to consider the substantial economic impact which its standard will have. One result of the regulation will be that the return on capital invested in government work, to which the CASB depreciation standard applies, will be smaller than that on non-government work, which will continue to use Internal Revenue Service depreciation guidelines. This will obviously make it difficult for a company to justify undertaking government contracts rather than more profitable non-government work. In addition, CASB considers neither the cost of inflation, nor the cost of money in its regulation, both of which seriously affect investment decisions by industry.

Finally, there is one "escape hatch" in the requirement that historical service lives be used to determine rates of depreciation. A company may claim a depreciation rate different from that based on the historical service life, but "the burden of proof shall be on the contractor to justify estimated service lives which are shorter than such experienced (retention) lives". This approach was tried and found to be unusable by the IRS because of the time lost in bookkeeping, auditing and litigation. The present IRS guidelines, which CASB would discard, were adopted to eliminate just those problems.

To conclude then, not only does this regulation not fulfill the requirements set for CASB regulations by law, but in addition, it will discourage industry from undertaking government contracts. While we in the Congress have been seeking to provide investment incentives in order to stimulate a flagging economy, this regulation would constitute a serious investment disincentive.

If we do not act, this regulation will become law on April 14th. Hearings on the regulation in the Economic Stabilization subcommittee of Banking and Currency have been tentatively scheduled for April 9th. I am enclosing a copy of Mr. Dana's opinion, and I urge you to consider the matter seriously over the recess. At the very least, we should delay implementation of the regulation to give it fuller consideration. To allow it to become law would be a serious mistake.

Sincerely,

Paul E. Tsongas

PAUL E. TSONGAS
Member of Congress

Enclosure