T3.3.2 - Contract Cost Principles Revised 10/2007
- A Contract Cost Principles
  - 1 Applicability Revised 4/2017
  - 2 Contracts with Commercial Organizations Revised 10/2014
  - 3 Contracts with Educational Institutions Revised 4/2017
  - 4 Contracts with State, Local, and Federally Recognized Indian Tribal Governments Revised 4/2017
  - 5 Contracts with Nonprofit Organizations Revised 4/2017
- B Clauses
- C Forms
- D Appendix Added 7/2007
  - 1 Appendix - Summary of Selected Costs Revised 1/2012
  - 2 Appendix - Selected Costs Revised 10/2014
  - 3 Appendix - Definitions Added 7/2007

## T3.3.2 - Contract Cost Principles Revised 10/2007

### A Contract Cost Principles

### 1 Applicability Revised 4/2017

a. *General*. To recognize different organizational characteristics, FAA cost principles and procedures are classified by organizational type, e.g., commercial concerns and educational institutions. The objective of this classification is to ensure, to the extent practicable, all similar types of organizations doing similar work follow the same cost principles and guidance. In general, FAA cost principles apply when the Contracting Officer (CO) performs cost analysis to price contracts, subcontracts, and modifications to contracts and subcontracts; and when a contract clause requires determination, negotiation, or allowance of costs.

b. *Fixed-price Contracts.*

(1) The applicable parts of AMS Procurement Guidance T3.3.2 must be used to price fixed-price contracts, subcontracts, and modifications to contracts and subcontracts whenever:

(a) Cost analysis is performed; or

(b) A fixed-price contract clause requires the determination or negotiation of costs.

(2) Applying cost principles to fixed-price contracts and subcontracts must not be construed as a requirement to negotiate agreements on individual elements of cost in arriving at agreement on the total price. The final price accepted by the parties reflects agreement only on the total price. Notwithstanding mandatory use of cost principles, the objective will continue to be to negotiate prices that are fair and reasonable, cost and other factors considered.

c. *Contracts with Commercial Organizations.*

This category includes all contracts and contract modifications for supplies, services, or experimental, developmental, or research work negotiated with organizations (other than educational institutions, construction and architect-engineer contracts, State and local governments, and nonprofit organizations) on the basis of cost.

(1) The cost principles and procedures in the below Section 2. “Contracts with Commercial Organizations” must be used to price negotiated supply, service, experimental, developmental, and research contracts and contract modifications with commercial organizations whenever cost analysis is performed.

(2) The CO must incorporate the cost principles and procedures in this Procurement Guidance T3.3.2 by reference in contracts with commercial organizations as the basis for:

(a) Determining reimbursable costs under cost-reimbursement contracts and cost- reimbursement subcontracts under these contracts performed by commercial organizations; and the cost-reimbursement portion of time-and-materials contracts except when material is priced on a basis other than at cost;

(b) Negotiating indirect cost rates;

(c) Proposing, negotiating, or determining costs under terminated contracts;

(d) Price revision of fixed-price incentive contracts;

(e) Price redetermination of price redetermination contracts; and

(f) Pricing changes and other contract modifications.

d. *Contracts with Educational Institutions.*

This category includes all contracts and contract modifications for research and development, training, and other work performed by educational institutions.

(1) The CO must incorporate the cost principles and procedures of the below Section 3. "Contracts with Educational Institutions," by reference in cost-reimbursement contracts with educational institutions as the basis for:

(a) Determining reimbursable costs under the contracts and cost-reimbursement subcontracts under these contracts performed by educational institutions;

(b) Negotiating indirect cost rates; and

(c) Settling costs of cost-reimbursement terminated contracts.

(2) The cost principles in this Procurement Guidance T3.3.2 are to be used as a guide in evaluating costs in connection with negotiating fixed-price contracts and termination settlements.

e. *Construction and Architect-engineer Contracts.*

This category includes all contracts and contract modifications negotiated on the basis of cost with organizations (other than educational institutions, State and local governments, and nonprofit organizations except those exempted under OMB Guidance "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards" at https://www.federalregister.gov/documents/2013/12/26/2013-30465/uniform-administrative-requirements-cost-principles-and-audit-requirements-for-federal-awards ("OMB Uniform Guidance") for construction management or construction, alteration or repair of buildings, bridges, roads, or other kinds of real property). It also includes architect-engineer contracts related to construction projects. It does not include contracts for vessels, aircraft, or other kinds of personal property.

(1) Except as otherwise provided in subparagraph e.(3) below, the cost principles and procedures in the below Section 2. "Contracts with Commercial Organizations" must be used to price contracts and contract modifications in this category if cost analysis is performed.

(2) The CO must incorporate the cost principles and procedures in the below Section 2. "Contracts with Commercial Organizations (as modified by subparagraph e.(3) below) by reference in contracts in this category as the basis for:

(a) Determining reimbursable costs under cost-reimbursement contracts, including cost-reimbursement subcontracts under these contracts;

(b) Negotiating indirect cost rates;

(c) Proposing, negotiating, or determining costs under terminated contracts;

(d) Price revision of fixed-price incentive contracts; and

(e) Pricing changes and other contract modifications.

(3) Except as otherwise provided in this subparagraph e.(3), the allowability of costs for construction and architect-engineer contracts must be determined in accordance with the below Section 2. "Contracts with Commercial Organizations."

(a) Advance agreements, as set forth in the below paragraph i. "Advance Agreements," for such items as home office overhead, partners' compensation, employment of consultants, and equipment usage costs, are particularly important in construction and architect-engineer contracts because of widely varying factors such as the nature, size, duration, and location of the construction project. When appropriate, they serve to express the parties' understanding and avoid possible subsequent disputes or disallowances.

(b) "Construction equipment," as used in this subparagraph e.(3), means equipment (including marine equipment) in sound workable condition, either owned or controlled by the contractor or the subcontractor at any tier, or obtained from a commercial rental source, and furnished for use under Government contracts.

(i) Allowable ownership and operating costs must be determined as follows:

(AA) Actual cost data must be used when such data can be determined for both ownership and operations costs for each piece of equipment, or groups of similar serial or series equipment, from the contractor's accounting records. When such costs cannot be so determined, the FAA may specify the use of a particular schedule of predetermined rates or any part thereof to

determine ownership and operating costs of construction equipment (see subparagraphs e.(3)(b)(i)(BB) and (CC) below). However, costs otherwise unallowable under this Procurement Guidance T3.3.2 must not become allowable through the use of any schedule (see below subparagraph i(3) “Advance Agreements”). For example, schedules need to be adjusted for Government contract costing purposes if they are based on replacement cost, include unallowable interest costs, or use improper cost of money rates or computations. COs should review the computations and factors included within the specified schedule and ensure that unallowable or unacceptably computed factors are not allowed in cost submissions.

(BB) Predetermined schedules of construction equipment use rates (e.g., the Construction Equipment Ownership and Operating Expense Schedule, published by the U.S. Army Corps of Engineers, industry sponsored construction equipment cost guides, or commercially published schedules of construction equipment use cost) provide average ownership and operating rates for construction equipment. The allowance for operating costs may include costs for such items as fuel, filters, oil, and grease; servicing, repairs, and maintenance; and tire wear and repair. Costs of labor, mobilization, demobilization, overhead, and profit are generally not reflected in schedules, and separate consideration may be necessary.

(CC) When a schedule of predetermined use rates for construction equipment is used to determine direct costs, all costs of equipment that are included in the cost allowances provided by the schedule must be identified and eliminated from the contractor's other direct and indirect costs charged to the contract. If the contractor's accounting system provides for site or home office overhead allocations, all costs which are included in the equipment allowances may need to be included in any cost input base before computing the contractor's overhead rate. In periods of suspension of work pursuant to a contract clause, the allowance for equipment ownership must not exceed an amount for standby cost as determined by the schedule or contract provision.

(ii) Reasonable costs of renting construction equipment are allowable (but see preceding subparagraph e.(3)(b)(i)CC)).

(AA) Costs, such as maintenance and minor or running repairs incident to operating such rented equipment, that are not included in the rental rate are allowable.

(BB) Costs incident to major repair and overhaul of rental equipment are unallowable.

(CC) The allowability of charges for construction equipment rented from any division, subsidiary, or organization under common control, will be determined in accordance with Attachment 2, Cost (33)(b)(3) "Rental Costs."

(c) Costs incurred at the job site incident to performing the work, such as the cost of superintendence, timekeeping and clerical work, engineering, utility costs, supplies, material handling, restoration and cleanup, etc., are allowable as direct or indirect costs, provided the accounting practice used is in accordance with the contractor's established and consistently followed cost accounting practices for all work.

(d) Rental and any other costs, less any applicable credits incurred in acquiring the temporary use of land, structures, and facilities are allowable. Costs, less any applicable credits, incurred in constructing or fabricating structures and facilities of a temporary nature are allowable.

f. *Facilities Contracts*.

(1) *Applicable Cost Principles.* The cost principles and procedures applicable to the evaluation and determination of costs under facilities contracts, and subcontracts under these contracts, will be governed by the type of entity to which a facilities contract is awarded. Except as otherwise provided in this paragraph f. "Facilities Contracts": Section 2. "Contracts with Commercial Organizations," applies to facilities contracts awarded to commercial organizations; Section 3. "Contracts with Educational Institutions," applies to facilities contracts awarded to educational institutions; and paragraph 1.e., “Construction and Architect-engineer Contracts,” applies to facilities contracts awarded to construction contractors.

Whichever cost principles are appropriate will be used in the pricing of facilities contracts and contract modifications if cost analysis is performed. In addition, the CO must incorporate the cost principles and procedures appropriate in the circumstances by reference in facilities contracts as the basis for:

(a) Determining reimbursable costs under facilities contracts, including cost- reimbursement subcontracts under these contracts;

(b) Negotiating indirect cost rates; and

(c) Determining costs of terminated contracts when the contractor elects to “voucher out” costs.

(2) *Exceptions to General Rules on Allowability and Allocability.*

(a) A contractor's established accounting system and procedures are normally directed to the equitable allocation of costs to the types of products which the contractor produces or services rendered in the course of normal operating activities. The acquisition of, or work on, facilities for the Government

normally does not involve the manufacturing processes, plant departmental operations, cost patterns of work, administrative and managerial control, or clerical effort usual to production of the contractor's normal products or services.

(b) Advance agreements (see below paragraph i. "Advance Agreements") should be made between the contractor and CO as to indirect cost items to be applied to the facilities acquisition. A contractor's normal accounting practice for allocating indirect costs to the acquisition of contractor facilities may range from charging all these costs to this acquisition to not charging any. When necessary to produce an equitable result, the contractor's usual method of allocating indirect cost shall be varied, and appropriate adjustment must be made to the pools of indirect cost and the bases of their distribution.

(c) The purchase of completed facilities (or services in connection with the facilities) from outside sources does not involve the contractor's direct labor or indirect plant maintenance personnel. Accordingly, indirect manufacturing and plant overhead costs, which are primarily incurred or generated by reason of direct labor or maintenance labor operations, are not allocable to the acquisition of such facilities.

(d) Contracts providing for installation of new facilities or rehabilitation of existing facilities may involve the use of the contractor's plant maintenance labor, as distinguished from direct labor engaged in the production of the company's normal products. In such instances, only those types of indirect manufacturing and plant operating costs that are related to or incurred by reason of the expenditures of the classes of labor used for the performance of the facilities work may be allocated to the facilities contract. A facilities contract which involves the use of plant maintenance labor only would not be subject to an allocation of such cost items as direct productive labor supervision, depreciation, and maintenance expense applicable to productive machinery and equipment, or raw material and finished goods storage costs.

(e) Where a facilities contract calls for the construction, production, or rehabilitation of equipment or other items that are involved in the regular course of the contractor's business by the use of the contractor's direct labor and manufacturing processes, the indirect costs normally allocated to all that work may be allocated to the facilities contract.

(3) *Contractor's Commercial Items.* If facilities constituting the contractor's usual commercial items (or only minor modifications thereof) are acquired by the Government under the contract, the Government must not pay any amount in excess of the contractor's most favored customer price or the price of other suppliers for like quantities of the same or substantially the same items, whichever is lower.

g. *Contracts with State, Local, and Federally Recognized Indian Tribal Governments.*

(1) *Applicable Cost Principles.* The below Section 4. "Contracts with State, Local, and Federally Recognized Indian Tribal Governments" provides principles and

standards for determining costs applicable to contracts with State, local, and Federally recognized Indian tribal governments. They provide the basis for a uniform approach to the problem of determining costs and to promote efficiency and better relationships between State, local, and Federally recognized Indian tribal governments, and Federal Government entities. They apply to all programs that involve contracts with State, local, and Federally recognized Indian tribal governments, except contracts with:

(a) Publicly financed educational institutions; or

(b) Publicly owned hospitals and other providers of medical care subject to requirements promulgated by the sponsoring Government agencies.

(2) The Office of Management and Budget will approve any other exceptions in particular cases when adequate justification is presented.

h. *Contracts with Nonprofit Organizations.*

The below Section 5. "Contract with Nonprofit Organizations" provides principles and standards for determining costs applicable to contracts with nonprofit organizations other than educational institutions, State and local governments, and those nonprofit organizations exempted under OMB Uniform Guidance.

i. *Advance Agreements*.

(1) The extent of allowability of the costs covered in this Procurement Guidance T.3.3.2 applies broadly to many accounting systems in varying contract situations. The reasonableness, allocability and allowability under specific cost principles of certain costs may be difficult to determine. To avoid possible subsequent disallowance or dispute based on unreasonableness, unallocability or unallowability under the specific cost principles, COs and contractors should seek advance agreement on the treatment of special or unusual costs and on statistical sampling methodologies. However, an advance agreement is not an absolute requirement and the absence of an advance agreement on any cost will not, in itself, affect the reasonableness, allocability or the allowability under the specific cost principles.

(2) Advance agreements may be negotiated either before or during a contract but should be negotiated before incurrence of the costs involved. The agreements must be in writing, executed by both contracting parties, and incorporated into applicable current and future contracts. An advance agreement must contain a statement of its applicability and duration.

(3) The CO is not authorized by this paragraph i. to agree to a treatment of costs inconsistent with this Procurement Guidance T3.3.2. For example, an advance agreement may not provide that, notwithstanding Attachment 2, Cost (17) “Interest and Other Financial Costs,” interest is allowable.

(4) Advance agreements may be negotiated with a particular contractor for a single contract, a group of contracts, or all the contracts of a contracting office, an agency, or several agencies.

(5) The cognizant CO, or other designated administrative CO, negotiates advance agreements. When the negotiation authority is delegated, the administrative CO coordinates the proposed agreement with the cognizant CO before executing the advance agreement.

(6) Before negotiating an advance agreement, the Government negotiator must:

(a) Determine if other contracting offices inside FAA or in other agencies have a significant unliquidated dollar balance in contracts with the same contractor;

(b) Inform any such office or agency of the matters under consideration for negotiation; and

(c) As appropriate, invite the office or agency and the responsible audit agency to participate in pre-negotiation discussions and in subsequent negotiations.

(7) Upon completion of the negotiation, the sponsor shall prepare and distribute to other interested agencies and offices, including the audit agency, copies of the executed agreement and negotiation memorandum.

(8) Examples of costs for which advance agreements may be particularly important are:

(a) Compensation for personal services, including but not limited to allowances for off-site pay, incentive pay, location allowances, hardship pay, cost of living differential, and termination of defined benefit pension plans;

(b) Use charges for fully depreciated assets;

(c) Deferred maintenance costs;

(d) Precontract costs;

(e) Independent research and development and bid and proposal costs;

(f) Royalties and other costs for use of patents;

(g) Selling and distribution costs;

(h) Travel and relocation costs, as related to special or mass personnel movements, as related to travel via contractor-owned, -leased, or -chartered aircraft; or as related to maximum per diem rates;

(i) Costs of idle facilities and idle capacity;

(j) Severance pay to employees on support service contracts;

(k) Plant reconversion;

(l) Professional services (e.g., legal, accounting, and engineering);

(m) General and administrative costs (e.g., corporate, division, or branch allocations) attributable to the general management, supervision, and conduct of the contractor's business as a whole. These costs are particularly significant in construction, job-site, architect-engineer, facilities, and Government-owned contractor operated (GOCO) plant contracts;

(n) Costs of construction plant and equipment;

(o) Costs of public relations and advertising;

and

(p) Training and education costs.

j. *Indirect Cost Rate Certification and Penalties on Unallowable Costs.*

Certain contracts require certification of the indirect cost rates proposed for final payment purposes. If unallowable costs are included in final indirect cost settlement proposals, penalties may be assessed.

**2 Contracts with Commercial Organizations** **Revised 10/2014**

a. *Composition of Total Cost*.

(1) The total cost of a contract is the sum of the direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits, plus any allocable cost of money pursuant to Attachment 2. Cost (7). In ascertaining what constitutes a cost, any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used, including standard costs properly adjusted for applicable variances.

(2) Although the total cost of a contract includes all costs properly allocable to the contract, allowable costs to the Government are limited to those allocable costs that are allowable pursuant to this Procurement Guidance Section T3.3.2.

b. *Determining Allowability.*

(1) The factors to be considered in determining whether a cost is allowable include:

(a) Reasonableness.

(b) Allocability.

(c) Standards promulgated by the Cost Accounting Standards (CAS) Board, if applicable; otherwise, generally accepted accounting principles and practices appropriate to the particular circumstances.

(d) Terms of the contract.

(e) Any limitations set forth in this Section 2. “Contracts with Commercial Organizations.”

(2) Certain cost principles in this Section 2. “Contracts with Commercial Organizations” incorporate the measurement, assignment, and allocability rules of selected CAS and limit the allowability of costs to the amounts determined using the criteria in those selected CAS. Only those CAS or portions of standards specifically made applicable by the cost principles in this Procurement Guidance Section T3.3.2 are mandatory, unless the contract is CAS-covered. Business units that are not otherwise subject to these standards under a CAS clause are subject to the selected standards only for the purpose of determining allowability of costs on Government contracts. Including the selected standards in the cost principles does not subject the business unit to any other CAS rules and regulations. The applicability of the CAS rules and regulations is determined by the CAS clause, if any, in the contract and the requirements of the standards themselves.

(3) When contractor accounting practices are inconsistent with the cost principles in this Section 2. “Contracts with Commercial Organizations,” costs resulting from such inconsistent practices must not be allowed in excess of the amount that would have resulted from using practices consistent with this section.

(4) A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The CO may disallow all or part of a claimed cost which is inadequately supported.

c. *Determining Reasonableness*.

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person conducting competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. No presumption of reasonableness must be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the CO or the CO's representative, the burden of proof must be upon the contractor to establish that such cost is reasonable. What is reasonable depends upon a variety of considerations and circumstances, including:

(1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;

(2) Generally accepted sound business practices, arm's-length bargaining, and Federal and State laws and regulations;

(3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and

(4) Any significant deviations from the contractor's established practices.

d. *Determining Allocability*.

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to allowability and reasonableness, a cost is allocable to a Government contract if it:

(1) Is incurred specifically for the contract;

(2) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(3) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

e. *Credits.*

The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor must be credited to the Government either as a cost reduction or by cash refund. See Attachment 2, Cost (4) for rules governing refund or credit to the Government associated with pension adjustments and asset reversions.

f. *Accounting for Unallowable Costs***.**

(1) Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, must be identified and excluded from any billing, claim, or proposal applicable to a Government contract. A directly associated cost is any cost which is generated solely as a result of incurring another cost, and which would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.

(2) Costs which specifically become designated as unallowable or as unallowable directly associated costs of unallowable costs as a result of a written decision furnished by a CO must be identified if included in or used in computing any billing, claim, or proposal applicable to a Government contract. This identification requirement applies also to any costs incurred for the same purpose under like circumstances as the costs specifically identified as unallowable under either this subparagraph f.(2) or subparagraph f.(1) above.

(3) The practices for accounting for and presentation of unallowable costs will be those as described in 48 CFR 9904.405, Accounting for Unallowable Costs.

(4) Statistical sampling is an acceptable practice for contractors to follow in

accounting for and presenting unallowable costs provided all of the following criteria are met:

(a) The statistical sampling results in an unbiased sample that is a reasonable representation of the sampling universe.

(b) Any large dollar value or high risk transaction is separately reviewed for unallowable costs and excluded from the sampling process.

(c) The statistical sampling permits audit verification.

(5) Use of statistical sampling methods for identifying and segregating unallowable costs should be the subject of an advance agreement under paragraph i. “Advance Agreements” between the contractor and CO. The advance agreement should specify the basic characteristics of the sampling process. The CO must request input from the cognizant auditor before entering into any such agreements.

(6) In the absence of an advance agreement, if an initial review of the facts results in a challenge of the statistical sampling methods by the CO or CO’s representative, the burden of proof must be on the contractor to establish that such a method meets the criteria in subparagraph f.(4) above.

(7) If a directly associated cost is included in a cost pool which is allocated over a base that includes the unallowable cost with which it is associated, the directly associated cost must remain in the cost pool. Since the unallowable costs will attract their allocable share of costs from the cost pool, no further action is required to assure disallowance of the directly associated costs. In all other cases, the directly associated costs, if material in amount, must be purged from the cost pool as unallowable costs.

(8) In determining the materiality of a directly associated cost, consideration should be given to the significance of:

(a) The actual dollar amount;

(b) The cumulative effect of all directly associated costs in a cost pool; or

(c) The ultimate effect on the cost of Government contracts.

(9) Salary expenses of employees who participate in activities that generate unallowable costs shall be treated as directly associated costs to the extent of the time spent on the proscribed activity, provided the costs are material in accordance with subparagraph f.(8) above (except when such salary expenses are, themselves, unallowable). The time spent in proscribed activities should be compared to total time spent on company activities to determine if the costs are material. Time spent by employees outside the normal working hours should not be considered except when it is evident that an employee engages so frequently in company activities during periods outside normal working hours as to indicate that such activities are a part of the employee's regular duties.

(10) When a selected item of cost under Attachment 2, ”Selected Costs" provides that directly associated costs be unallowable, it is intended that such directly associated costs be unallowable only if determined to be material in amount in accordance with the criteria provided in above subparagraphs f.(8) and 2.f.(9), except in those situations where allowance of any of the directly associated costs involved would be considered to be contrary to public policy.

g. *Construction and Architect-engineer Contracts.*

Specific principles and procedures for evaluating and determining costs in connection with contracts and subcontracts for construction, and architect-engineer contracts related to construction projects, are in paragraph 1.e. "Construction and Architect-Engineer Contracts."

h. *Direct Costs*

(1) A direct cost is any cost that can be identified specifically with a particular final cost objective. No final cost objective must have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly to the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.

(2) For reasons of practicality, any direct cost of minor dollar amount may be treated as an indirect cost if the accounting treatment is consistently applied to all final cost objectives and produces substantially the same results as treating the cost as a direct cost.

i. *Indirect Costs*

(1) An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. It is not subject to treatment as a direct cost. After direct costs have been determined and charged directly to the contract or other work, indirect costs are those remaining to be allocated to the several cost objectives. An indirect cost must not be allocated to a final cost objective if other costs incurred for the same purpose in like circumstances have been included as a direct cost of that or any other final cost objective.

(2) Indirect costs must be accumulated by logical cost groupings with due consideration of the reasons for incurring such costs. Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives. Commonly, manufacturing overhead, selling expenses, and general and administrative (G&A) expenses are separately grouped. Similarly, the particular case may require subdivision of these groupings, e.g., building occupancy costs might be separable from those of personnel administration within the manufacturing overhead group. This necessitates selecting a distribution base common

to all cost objectives to which the grouping is to be allocated. The base should be selected so as to permit allocation of the grouping on the basis of the benefits accruing to the several cost objectives. When substantially the same results can be achieved through less precise methods, the number and composition of cost groupings should be governed by practical considerations and should not unduly complicate the allocation.

(3) Once an appropriate base for distributing indirect costs has been accepted, it must not be fragmented by removing individual elements. All items properly includable in an indirect cost base should bear a pro rata share of indirect costs irrespective of their acceptance as Government contract costs. For example, when a cost input base is used for the distribution of G&A costs, all items that would properly be part of the cost input base, whether allowable or unallowable, shall be included in the base and bear their pro rata share of G&A costs.

(4) The contractor's method of allocating indirect costs must be in accordance with standards promulgated by the CAS Board, if applicable to the contract; otherwise, the method must be in accordance with generally accepted accounting principles which are consistently applied. The method may require examination when:

(a) Substantial differences occur between the cost patterns of work under the contract and the contractor's other work;

(b) Significant changes occur in the nature of the business, the extent of subcontracting, fixed-asset improvement programs, inventories, the volume of sales and production, manufacturing processes, the contractor's products, or other relevant circumstances; or

(c) Indirect cost groupings developed for a contractor's primary location are applied to offsite locations. Separate cost groupings for costs allocable to offsite locations may be necessary to permit equitable distribution of costs on the basis of the benefits accruing to the several cost objectives.

(d) A base period for allocating indirect costs is the cost accounting period during which such costs are incurred and accumulated for distribution to work performed in that period. The criteria and guidance in Section 2. "Contracts with Commercial Organizations" for selecting the cost accounting periods to be used in allocating indirect costs are incorporated herein for application to contracts subject to full CAS coverage. For contracts subject to modified CAS coverage and for non-CAS-covered contracts, the base period for allocating indirect costs will normally be the contractor's fiscal year. But a shorter period may be appropriate in the following instances:

(i) For contracts in which performance involves only a minor portion of the fiscal year; or

(ii) When it is general practice in the industry to use a shorter period. When a contract is performed over an extended period, as many base periods shall be used as are required to represent the period of contract performance.

(5) Special care should be exercised in applying the principles of above subparagraphs i.(2), i.(3), and i.(4) (b), (c), and (d) when Government-owned contractor-operated (GOCO) plants are involved. The distribution of corporate, division, or branch office G&A expenses to such plants operating with little or no dependence on corporate administrative activities may require more precise cost groupings, detailed accounts screening, and carefully developed distribution bases.

j. *Application of Principles and Procedures*

(1) Costs must be allowed to the extent they are reasonable, allocable, and determined to be allowable under this Procurement Guidance Section T3.3.2. These criteria apply to all of the selected items that follow in Attachment 2 “Selected Costs,” even if particular guidance is provided for certain items for emphasis or clarity.

(2) For the following subcontract types, costs incurred as reimbursements or payments to a subcontractor are allowable to the extent the reimbursements or payments are for costs incurred by the subcontractor that are consistent with this Procurement Guidance Section T3.3.2:

(a) Cost-reimbursement.

(b) Fixed-price incentive.

(c) Price redeterminable (*i.e.*, fixed-price contracts with prospective price redetermination and fixed-ceiling-price contracts with retroactive price redetermination).

(3) The requirements of above subparagraph j.(2)(a) apply to any tier above the first firm- fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions.

(4) Costs incurred as payments under firm-fixed-price subcontracts or fixed-price subcontracts with economic price adjustment provisions or modifications thereto, when cost analysis was performed, must be allowable only to the extent that the price was negotiated in accordance with the above paragraph 1.b. "Fixed-price Contracts."

(5) The above paragraph 1.e "Construction and Architect-engineer Contracts" does not cover every element of cost. Failure to include any item of cost does not imply that it is either allowable or unallowable. The determination of allowability must be based on the principles and standards in this subpart and the treatment of similar or related selected items. When more than one subparagraph in 1.e "Construction and Architect-Engineer Contracts" is relevant to a contractor cost, the cost must be apportioned among the applicable subparagraphs, and the determination of allowability of each portion must be based on the guidance contained in the applicable subparagraph. When a cost, to which more than one subparagraph in 1. e "Construction and Architect-Engineer Contracts” is relevant, cannot be apportioned, the determination of allowability must be based on the guidance contained in the topics that most specifically deals with, or best captures the essential nature of, the cost at issue.

## 3 Contracts with Educational Institutions Revised 4/2017

a. *Purpose.* This Subsection provides the principles for determining cost of research and development, training, and other work performed by educational institutions under contracts with the Government.

b. *General.* OMB Uniform Guidance provides principles for determining the costs applicable to research and development, training, and other work performed by educational institutions under contracts with the Government.

c. *Requirements*.

(1) Contracts that refer to this Section 3. "Contracts with Educational Institutions" for determining allowable costs under contracts with educational institutions must be deemed to refer to, and must have the allowability of costs determined by the CO in accordance with, the revision of OMB Uniform Guidance in effect on the date of the contract.

(2) FAA should not place additional restrictions on individual items of cost.

## 4 Contracts with State, Local, and Federally Recognized Indian Tribal Governments

Revised 4/2017

a. *Purpose*. This Subsection provides the principles for determining allowable cost of contracts and subcontracts with State, local, and federally recognized Indian tribal governments.

b. General. OMB Uniform Guidance sets forth the principles for determining the allowable costs of contracts and subcontracts with State, local, and federally recognized Indian tribal governments. These principles are for cost determination and are not intended to identify the circumstances or dictate the extent of Federal and State or local participation in financing a particular contract.

c. *Requirements*.

(1) Contracts that refer to this Section 4. "Contracts with State, Local, and Federally Recognized Indian Tribal Governments" for determining allowable costs under contracts with State, local and Indian tribal governments must be deemed to refer to, and must have the allowability of costs determined by the CO in accordance with, the revision of OMB Uniform Guidance which is in effect on the date of the contract.

(2) FAA should not place additional restrictions on individual items of cost. However, the following costs are unallowable:

(a) Costs of entertainment, including amusement, diversion, and social activities, and any costs directly associated with such costs (such as tickets to

shows or sports events, meals, lodging, rentals, transportation, and gratuities).

(b) Costs incurred to influence (directly or indirectly) legislative action on any matter pending before Congress, a State legislature, or a legislative body of a political subdivision of a State.

(c) Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of any false certification) brought by the United States where the contractor is found liable or has pleaded nolo contendere to a charge of fraud or similar proceeding (including filing of a false certification).

(d) Payments of fines and penalties resulting from violations of, or failure to comply with, Federal, state, local, or foreign laws and regulations, except when incurred as a result of compliance with specific terms and conditions of the contract or specific written instructions from the contracting officer authorizing in advance such payments.

(e) Costs of any membership in any social, dining, or country club or organization.

(f) Costs of alcoholic beverages.

(g) Contributions or donations, regardless of the recipient.

(h) Costs of advertising designed to promote the contractor or its products.

(i) Costs of promotional items and memorabilia, including models, gifts, and souvenirs.

(j) Costs for travel by commercial aircraft which exceed the amount of the standard commercial fare.

(k) Costs incurred in making any payment (commonly known as a "golden parachute payment") which is in an amount in excess of the normal severance pay paid by the contractor to an employee upon termination of employment; and is paid to the employee contingent upon, and following, a change in management control over, or ownership of, the contractor or a substantial portion of the contractor's assets.

(l) Costs of commercial insurance that protects against the costs of the contractor for correction of the contractor's own defects in materials or workmanship.

(m) Costs of severance pay paid by the contractor to foreign nationals employed by the contractor under a service contract performed outside the United States, to the extent that the amount of the severance pay paid in any case exceeds the amount paid in the industry involved under the customary or prevailing practice for firms in that industry providing similar services in the

United States.

(n) Costs of severance pay paid by the contractor to a foreign national employed by the contractor under a service contract performed in a foreign country if the termination of the employment of the foreign national is the result of the closing of, or curtailment of activities at, a United States facility in that country at the request of the government of that country.

(o) Costs incurred by a contractor in connection with any criminal, civil, or administrative proceedings commenced by the United States or a State.

**5 Contracts with Nonprofit Organizations** **Revised 4/2017**

a. *Purpose*. This Subsection provides the principles for determining cost applicable to work performed by nonprofit organizations under contracts with the Government. A nonprofit organization, for purpose of identification, is defined as a business entity organized and operated exclusively for charitable, scientific, or educational purposes, of which no part of the net earnings inure to the benefit of any private shareholder or individual, of which no substantial part of the activities is carrying on propaganda or otherwise attempting to influence legislation or participating in any political campaign on behalf of any candidate for public office, and which are exempt from Federal income taxation under section 501 of the Internal Revenue Code.

b. *General.* OMB Uniform Guidance sets forth principles for determining the costs applicable to work performed by nonprofit organizations under contracts (also applies to grants and other agreements) with the Government.

c. *Requirements.*

(1) Contracts which determine allowable costs pursuant to this Section 5. "Contracts With Nonprofit Organizations" must be deemed to refer to, and must have the allowability of costs determined by the CO in accordance with, the revision of OMB Uniform Guidance in effect on the date of the contract.

(2) FAA should not place additional restrictions on individual items of cost. However, the costs cited in subparagraph c.(2) "Requirements" of the above Section 4. “Contracts with State, Local, and Federally Recognized Indian Tribal Governments” are unallowable.

**B Clauses**

view contract clauses

**C Forms**

view procurement forms

## D Appendix Added 7/2007

### 1 Appendix - Summary of Selected Costs Revised 1/2012

| Selected Cost Title | Selected Cost Number | Allowable | Unallowable | Exception / Restriction Applies |
|---|---|---|---|---|
| Alcoholic Beverages | Cost 47 | | X | |
| Asset Valuations Resulting from Business Combinations | Cost 48 | X | | X |
| Bad Debts | Cost 2 | | X | |
| Bonding Costs | Cost 3 | X | | X |
| Compensation for Personal Services | Cost 4 | X | | X |
| Contingencies | Cost 5 | | X | X |
| Contributions or Donations | Cost 6 | | X | |
| Cost of Money | Cost 7 | X | | X |
| Depreciation | Cost 8 | X | | X |
| Economic Planning Costs | Cost 9 | X | | |
| Employee Morale, Health, Welfare, Food Service, and Dormitory Costs and Credits | Cost 10 | X | | X |
| Entertainment Costs | Cost 11 | | X | |
| Fines, Penalties, and Mischarging Costs | Cost 12 | | X | X |
| Gains and Losses on Disposition or Impairment of Depreciable Property or Other Capital Assets | Cost 13 | X | | X |

| | | | | |
|---|---|---|---|---|
| Goodwill | Cost 46 | | X | |
| Idle Facilities and Idle Capacity Costs | Cost 14 | | X | X |
| Independent Research and Development and Bid and Proposal Costs | Cost 15 | X | | X |
| Insurance and Indemnification | Cost 16 | X | | X |
| Interest and Other Financial Costs | Cost 17 | | X | X |
| Labor Relations Costs | Cost 18 | X | | X |
| Legal and Other Proceedings | Cost 44 | | X | X |
| Lobbying and Political Activity Costs | Cost 19 | | X | X |
| Losses on Other Contracts | Cost 20 | | X | |
| Manufacturing and Production Engineering Costs | Cost 22 | X | | |
| Material Costs | Cost 23 | X | | |
| Organization Costs | Cost 24 | | X | |
| Other Business Expenses | Cost 25 | X | | |
| Patent Costs | Cost 27 | X | | X |
| Plant Protection Costs | Cost 26 | X | | |
| Plant Reconversion Costs | Cost 28 | | X | X |
| Precontract Costs | Cost 29 | X | | |
| Professional and Consultant Service Costs | Cost 30 | X | | X |
| Public Relations and Advertising Costs | Cost 1 | | X | X |
| Recruitment Costs | Cost 31 | X | | X |
| Relocation Costs | Cost 32 | X | | X |

| | | | | |
|---|---|---|---|---|
| Rental Costs | Cost 33 | X | | |
| Research and Development Costs | Cost 45 | X | X | |
| Royalties and Other Costs for Use of Patents | Cost 34 | X | | X |
| Selling Costs | Cost 35 | | X | X |
| Service and Warranty Costs | Cost 36 | X | | |
| Special Tooling and Special Test Equipment Costs | Cost 37 | X | | |
| Taxes | Cost 38 | X | | X |
| Termination Costs | Cost 39 | X | | X |
| Trade, Business, Technical and Professional Activity Costs | Cost 40 | X | | |
| Training and Education Costs | Cost 41 | X | | X |
| Travel Costs | Cost 43 | X | | X |

## 2 Appendix - Selected Costs Revised 10/2014

This Appendix 2 does not cover every element of cost. Failure to include any item of cost does not imply that it is either allowable or unallowable. The determination of allowability must be based on the principles and standards in AMS Procurement Guidance T3.2.2 and the treatment of similar or related selected items.

**(1) *Public Relations and Advertising Costs.***

(a) “Public relations” means all functions and activities dedicated to:

(1) Maintaining, protecting, and enhancing the image of a concern or its products; or

(2) Maintaining or promoting reciprocal understanding and favorable relations with the public at large, or any segment of the public. The term public relations includes activities associated with areas such as advertising, customer relations, etc.

(b) “Advertising” means the use of media to promote the sale of products or services and to accomplish the activities referred to in paragraph (d) of this subsection, regardless of the medium employed, when the advertiser has control over the form and content of what will appear, the media in which it will appear, and when it will appear. Advertising media include

but are not limited to conventions, exhibits, free goods, samples, magazines, newspapers, trade papers, direct mail, dealer cards, window displays, outdoor advertising, radio, and television.

(c) Public relations and advertising costs include the costs of media time and space, purchased services performed by outside organizations, as well as the applicable portion of salaries, travel, and fringe benefits of employees engaged in the functions and activities identified in subparagraphs (e)(1) through (6).

(d) The only allowable advertising costs are those that are

(1) Specifically required by contract, or that arise from requirements of Government contracts, and that are exclusively for

(i) Acquiring scarce items for contract performance; or

(ii) Disposing of scrap or surplus materials acquired for contract performance;

(2) Costs of activities to promote sales of products normally sold to the U.S. Government, including trade shows, which contain a significant effort to promote exports from the United States. Such costs are allowable, notwithstanding subparagraphs (d)(1), (d)(3), (d)(4)(ii) and (d)(5) ( of this subsection). However, such costs do not include the costs of memorabilia (*e.g.*, models, gifts, and souvenirs), alcoholic beverages, entertainment, and physical facilities that are used primarily for entertainment rather than product promotion; or

(3) Allowable in accordance with Cost (31) Recruitment Costs.

(e) Allowable public relations costs include the following:

(1) Costs specifically required by contract.

(2) Costs of

(i) Responding to inquiries on company policies and activities;

(ii) Communicating with the public, press, stockholders, creditors, and customers; and

(iii) Conducting general liaison with news media and Government public relations officers, to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters of public concern such as notice of contract awards, plant closings or openings, employee layoffs or rehires, financial information, etc.

(3) Costs of participation in community service activities (*e.g.*, blood bank

drives, charity drives, savings bond drives, disaster assistance, etc.).

(4) Costs of plant tours and open houses (but see subparagraph (d)(5) of this subsection).

(5) Costs of keel laying, ship launching, commissioning, and roll-out ceremonies, to the extent specifically provided for by contract.

(f) Unallowable public relations and advertising costs include the following:

(1) All public relations and advertising costs, other than those specified in subparagraphs (d) and (e) of this subsection, whose primary purpose is to promote the sale of products or services by stimulating interest in a product or product line (except for those costs made allowable under Cost (35), or by disseminating messages calling favorable attention to the contractor for purposes of enhancing the company image to sell the company's products or services.

(2) All costs of trade shows and other special events which do not contain a significant effort to promote the export sales of products normally sold to the U.S. Government.

(3) Costs of sponsoring meetings, conventions, symposia, seminars, and other special events when the principal purpose of the event is other than dissemination of technical information or stimulation of production.

(4) Costs of ceremonies such as

(i) Corporate celebrations and

(ii) New product announcements.

(5) Costs of promotional material, motion pictures, videotapes, brochures, handouts, magazines, and other media that are designed to call favorable attention to the contractor and its activities.

(6) Costs of souvenirs, models, imprinted clothing, buttons, and other mementos provided to customers or the public.

(7) Costs of memberships in civic and community organizations.

***(2) Bad Debts***.

Bad debts, including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims, and any directly associated costs such as collection costs, and legal costs are unallowable.

**(3) *Bonding Costs*.**

(a) Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the contractor. They arise also in instances where the contractor requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

(b) Costs of bonding required pursuant to the terms of the contract are allowable.

(c) Costs of bonding required by the contractor in the general conduct of its business are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

**(4) *Compensation for Personal Services.***

(a) *General.* Compensation for personal services is allowable subject to the following general criteria and additional requirements contained in other parts of this cost principle:

(1) Compensation for personal services must be for work performed by the employee in the current year and must not represent a retroactive adjustment of prior years' salaries or wages (but see paragraphs (g), (h), (j), (k), (m), and (o) of this subsection).

(2) The total compensation for individual employees or job classes of employees must be reasonable for the work performed; however, specific restrictions on individual compensation elements apply when prescribed.

(3) The compensation must be based upon and conform to the terms and conditions of the contractor's established compensation plan or practice followed so consistently as to imply, in effect, an agreement to make the payment.

(4) No presumption of allowability will exist where the contractor introduces major revisions of existing compensation plans or new plans and the contractor has not provided the cognizant CO, either before implementation or within a reasonable period after it, an opportunity to review the allowability of the changes.

(5) Costs that are unallowable under other paragraphs of this Procurement Guidance Section T3.3.2 are not allowable under this subsection solely on the basis that they constitute compensation for personal services.

(6)

(i) Compensation costs for certain individuals give rise to the need for special consideration. Such individuals include:

(A) Owners of closely held corporations, members of limited liability companies, partners, sole proprietors, or members of their immediate families; and

(B) Persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise.

(ii) For these individuals, compensation must-

(A) Be reasonable for the personal

services rendered; and

(B) Not be a distribution of profits (which is not an allowable contract cost).

(iii) For owners of closely held companies, compensation in excess of the costs that are deductible as compensation under the Internal Revenue Code (26 U.S.C.) and regulations under it is unallowable.

(b) *Reasonableness*

(1) *Compensation pursuant to labor-management agreements*. If costs of compensation established under "arm's length" labor-management agreements negotiated under the terms of the Federal Labor Relations Act or similar state statutes are otherwise allowable, the costs are reasonable unless, as applied to work in performing Government contracts, the costs are unwarranted by the character and circumstances of the work or discriminatory against the Government. The application of the provisions of a labor-management agreement designed to apply to a given set of circumstances and conditions of employment (*e.g.*, work involving extremely hazardous activities or work not requiring recurrent use of overtime) is unwarranted when applied to a Government contract involving significantly different circumstances and conditions of employment (*e.g.*, work involving less hazardous activities or work continually requiring use of overtime). It is discriminatory against the Government if it results in employee compensation (in whatever form or name) in excess of that being paid for similar non-Government work under comparable circumstances.

(2) *Compensation not covered by labor-management agreements*. Compensation for each employee or job class of employees must be reasonable for the work performed. Compensation is reasonable if the aggregate of each measurable and allowable element sums to a reasonable total. In determining the reasonableness of total compensation, consider only allowable individual elements of compensation. In testing the reasonableness of compensation for particular employees or job classes of employees, consider factors determined to be relevant by the contracting officer. Factors that may be relevant include, but are not limited to, conformity with compensation practices of other firms

(i) Of the same size;

(ii) In the same industry;

(iii) In the same geographic area; and

(iv) Engaged in similar non-Government work under comparable circumstances.

(c) [Reserved]

(d) *Form of payment.*

(1) Compensation for personal services includes compensation paid or to be paid in the future to employees in the form of

(i) Cash;

(ii) Corporate securities, such as stocks, bonds, and other financial instruments (see paragraph (d)(2) of this subsection regarding valuation); or

(iii) Other assets, products, or services.

(2) When compensation is paid with securities of the contractor or of an affiliate, the following additional restrictions apply:

(i) Valuation placed on the securities is the fair market value on the first date the number of shares awarded is known, determined upon the most objective basis available.

(ii) Accruals for the cost of securities before issuing the securities to the employees are subject to adjustment according to the possibilities that the employees will not receive the securities and that their interest in the accruals will be forfeited.

(e) *Income tax differential pay.*

(1) Differential allowances for additional income taxes resulting from foreign assignments are allowable.

(2) Differential allowances for additional income taxes resulting from domestic assignments are unallowable. (However, payments for increased employee income or Federal Insurance Contributions Act taxes incident to allowable reimbursed relocation costs are allowable under Cost (32).

(f) *Bonuses and incentive compensation*.

(1) Bonuses and incentive compensation are allowable provided the-

(i) Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; and

(i) Basis for the award is supported.

(2) When the bonus and incentive compensation payments are deferred, the costs are subject to the requirements of paragraphs (f)(1) and (k) of this subsection.

(g) *Severance pay.*

(1) Severance pay is a payment in addition to regular salaries and wages by contractors to workers whose employment is being involuntarily terminated. Payments for early retirement incentive plans are covered in paragraph (j)(6) of this subsection.

(2) Severance pay is allowable only to the extent that, in each case, it is required by

(i) Law;

(ii) Employer-employee agreement;

(ii) Established policy that constitutes, in effect, an implied agreement on the contractor's part; or

(iv) Circumstances of the particular employment.

(3) Payments made in the event of employment with a replacement contractor where continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employment, or continued employment by the contractor at another facility, subsidiary, affiliate, or parent company of the contractor are not severance pay and are unallowable.

(4) Actual normal turnover severance payments shall be allocated to all work performed in the contractor's plant. However, if the contractor uses the accrual method to account for normal turnover severance payments, that method will be acceptable if the amount of the accrual is-

(i) Reasonable in light of payments actually made for normal severances over a representative past period; and

(ii) Allocated to all work performed in the contractor's plant.

(5) Abnormal or mass severance pay is of such a conjectural nature that accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, the Government will consider allowability on a case-by-case basis.

(6) The costs of severance payments to foreign nationals employed under a service contract performed outside the United States are unallowable to the extent that such payments exceed amounts typically paid to employees providing similar services in the same industry in the United States. Further, all such costs of severance payments that are otherwise allowable are unallowable if the termination of employment of the foreign national is the result of the closing of, or the curtailment of activities at, a United States facility in that country at the request of the government of that country; this does not apply if the closing of a facility or curtailment of activities is made pursuant to a status-of-forces or other country-to-country agreement entered into with the government of that country before November 29, 1989. The head of the agency is permitted to waive these cost allowability limitations under certain circumstances.

(h) *Back pay*. Back pay is a retroactive adjustment of prior years' salaries or wages. Back pay is unallowable except as follows:

(1) Payments to employees resulting from underpaid work actually performed are allowable, if required by a negotiated settlement, order, or court decree.

(2) Payments to union employees for the difference in their past and current wage rates for working without a contract or labor agreement during labor management negotiation are allowable.

(3) Payments to nonunion employees based upon results of union agreement negotiation are allowable only if-

(i) A formal agreement or understanding exists between management and the employees concerning these payments; or

(ii) An established policy or practice exists and is followed by the contractor so consistently as to imply, in effect, an agreement to make such payments.

(i) *Compensation and Price of Corporate Securities*. Compensation based on changes in the prices of corporate securities or corporate security ownership, such as stock options, stock appreciation rights, phantom stock plans, and junior stock conversions.

(1) Any compensation which is calculated, or valued, based on changes in the price of corporate securities is unallowable.

(2) Any compensation represented by dividend payments or which is calculated based on dividend payments is unallowable.

(3) If a contractor pays an employee in lieu of the employee receiving or exercising a right, option, or benefit which would have been unallowable under Cost (4)(d) "Compensation and Price of Corporate Securities," such payments are also unallowable.

(j) *Pension costs.*

(1) A pension plan is a deferred compensation plan. Additional benefits such as permanent and total disability and death payments and survivorship payments to beneficiaries of deceased employees may be treated as pension costs, provided the benefits are an integral part of the pension plan and meet all the criteria pertaining to pension costs.

(2) Pension plans are normally segregated into two types of plans: defined-benefit or defined-contribution pension plans. The cost of all defined-benefit pension plans shall be measured, allocated, and accounted for in compliance with the provisions of 48 CFR 9904.412, Cost Accounting Standard for composition and measurement of pension cost, and 48 CFR 9904.413, Adjustment and allocation of pension cost. The costs of all defined-contribution pension plans shall be measured, allocated, and accounted for in accordance with the provisions of 48 CFR 9904.412 and 48 CFR 9904.413. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth in subparagraph (j)(2)(i) and in subparagraphs (j)(3) through (7) of this subsection.

(i) Except for nonqualified pension plans using the pay-as- you-go cost method, to be allowable in the current year, pension costs must be funded by the time set for filing of the Federal income tax return or any extension thereof. Pension costs assigned to the current year, but not funded by the tax return time, shall not be allowable in any subsequent year. For nonqualified pension plans using the pay-as-you-go cost method, to be allowable in the current year, pension costs must be allocated in the cost accounting period that the pension costs are assigned.

(ii) Pension payments must be reasonable in amount and must be paid pursuant to an agreement entered into in good faith between the contractor and employees before the work or services are performed; and the terms and conditions of the established plan. The cost of changes in pension plans that are discriminatory to the Government or are not intended to be applied consistently for all employees under similar circumstances in the future are not allowable.

(iii) Except as provided for early retirement benefits in subparagraph (j)( 7) of this subsection, one-time-only pension supplements not available to all participants of the basic plan are not allowable as pension costs unless the supplemental benefits represent a separate pension plan and the benefits

are payable for life at the option of the employee.

(iv) Increases in payments to previously retired plan participants covering cost-of living adjustments are allowable if paid in accordance with a policy or practice consistently followed.

(3) *Defined-benefit Pension Plans.* This paragraph covers pension plans in which the benefits to be paid or the basis for determining such benefits are established in advance and the contributions are intended to provide the stated benefits. The cost limitations and exclusions pertaining to defined-benefit plans are as follows:

(i)

(A) Except for nonqualified pension plans, pension costs (see 48 CFR 9904.412-40(a)(1)) assigned to the current accounting period, but not funded during it, shall not be allowable in subsequent years (except that a payment made to a fund by the time set for filing the Federal income tax return or any extension thereof is considered to have been made during such taxable year). However, any portion of pension cost computed for a cost accounting period, that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of the Employee's Retirement Income Security Act of 1974 (ERISA), will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR 9904.412-50(c)(5)).

(B) For nonqualified pension plans, except those using the pay-as-you-go cost method, allowable costs are limited to the amount allocable in accordance with 48 CFR 9904.412-50(d)(2).

(C) For nonqualified pension plans using the pay- as-you-go cost method, allowable costs are limited to the amounts allocable in accordance with 48 CFR 9904.412-50(d)(3).

(ii) Any amount funded in excess of the pension cost assigned to a cost accounting period is not allowable and shall be accounted for as set forth at 48 CFR 9904.412-50(a)(4), and shall be allowable in the future period to which it is assigned, to the extent it is allocable, reasonable, and not otherwise unallowable.

(iii) Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable. If a composite rate is used for allocating pension costs between the segments of a company and if, because of differences in the timing of the funding by the segments, an inequity exists, allowable pension costs for each segment will be limited to that particular segment's calculation of pension costs as provided for in 48 CFR 9904.413-50(c). Determinations of unallowable costs shall be made in accordance with the actuarial cost method used in calculating pension costs.

(iv) Allowability of the cost of indemnifying the Pension Benefit Guaranty Corporation (PBGC) under ERISA Section 4062 or 4064 arising from terminating an employee deferred compensation plan will be considered on a case-by-case basis, provided that if insurance was required by the PBGC under ERISA Section 4023, it was so obtained and the indemnification payment is not recoverable under the insurance. Consideration under the foregoing circumstances will be primarily for the purpose of appraising the extent to which the indemnification payment is allocable to Government work. If a beneficial or other equitable relationship exists, the Government will participate in the indemnification payment to the extent of its fair share.

(iv) Increased pension costs resulting from the withdrawal of assets from a pension fund and transfer to another employee benefit plan fund, or transfer of assets to another account within the same fund, are unallowable except to the extent authorized by an advance agreement. If the withdrawal of assets from a pension fund is a plan termination under ERISA, the provisions of subparagraph (j)(6) of this subsection apply. The advance agreement shall

(A) State the amount of the Government's equitable share in the gross amount withdrawn or transferred; and

(B) Provide that the Government receive a credit equal to the amount of the Government's equitable share of the gross withdrawal or transfer.

(4) *Pension Adjustments and Asset Reversions.*

(i) For segment closings, pension plan terminations, or curtailment of benefits, the adjustment amount shall be the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413-50(c)(12) for contracts and subcontracts that are subject to Cost Accounting Standards (CAS) Board rules and regulations (48 CFR Chapter 99). For contracts and subcontracts that are not subject to CAS, the adjustment amount shall be the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413-50(c)(12), except the numerator of the fraction at 48 CFR 9904.413-50(c)(12)(vi) shall be the sum of the pension plan costs allocated to all non-CAS-covered contracts and subcontracts that are subject to subparagraph A.2 of Procurement Guidance Section T3.3.2 or for which cost or pricing data were submitted.

(ii) For all other situations where assets revert to the contractor, or such assets are constructively received by it for any reason, the contractor shall, at the Government's option, make a refund or give a credit to the Government for its equitable share of the gross amount withdrawn. The Government's equitable share shall reflect the Government's participation in pension costs through those contracts for which cost or pricing data were submitted or that are subject to this Procurement Guidance section 3.3.2. Excise taxes on pension plan asset reversions or withdrawals under this subparagraph (j)(4)(ii) are unallowable in accordance with Cost (38)(b)(6).

(5) *Defined-contribution Pension Plans*. This paragraph covers those pension plans in which the contributions are established in advance and the level of benefits is determined by the contributions made. It also covers profit sharing, savings plans, and other such plans, provided the plans fall within the definition of a pension plan in subparagraph (j)(1) of this subsection.

(i) Allowable pension cost is limited to the net contribution required to be made for a cost accounting period after taking into account dividends and other credits, where applicable. However, any portion of pension cost computed for a cost accounting period that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of ERISA will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR 9904.412-50(c)(5)).

(ii) The provisions of subparagraphs (j)(3)(ii) and (iv) of this subsection apply to defined-contribution plans.

(6) *Pension Plans Using the Pay-as-you-go Cost method*. The cost of pension plans using the pay-as-you-go cost method shall be measured, allocated, and accounted for in accordance with 48 CFR 9904.412 and 9904.413. Pension costs for a pension plan using the pay-as-you-go cost method shall be allowable to the extent they are allocable, reasonable, and not otherwise unallowable.

(7) *Early retirement incentive plans.* An early retirement incentive plan is a plan under which employees receive a bonus or incentive, over and above the requirement of the basic pension plan, to retire early. These plans normally are not applicable to all participants of the basic plan and do not represent life income settlements, and as such would not qualify as pension costs. However, for contract costing purposes, early retirement incentive payments are allowable subject to the pension cost criteria contained in subparagraphs (j)(3)(ii) through (iv) provided

(i) The costs are accounted for and allocated in accordance with the contractor's system of accounting for pension costs;

(ii) The payments are made in accordance with the terms and conditions of the contractor's plan;

(iii) The plan is applied only to active employees. The cost of extending the plan to employees who retired or were terminated before the adoption of the plan is unallowable; and

(iv) The total of the incentive payments to any employee may not exceed the amount of the employee's annual salary for the previous fiscal year before the employee's

retirement.

(8) *Employee Stock Ownership Plans (ESOP).*

(i) An ESOP is an individual stock bonus plan designed specifically to invest in the stock of the employer corporation. The contractor's contributions to an Employee Stock Ownership Trust (ESOT) may be in the form of cash, stock, or property. Costs of ESOP's are allowable subject to the following conditions:

(A) Contributions by the contractor in any one year may not exceed 15 percent (25 percent when a money purchase plan is included) of salaries and wages of employees participating in the plan in any particular year.

(B) The contribution rate (ratio of contribution to salaries and wages of participating employees) may not exceed the last approved contribution rate except when approved by the contracting officer based upon justification provided by the contractor. When no contribution was made in the previous year for an existing ESOP, or when a new ESOP is first established, and the contractor proposes to make a contribution in the current year, the contribution rate shall be subject to the contracting officer's approval.

(C) When a plan or agreement exists wherein the liability for the contribution can be compelled for a specific year, the expense associated with that liability is assignable only to that period. Any portion of the contribution not funded by the time set for filing of the Federal income tax return for that year or any extension thereof shall not be allowable in subsequent years.

(D) When a plan or agreement exists wherein the liability for the contribution cannot be compelled, the amount contributed for any year is assignable to that year provided the amount is funded by the time set for filing of the Federal income tax return for that year.

(E) When the contribution is in the form of stock, the value of the stock contribution shall be limited to the fair market value of the stock on the date that title is effectively transferred to the trust.

Cash contributions shall be allowable only when the contractor furnishes evidence satisfactory to the contracting officer demonstrating that stock purchases by the ESOP are or will be at a fair market price; *e.g.*, makes arrangements with the trust permitting the contracting officer to examine purchases of stock by the trust to determine that prices paid are at fair market value. When excessive prices are paid, the amount of the excess will be credited to the same indirect cost pools that were charged for the ESOP contributions in the year in which the stock purchase occurs. However, when the trust purchases the stock with borrowed funds which will be repaid over a period of years by cash contributions from the contractor to the trust, the excess price over fair market value shall be credited to the indirect cost pools pro rata over the period of years during which the contractor contributes the cash used by the trust to repay the loan. When the fair market value of unissued stock or stock of a closely held corporation is not readily determinable, the valuation will be made on a case-by-case basis taking into consideration the guidelines for valuation used by the IRS.

(ii) Amounts contributed to an ESOP arising from either

(A) An additional investment tax credit (see 1975 Tax Reduction Act TRASOP's); or

(B) A payroll-based tax credit (see Economic Recovery Tax Act of 1981) are unallowable.

(iii) The requirements of subparagraph (j)(3)(ii) of this subsection are applicable to Employee Stock Ownership Plans.

(k) *Deferred Compensation Other Than Pensions.*

(1) Deferred compensation is an award given by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods before the date of receipt of compensation by the employee. Deferred compensation does not include the amount of year-end accruals for salaries, wages, or bonuses that are paid within a reasonable period of time after the end of a cost accounting period. Deferred awards are allowable when they are based on current or future services. Awards made in periods subsequent to the period when the work being remunerated was performed are not allowable.

(2) The costs of deferred awards shall be measured, allocated, and accounted for in compliance with the provisions of 48 CFR 9904.415, Accounting for the Cost of Deferred Compensation.

(3) Deferred compensation payments to employees under awards made before the effective date of 48 CFR 9904.415 are allowable to the extent they would have been allowable under prior acquisition regulations.

(l) *Compensation Incidental to Business Acquisitions.* The following costs are unallowable:

(1) Payments to employees under agreements in which they receive special compensation, in excess of the contractor's normal severance pay practice, if their employment terminates following a change in the management control over, or ownership of, the contractor or a substantial portion of its assets.

(2) Payments to employees under plans introduced in connection with a change (whether actual or prospective) in the management control over, or ownership of, the contractor or a substantial portion of its assets in which those employees receive special compensation, which is contingent upon the employee remaining with the contractor for a specified period of time.

(m) *Fringe Benefits.*

(1) Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. Fringe benefits include, but are not limited to, the cost of vacations, sick leave, holidays, military leave, employee insurance, and supplemental unemployment benefit plans. Except as provided otherwise in subparagraph A.2 of Procurement Guidance T3.3.2. “Contracts with Commercial Organizations,” the costs of fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor.

(2) That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees (see Cost (43)(f).

(n) *Employee Rebate and Purchase Discount Plans.* Rebates and purchase discounts, in whatever form, granted to employees on products or services produced by the contractor or affiliates are unallowable.

(o) *Postretirement Benefits Other Than Pensions (PRB).*

(1) PRB covers all benefits, other than cash benefits and life insurance benefits paid by pension plans, provided to employees, their beneficiaries, and covered dependents during the period following the employees' retirement. Benefits encompassed include, but are not limited to, postretirement health care; life insurance provided outside a pension plan;

and other welfare benefits such as tuition assistance, day care, legal services, and housing subsidies provided after retirement.

(2) To be allowable, PRB costs must be reasonable and incurred pursuant to law, employer-employee agreement, or an established policy of the contractor. In addition, to be allowable, PRB costs must also be calculated in accordance with subparagraphs (o)(2)(i) or (iii) of this section.

(i) *Cash Basis.* Cost recognized as benefits when they are actually provided, must be paid to an insurer, provider, or other recipient for current year benefits or premiums.

(ii) *Terminal Funding.* If a contractor elects a terminal-funded plan, it does not accrue PRB costs during the working lives of employees. Instead, it accrues and pays the entire PRB liability to an insurer or trustee in a lump sum upon the termination of employees (or upon conversion to such a terminal-funded plan) to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees. The lump sum is allowable if amortized over a period of 15 years.

(iii) *Accrual Basis.* Accrual costing other than terminal funding must be measured and assigned according to Generally Accepted Accounting Principles and be paid to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees. The accrual must also be calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

(3) To be allowable, costs must be funded by the time set for filing the Federal income tax return or any extension thereof. PRB costs assigned to the current year, but not funded or otherwise liquidated by the tax return time, shall not be allowable in any subsequent year.

(4) Increased PRB costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable.

(5) Costs of postretirement benefits in subdivision (o)(2)(iii) of this subsection attributable to past service ("transition obligation") as defined in Financial Accounting Standards Board Statement 106, paragraph 110, are allowable subject to the following limitation: The allowable amount of such costs assignable to a contractor fiscal year cannot exceed the amount of such costs which would be assigned to that contractor fiscal year under the delayed recognition methodology described in paragraphs 112 and 113 of Statement 106.

(6) The Government shall receive an equitable share of any amount of previously funded PRB costs which revert or inure to the contractor. Such equitable share shall reflect the Government's previous participation in PRB costs through those contracts for which cost or pricing data were required or which were subject to subparagraph A.2. “Contracts with Commercial Organization” of Procurement Guidance T3.3.2.

(p) *Limitation on Allowability of Compensation for Certain Contractor Personnel*.

(1) Costs incurred after January 1, 1998, for compensation of a senior executive in excess of the benchmark compensation amount determined applicable for the contractor fiscal year are unallowable . This limitation is the sole statutory limitation on allowable senior executive compensation costs incurred after January 1, 1998, under new or previously existing contracts. This limitation applies whether or not the affected contracts were previously subject to a statutory limitation on such costs. (Note that pursuant to Section 804 of Pub. L. 105-261, the definition of "senior executive" in (p)(2)(ii) has been changed for compensation costs incurred after January 1, 1999.

(2) As used in this paragraph:

(i) "Compensation" means the total amount of wages, salary, bonuses, deferred compensation (see subparagraph (k) of this subsection), and employer contributions to defined contribution pension plans (see subparagraphs (j)(5) and (j)(7) of this subsection), for the fiscal year, whether paid, earned, or otherwise accruing, as recorded in the contractor's cost accounting records for the fiscal year.

(ii) "Senior executive" means

(A) Prior to January 2, 1999;

(*aa)* The Chief Executive Officer (CEO) or any individual acting in a similar capacity at the contractor's headquarters;

(*bb*) The four most highly compensated employees in management positions at the contractor's headquarters, other than the CEO; and

(*cc*) If the contractor has intermediate home offices or segments that report directly to the contractor's headquarters, the five

most highly compensated
employees in management
positions at each
such intermediate home office
or segment.

(B) Effective January 2, 1999, the five most highly compensated employees in management positions at each home office and each segment of the contractor, whether or not the home office or segment reports directly to the contractor's headquarters.

(iii) "Fiscal year" means the fiscal year established by the contractor for accounting purposes.

(iv) "Contractor's headquarters" means the highest organizational level from which executive compensation costs are allocated to Government contracts.

(q) *Employee Stock Ownership Plans (ESOP)*

(1) An ESOP is a stock bonus plan designed to invest primarily in the stock of the employer corporation. The contractor’s contributions to an Employee Stock Ownership Trust (ESOT) may be in the form of cash, stock, or property.
(2) Costs of ESOPs are allowable subject to the following conditions:

(i) For ESOPs that meet the definition of a pension plan at, the contractor:

(A) Measures, assigns, and allocates the costs; and

(B) Funds the pension costs by the time set for filing of the Federal income tax return or any extension. Pension costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year.

(ii) For ESOPs that do not meet the definition of a pension plan, the contractor measures, assigns, and allocates costs in accordance with 48 CFR 9904.415.

(iii) Contributions by the contractor in any one year that exceed the deductibility limits of the Internal Revenue Code for that year are unallowable.

(iv) When the contribution is in the form of stock, the value f the stock contribution is limited to the fair market value

of the stock on the date that title is effectively transferred to the trust.

(v) When the contribution is in the form of cash:

(A) Stock purchases by the ESOP in excess of fair market value are unallowable; and

(B) When stock purchases are in excess of fair market value, the contractor must credit the amount of the excess to the same indirect cost pools that were charged for the ESOP contributions in the year in which the stock purchase occurs. However, when the trust purchases the stock with borrowed funds which will be repaid over a period of years by cash contributions from the contractor to the trust, the contractor shall credit the excess price over fair market value to the indirect cost pools pro rata over the period of years during which the contractor contributes the cash used by the trust to repay the loan.

(iii) When the fair market value of unissued stock or stock of a closely held corporation is not readily determinable, the valuation will be made on a case-by-case basis taking into consideration the guidelines for valuation used by the IRS.

***(5) Contingencies.***

(a) "Contingency," as used in this subpart, means a possible future event or condition arising from presently known or unknown causes, the outcome of which is indeterminable at the present time.

(b) Costs for contingencies are generally unallowable for historical costing purposes because such costing deals with costs incurred and recorded on the contractor's books. However, in some cases, as for example, terminations, a contingency factor may be recognized when it is applicable to a past period to give recognition to minor unsettled factors in the interest of expediting settlement.

(c) In connection with estimates of future costs, contingencies fall into two categories:

(1) Those that may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; *e.g.*, anticipated costs of rejects and defective work. Contingencies of this category are to be included in the estimates of future costs so as to provide the best estimate of performance cost.

(2) Those that may arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government; *e.g.*, results of pending litigation. Contingencies of this category are to be excluded from cost estimates under the several items of cost, but should be disclosed separately (including the basis upon which the contingency is computed) to facilitate the negotiation of appropriate contractual coverage.

**(6)** ***Contributions or Donations***.

Contributions or donations, including cash, property and services, regardless of recipient, are unallowable, except as provided in Cost (1)(c)(3).

(**7)** ***Cost of Money***

(a) *General.* Cost of money:

(1) Is an imputed cost that is not a form of interest on borrowings [see Cost (17)];

(2) Is an "incurred cost" for cost-reimbursement purposes under applicable cost-reimbursement contracts and for progress payment purposes under fixed-price contracts; and

(3) Refers to

(i) Facilities capital cost of money (48 CFR 9904.414); and

(ii) Cost of money as an element of the cost of capital assets under construction (48 CFR 9904.417).

(b) Cost of money is allowable, provided-

(1) It is measured, assigned, and allocated to contracts in accordance with 48 CFR 9904.414 or measured and added to the cost of capital assets under construction in accordance with 48 CFR 9904.417, as applicable;

(2) The requirements of Cost (48), which limit the allowability of cost of money, are followed; and

(3) The estimated facilities capital cost of money is specifically identified and proposed in cost proposals relating to the contract under which the cost is to be claimed.

(c) Actual interest cost in lieu of the calculated imputed cost of money is unallowable.

**(8)** ***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 need be used in establishing depreciable costs. Where either the declining balance method of depreciation or the class life asset depreciation range system is used, the residual value need not be deducted from capitalized cost to determine depreciable costs. Depreciation cost that would significantly 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 must 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 which meets the criteria for allowance at price under Cost (23)(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 . In determining the charge, consideration shall be given to 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 requirements of Cost (48) shall be observed.

(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 Cost (13(h)]. 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) In the event the contractor reacquires property involved in a sale and leaseback

arrangement, allowable depreciation of reacquired property shall be based on the net book value of the asset as of the date the contractor originally became a lessee of the property in the sale and leaseback arrangement:

(1) Adjusted for any allowable gain or loss; and

(2) Less any amount of depreciation expense included in the calculation of the amount that would have been allowed had the contractor retained title.

j. 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, except that:

(1) Lease 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; and

(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.

**(9)** ***Economic Planning Costs.***

Economic planning costs are the costs of general long-range management planning that is concerned with the future overall development of the contractor's business and that may take into account the eventual possibility of economic dislocations or fundamental alterations in those markets in which the contractor currently does business. Economic planning costs are allowable. Economic planning costs do not include organization or reorganization costs covered by Cost.(24). See Cost (35) for market planning costs other than economic planning costs.

**(10)** ***Employee Morale, Health, Welfare, Food Service, and Dormitory Costs and Credits*****.**

(a) Aggregate costs incurred on activities designed to improve working conditions, employer- employee relations, employee morale, and employee performance (less income generated by these activities) are allowable, subject to the limitations contained in this subsection. Some examples of allowable activities are-

(1) House publications;

(2) Health clinics;

(3) Wellness/fitness centers;

(4) Employee counseling services; and

(5) Food and dormitory services for the contractor's employees at or near the contractor's facilities. These services include-

(i) Operating or furnishing facilities for cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations; and

(ii) Similar types of services.

(b) *Costs of Gifts Are Unallowable.* (Gifts do not include awards for performance or awards made in recognition of employee achievements pursuant to an established contractor plan or policy.)

(c) Costs of recreation are unallowable, except for the costs of employees' participation in company sponsored sports teams or employee organizations designed to improve company loyalty, team work, or physical fitness.

(d)

(1) The allowability of food and dormitory losses are determined by the following factors:

(i) Losses from operating food and dormitory services are allowable only if the contractor's objective is to operate such services on a break-even basis.

(ii) Losses sustained because food services or lodging accommodations are furnished without charge or at prices or rates which obviously would not be conducive to the accomplishment of the objective in paragraph (d)(1)(i) of this subsection are not allowable, except as described in paragraph (d)(1)(iii) of this subsection.

(iii) A loss may be allowed to the extent that the contractor can demonstrate that unusual circumstances exist such that even with efficient management, operating the services on a break-even basis would require charging inordinately high prices, or prices or rates higher than those charged by commercial establishments offering the same services in the same geographical areas. The following are examples of unusual circumstances:

(A) The contractor must provide food or dormitory services at remote locations where adequate commercial facilities are not reasonably available.

(B) The contractor's charged (but unproductive) labor costs would be excessive if the services were not available.

(C) If cessation or reduction of food or dormitory operations will not otherwise yield net cost savings.

(2) Costs of food and dormitory services shall include an allocable share of indirect expenses pertaining to these activities.

(e) When the contractor has an arrangement authorizing an employee association to provide or operate a service, such as vending machines in the contractor's plant, and retain the profits, such profits shall be treated in the same manner as if the contractor were providing the service (but see subparagraph (f) of this subsection).

(f) Contributions by the contractor to an employee organization, including funds from vending machine receipts or similar sources, are allowable only to the extent that the contractor demonstrates that an equivalent amount of the costs incurred by the employee organization would be allowable if directly incurred by the contractor.

**(11)** ***Entertainment Costs*****.** Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle. Costs of membership in social, dining, or country clubs or other organizations having the same purposes are also unallowable, regardless of whether the cost is reported as taxable income to the employees.

**(12)** ***Fines, Penalties, and Mischarging Costs.***

(a) Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, Federal, State, local, or foreign laws and regulations, are unallowable except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer.

(b) Costs incurred in connection with, or related to, the mischarging of costs on Government contracts are unallowable when the costs are caused by, or result from, alteration or destruction of records, or other false or improper charging or recording of costs. Such costs include those incurred to measure or otherwise determine the magnitude of the improper charging, and costs incurred to remedy or correct the mischarging, such as costs to rescreen and reconstruct records.

**(13)** ***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 Cost (16)] of depreciable property 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 subparagraph (d) of this subsection]. However, no gain or loss shall be recognized as a result of the transfer of assets in a business combination . See subparagraph

Cost (48), “Asset Valuations Resulting from Business Combinations.”

(b) Notwithstanding the provisions in paragraph (c) of this subsection, when costs of depreciable property are subject to the sale and leaseback limitations:

(1) The gain or loss is the difference between the net amount realized and the undepreciated balance of the asset on the date the contractor becomes a lessee; and

(2) When the application of (b)(1) of this subsection results in a loss:

(i) The allowable portion of the loss is zero if the fair market value exceeds the undepreciated balance of the asset on the date the contractor becomes a lessee; and

(ii) The allowable portion of the loss is limited to the difference between the fair market value and the undepreciated balance of the asset on the date the contractor becomes a lessee if the fair market value is less than the undepreciated balance of the asset on the date the contractor becomes a lessee.

(c) Gains and losses on disposition of tangible capital assets, including those acquired under capital leases, 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. 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 subdivisions (c)(2)(i) or (ii) of this section).

(d) Special considerations apply to an involuntary con-version which occurs when a contractor's property is destroyed by events over which the owner has no control, such as fire, windstorm, flood, accident, theft, etc., and an insurance award is recovered. The following govern involuntary conversions:

(1) When there is a cash award and the converted asset is not replaced, gain or loss shall be recognized in the period of disposition. The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost of the asset and its undepreciated balance.

(2) When the converted asset is replaced, the contractor shall either

(i) Adjust the depreciable basis of the new asset by the amount of the total realized gain or loss; or

(ii) Recognize the gain or loss in the period of disposition, in which case the Government shall participate to the same

extent as outlined in subparagraph (d)(1) of this subsection.

(e) Gains and losses on the disposition of depreciable property shall not be recognized as a separate charge or credit when

(1) Gains and losses are processed through the depreciation reserve account and reflected in the depreciation allowable under Cost.(8); or

(2) The property is exchanged as part of the purchase price of a similar item, and the gain or loss is taken into consideration in the depreciation cost basis of the new item.

(f) Gains and losses arising from mass or extraordinary sales, retirements, or other disposition other than through business combinations shall be considered on a case-by-case basis.

(g) Gains and losses of any nature arising from the sale or exchange of capital assets other than depreciable property shall be excluded in computing contract costs.

(h) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be allowed for a write-down from carrying value to fair value as a result of impairments caused by events or changes in circumstances (*e.g.*, environmental damage, idle facilities arising from a declining business base, etc.). If depreciable property or other capital assets have been written down from carrying value to fair value due to impairments, gains or losses upon disposition shall be the amounts that would have been allowed had the assets not been written down.

**(14)** ***Idle Facilities and Idle Capacity Costs.***

(a) "Costs of idle facilities or idle capacity," as used in this subsection, means costs such as maintenance, repair, housing, rent, and other related costs; *e.g.*, property taxes, insurance, and depreciation.

(1) "Facilities," as used in this subsection, means plant or any portion thereof (including land integral to the operation), equipment, individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the contractor.

(2) "Idle capacity," as used in this subsection, means the unused capacity of partially used facilities. It is the difference between that which a facility could achieve under 100 percent operating time on a one-shift basis, less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and the extent to which the facility was actually used to meet demands during the accounting period. A multiple-shift basis may be used in the calculation instead of a one-shift basis if it can be shown that this amount of usage could normally be expected for the type of facility involved.

(3) "Idle facilities," as used in this subsection, means completely unused facilities that are excess to the contractor's current needs.

(b) The costs of idle facilities are unallowable unless the facilities

(1) Are necessary to meet fluctuations in workload; or

(2) Were necessary when acquired and are now idle because of changes in requirements, production economies, reorganization, termination, or other causes which could not have been reasonably foreseen. (Costs of idle facilities are allowable for a reasonable period, ordinarily not to exceed 1 year, depending upon the initiative taken to use, lease, or dispose of the idle facilities (but see Cost (39)).

(c) Costs of idle capacity are costs of doing business and are a factor in the normal fluctuations of usage or overhead rates from period to period. Such costs are allowable provided the capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire plant or among a group of assets having substantially the same function may be idle facilities.

(d) Any costs to be paid directly by the Government for idle facilities or idle capacity reserved for defense mobilization production shall be the subject of a separate agreement.

**(15)** ***Independent Research and Development and Bid and Proposal Costs*****.**

(a) *Definitions.*

(1) "Applied research," as used in this subsection, means that effort which (1) normally follows basic research, but may not be severable from the related basic research, (2) attempts to determine and exploit the potential of scientific discoveries or improvements in technology, materials, processes, methods, devices, or techniques, and (3) attempts to advance the state of the art. Applied research does not include efforts whose principal aim is design, development, or test of specific items or services to be considered for sale; these efforts are within the definition of the term "development," defined in this subsection.

(2) "Basic research," as used in this subsection, means that research which is directed toward increase of knowledge in science. The primary aim of basic research is a fuller knowledge or understanding of the subject under study, rather than any practical application thereof.

(3) "Bid and proposal (B&P) costs," as used in this subsection, means the costs incurred in preparing, submitting, and supporting bids and proposals (whether or not solicited) on potential Government or non-Government contracts. The term does not include the costs of effort sponsored by a grant or cooperative agreement, or required in the performance of a contract.

(4) "Company," as used in this subsection, means all divisions, subsidiaries,

and affiliates of the contractor under common control.

(5) "Development," as used in this subsection, means the systematic use, under whatever name, of scientific and technical knowledge in the design, development, test, or evaluation of a potential new product or service (or of an improvement in an existing product or service) for the purpose of meeting specific performance requirements or objectives. Development includes the functions of design engineering, prototyping, and engineering testing. Development excludes

(i) Subcontracted technical effort which is for the sole purpose of developing an additional source for an existing product, or

(ii) Development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for sale.

(iii) "Independent research and development (IR&D)," as used in this subsection, means a contractor's IR&D cost that consists of projects falling within the four following areas: (1) basic research, (2) applied research, (3) development, and (4) systems and other concept formulation studies. The term does not include the costs of effort sponsored by a grant or required in the performance of a contract. IR&D effort shall not include technical effort expended in developing and preparing technical data specifically to support submitting a bid or proposal.

(iv) "Systems and other concept formulation studies," as used in this subsection, means analyses and study efforts either related to specific IR&D efforts or directed toward identifying desirable new systems, equipment or components, or modifications and improvements to existing systems, equipment, or components.

(b) *Composition and Allocation of Costs.* The requirements of 48 CFR 9904.420, Accounting for independent research and development costs and bid and proposal costs, are incorporated in their entirety and shall apply as follows

(1) *Fully-CAS-covered contracts.* Contracts that are fully-CAS-covered shall be subject to all requirements of 48 CFR 9904.420.

(2) *Modified CAS-covered and Non-CAS-covered Contracts.* Contracts that are not CAS-covered or that contain terms or conditions requiring modified CAS coverage shall be subject to all requirements of 48 CFR 9904.420 except 48 CFR 9904.420-50(e)(2) and 48 CFR 9904.420-50(f)(2), which are not then applicable. However, non-CAS-covered or modified CAS-covered contracts awarded at a time the contractor has CAS-covered contracts requiring

compliance with 48 CFR 9904.420, shall be subject to all the requirements of 48 CFR 9904.420. When the requirements of 48 CFR 9904.420-50(e)(2) and 48 CFR 9904.420-50(f)(2) are not applicable, the following apply:

(i) IR&D and B&P costs shall be allocated to final cost objectives on the same basis of allocation used for the G&A expense grouping of the profit center in which the costs are incurred. However, when IR&D and B&P costs clearly benefit other profit centers or benefit the entire company, those costs shall be allocated through the G&A of the other profit centers or through the corporate G&A, as appropriate.

(ii) If allocations of IR&D or B&P through the G&A base do not provide equitable cost allocation, the contracting officer may approve use of a different base.

(c) *Allowability*. Except as provided in subparagraphs (d) and (e) of this subsection, or as provided in agency regulations, costs for IR&D and B&P are allowable as indirect expenses on contracts to the extent that those costs are allocable and reasonable.

(d) *Deferred IR&D costs*.

(1) IR&D costs that were incurred in previous accounting periods are unallowable, except when a contractor has developed a specific product at its own risk in anticipation of recovering the development costs in the sale price of the product provided that

(i) The total amount of IR&D costs applicable to the product can be identified;

(ii) The proration of such costs to sales of the product is reasonable;

(iii) The contractor had no Government business during the time that the costs were incurred or did not allocate IR&D costs to Government contracts except to prorate the cost of developing a specific product to the sales of that product; and

(iv) No costs of current IR&D programs are allocated to Government work except to prorate the costs of developing a specific product to the sales of that product.

(2) When deferred costs are recognized, the contract (except firm-fixed-price and fixed-price with economic price adjustment) will include a specific provision setting forth the amount of deferred IR&D costs that are allocable to the contract. The negotiation memorandum will state the circumstances

pertaining to the case and the reason for accepting the deferred costs.

(e) *Cooperative Arrangements.*

(1) IR&D costs may be incurred by contractors working jointly with one or more non-Federal entities pursuant to a cooperative arrangement (for example, joint ventures, limited partnerships, teaming arrangements, and collaboration and consortium arrangements). IR&D costs also may include costs contributed by contractors in performing cooperative research and development agreements, or similar arrangements, entered into under

(i) Section 12 of the Stevenson-Wydler Technology Transfer Act of 1980 (15 U.S.C. 3710(a));

(ii) Sections 203(c)(5) and (6) of the National Aeronautics and Space Act of 1958, as amended (42 U.S.C. 2473(c)(5) and (6));

(iii) 10 U.S.C. 2371 for the Defense Advanced Research Projects Agency; or

(iv) Other equivalent authority.

(2) IR&D costs incurred by a contractor pursuant to these types of cooperative arrangements should be considered as allowable IR&D costs if the work performed would have been allowed as contractor IR&D had there been no cooperative arrangement.

(3) Costs incurred in preparing, submitting, and supporting offers on potential cooperative arrangements are allowable to the extent they are allocable, reasonable, and not otherwise unallowable.

**(16)** ***Insurance and Indemnification.***

(a) Insurance by purchase or by self-insuring includes

(1) Coverage the contractor is required to carry or to have approved, under the terms of the contract; and

(2) Any other coverage the contractor maintains in connection with the general conduct of its business.

(b) For purposes of applying the provisions of this subsection, the Government considers insurance provided by captive insurers (insurers owned by or under control of the contractor) as self-insurance, and charges for it shall comply with the provisions applicable to self-insurance costs in this subsection. However, if the captive insurer also sells insurance to the general public in substantial quantities and it can be demonstrated that the charge to the contractor is based on competitive market forces, the Government will consider the insurance as purchased insurance.

(c) Whether or not the contract is subject to CAS, self-insurance charges are allowable subject to paragraph (e) of this subsection and the following limitations:

(1) The contractor shall measure, assign, and allocate costs in accordance with 48 CFR 9904.416, Accounting for Insurance Costs.

(2) The contractor shall comply with Procurement Guidance T3.4.1. However, approval of a contractor's insurance program does not constitute a determination as to the allowability of the program's cost.

(3) If purchased insurance is available, any self-insurance charge plus insurance administration expenses in excess of the cost of comparable purchased insurance plus associated insurance administration expenses is unallowable.

(4) Self-insurance charges for risks of catastrophic losses are unallowable.

(d) Purchased insurance costs are allowable, subject to paragraph (e) of this subsection and the following limitations:

(1) For contracts subject to full CAS coverage, the contractor shall measure, assign, and allocate costs in accordance with 48 CFR 9904.416.

(2) For all contracts, premiums for insurance purchased from fronting insurance companies (insurance companies not related to the contractor but who reinsure with a captive insurer of the contractor) are unallowable to the extent they exceed the sum of

(i) The amount that would have been allowed had the contractor insured directly with the captive insurer; and

(ii) Reasonable fronting company charges for services rendered.

(3) Actual losses are unallowable unless expressly provided for in the contract, except-

(i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable; and

(ii) Minor losses, such as spoilage, breakage, and disappearance of small hand tools that occur in the ordinary course of business and that are not covered by insurance, are allowable.

(e) Self-insurance and purchased insurance costs are subject to the cost limitations in the following paragraphs:

(1) Costs of insurance required or approved pursuant to the contract are allowable.

(2) Costs of insurance maintained by the contractor in connection with the general conduct of its business are allowable subject to the following limitations:

(i) Types and extent of coverage shall follow sound business practice, and the rates and premiums shall be reasonable.

(iii) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of profit.

(iv) The cost of property insurance premiums for insurance coverage in excess of the acquisition cost of the insured assets is allowable only when the contractor has a formal written policy assuring that in the event the insured property is involuntarily converted, the new asset shall be valued at the book value of the replaced asset plus or minus adjustments for differences between insurance proceeds and actual replacement cost. If the contractor does not have such a formal written policy, the cost of premiums for insurance coverage in excess of the acquisition cost of the insured asset is unallowable.

(iv) Costs of insurance for the risk of loss of, or damage to, Government property are allowable only to the extent that the contractor is liable for such loss or damage and such insurance does not cover loss or damage which results from willful misconduct or lack of good faith on the part of any of the contractor's directors or officers, or other equivalent representatives.

(v) Costs of insurance on the lives of officers, partners, proprietors, or employees are allowable only to the extent that the insurance represents additional compensation [see Procurement Guidance T3.3.2].

(3) The cost of insurance to protect the contractor against the costs of correcting its own defects in materials and workmanship is unallowable. However, insurance costs to cover fortuitous or casualty losses resulting from defects in materials or workmanship are allowable as a normal business expense.

(4) Premiums for retroactive or backdated insurance written to cover losses that have occurred and are known are unallowable.

(5) The Government is obligated to indemnify the contractor only to the extent authorized by law, as expressly provided for in the contract, except as provided in paragraph (d)(3) of this subsection.

(6) Late premium payment charges related to employee deferred compensation plan insurance incurred pursuant to Section 4007 (29 U.S.C. 1307) or Section 4023 (29 U.S.C. 1323) of the Employee Retirement Income Security Act of 1974 are unallowable.

**(17)** ***Interest and Other Financial Costs.*** Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities), legal and professional fees paid in connection with preparing prospectuses, costs of preparing and issuing stock rights, and directly associated costs are unallowable except for interest assessed by State or local taxing authorities under the conditions specified in Cost (38) [but see Cost (25)].

**(18)** ***Labor Relations Costs*****.** (a) Costs incurred in maintaining satisfactory relations between the contractor and its employees, (other than those made unallowable in paragraph (b) of this section), including costs of shop stewards, labor management committees, employee publications, and other related activities, are allowable.

(b) As required by Executive Order 13494, Economy in Government Contracting, costs of any activities undertaken to persuade employees, of any entity, to exercise or not to exercise, or concerning the manner of exercising, the right to organize and bargain collectively through representatives of the employees' own choosing are unallowable. Examples of unallowable costs in paragraph (b) of this section include, but are not limited to, the costs of—

(1) Preparing and distributing materials;

(2) Hiring or consulting legal counsel or consultants;

(3) Meetings (including paying the salaries of the attendees at meetings held for this purpose); and

(4) Planning or conducting activities by managers, supervisors, or union representatives during work hours.

**(19)** ***Lobbying and Political Activity Costs.***

(a) Costs associated with the following activities are unallowable:

(1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activities;

(2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of

elections;

(3) Any attempt to influence

(i) The introduction of Federal, state, or local legislation, or

(ii) The enactment or modification of any pending Federal, state, or local legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence state or local officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

(4) Any attempt to influence

(i) The introduction of Federal, state, or local legislation, or

(ii) The enactment or modification of any pending Federal, state, or local legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fund raising drive, lobbying campaign or letter writing or telephone campaign;

(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable activities; or

(6) Costs incurred in attempting to improperly influence, either directly or indirectly, an employee or officer of the Executive branch of the Federal Government to give consideration to or act regarding a regulatory or contract matter.

(b) The following activities are excepted from the coverage of (a) of this section:

(1) Providing a technical and factual presentation of information on a topic directly related to the performance of a contract through hearing testimony, statements or letters to the Congress or a state legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided such information is readily obtainable and can be readily put in deliverable form; and further provided that costs under this section for transportation, lodging or

meals are unallowable unless incurred for the purpose of offering testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.

(2) Any lobbying made unallowable by subparagraph (a)(3) of this subsection to influence state or local legislation in order to directly reduce contract cost, or to avoid material impairment of the contractor's authority to perform the contract.

(3) Any activity specifically authorized by statute to be undertaken with funds from the contract.

(c) When a contractor seeks reimbursement for indirect costs, total lobbying costs shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable activity costs.

(d) Contractors shall maintain adequate records to demonstrate that the certification of costs as being allowable or unallowable.

(e) Existing procedures should be utilized to resolve in advance any significant questions or disagreements concerning the interpretation or application of this subsection.

**(20)** ***Losses on Other Contracts***. An excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts) is unallowable.

**(21)** ***RESERVED***

**(22)** ***Manufacturing and Production Engineering Costs.***

(a) The costs of manufacturing and production engineering effort as described in (1) through (4) of this subparagraph are all allowable:

(1) Developing and deploying new or improved materials, systems, processes, methods, equipment, tools and techniques that are or are expected to be used in producing products or services;

(2) Developing and deploying pilot production lines;

(3) Improving current production functions, such as plant layout, production scheduling and control, methods and job analysis, equipment capabilities and capacities, inspection techniques, and tooling analysis (including tooling design and application improvements); and

(4) Material and manufacturing producibility analysis for production suitability and to optimize manufacturing processes, methods, and techniques.

(b) This cost principle does not cover

(1) Basic and applied research effort (as defined in Cost (15)(1)) related to new technology, materials, systems, processes, methods, equipment, tools and techniques. Such technical effort is governed by Cost (15), Independent Research and Development and Bid and Proposal Costs; and

(2) Development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques that are intended for sale is also governed by Cost (15).

(c) Where manufacturing or production development costs are capitalized or required to be capitalized under the contractor's capitalization policies, allowable cost will be determined in accordance with the requirements of Cost (8), “Depreciation”.

**(23)** ***Material Costs.***

(a) Material costs include the costs of such items as raw materials, parts, subassemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and in-transit insurance. In computing material costs, the contractor shall consider reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work).

(b) The contractor shall-

(1) Adjust the costs of material for income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts, and credits for scrap, salvage, and material returned to vendors; and

(2) Credit such income and other credits either directly to the cost of the material or allocate such income and other credits as a credit to indirect costs. When the contractor can demonstrate that failure to take cash discounts was reasonable, the contractor does not need to credit lost discounts.

(c) Reasonable adjustments arising from differences between periodic physical inventories and book inventories may be included in arriving at costs; provided such adjustments relate to the period of contract performance.

(d) When materials are purchased specifically for and are identifiable solely with performance under a contract, the actual purchase cost of those materials should be charged to the contract. If material is issued from stores, any generally recognized method of pricing such material is acceptable if that method is consistently applied and the results are equitable.

(e) Allowance for all materials, supplies and services that are sold or transferred between any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control shall be on the basis of cost incurred in accordance with this subpart. However, allowance may be at price when

(1) It is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary or affiliate of the contractor under a common control; and

(2) The item being transferred qualifies for an exception and the contracting officer has not determined the price to be unreasonable.

(f) When a commercial item under paragraph (e) of this subsection is transferred at a price based on a catalog or market price, the contractor-

(1) Should adjust the price to reflect the quantities being acquired; and

(2) May adjust the price to reflect the actual cost of any modifications necessary because of contract requirements.

**(24)** ***Organization Costs.***

(a) Except as provided in subparagraph (b) of this subsection, expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, (2) resisting or planning to resist the reorganization of the corporate structure of a business or a change in the controlling interest in the ownership of a business, and (3) raising capital (net worth plus long-term liabilities), are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counselors, whether or not employees of the contractor. Unallowable "reorganization" costs include the cost of any change in the contractor's financial structure, excluding administrative costs of short-term borrowings for working capital, resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised.

(b) The cost of activities primarily intended to provide compensation will not be considered organizational costs subject to this subsection, but will be governed by Cost (4). These activities include acquiring stock for

(1) Executive bonuses,

(2) Employee savings plans, and

(3) Employee stock ownership plans.

**(25)** ***Other Business Expenses***. The following types of recurring costs are allowable:

(a) Registry and transfer charges resulting from changes in ownership of securities issued by the contractor.

(b) Cost of shareholders' meetings.

(c) Normal proxy solicitations.

(d) Preparing and publishing reports to shareholders.

(e) Preparing and submitting required reports and forms to taxing and other regulatory bodies.

(f) Incidental costs of directors' and committee meetings.

(g) Other similar costs.

**(26)** ***Plant Protection Costs***. Costs of items such as

(a) Wages, uniforms, and equipment of personnel engaged in plant protection,

(b) Depreciation on plant protection capital assets, and

(c) Necessary expenses to comply with military requirements, are allowable.

**(27)** ***Patent Costs*****.**

(a) The following patent costs are allowable to the extent that they are incurred as requirements of a Government contract [but see Cost (30)]:

> (1) Costs of preparing invention disclosures, reports, and other documents.
>
> (2) Costs for searching the art to the extent necessary to make the invention disclosures.
>
> (3) Other costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is to be conveyed to the Government.

(b) General counseling services relating to patent matters, such as advice on patent laws, regulations, clauses, and employee agreements, are allowable [but see Cost (30)].

(c) Other than those for general counseling services, patent costs not required by the contract are unallowable. [See also Cost (34)].

**(28)*****Plant Reconversion Costs.*** Plant reconversion costs are those incurred in restoring or rehabilitating the contractor's facilities to approximately the same condition existing immediately before the start of the Government contract, fair wear and tear excepted. Reconversion costs are unallowable except for the cost of removing Government property and the restoration or rehabilitation costs caused by such removal. However, in special circumstances where equity so dictates, additional costs may be allowed to the extent agreed upon before costs are incurred.

Care should be exercised to avoid duplication through allowance as contingencies, additional profit or fee, or in other contracts.

**(29)** ***Precontract Costs.*** Precontract costs are those incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule. Such costs are allowable to the extent that they would have been allowable if incurred after the date of the contract.

**(30)** ***Professional and Consultant Service Costs.***

(a) *Definition.* "Professional and consultant services", as used in this subpart, are those services rendered by persons who are members of a particular profession or possess a special skill and who are not officers or employees of the contractor. Examples include those services acquired by contractors or subcontractors in order to enhance their legal, economic, financial, or technical positions. Professional and consultant services are generally acquired to obtain information, advice, opinions, alternatives, conclusions, recommendations, training, or direct assistance, such as studies, analyses, evaluations, liaison with Government officials, or other forms of representation.

(b) Costs of professional and consultant services are allowable subject to this subparagraph and subparagraphs (c) through (f) of this subsection when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government [but see Costs (27) and (44)].

(c) Costs of professional and consultant services performed under any of the following circumstances are unallowable:

> (1) Services to improperly obtain, distribute, or use information or data protected by law or regulation .
>
> (2) Services that are intended to improperly influence the contents of solicitations, the evaluation of proposals or quotations, or the selection of sources for contract award, whether award is by the Government, or by a prime contractor or subcontractor.
>
> (3) Any other services obtained, performed, or otherwise resulting in violation of any statute or regulation prohibiting improper business practices or conflicts of interest.
>
> (4) Services performed which are not consistent with the purpose and scope of the services contracted for or otherwise agreed to.

(d) In determining the allowability of costs (including retainer fees) in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the contracting officer shall consider the following factors, among others:

(1) The nature and scope of the service rendered in relation to the service required.

(2) The necessity of contracting for the service, considering the contractor's capability in the particular area.

(3) The past pattern of acquiring such services and their costs, particularly in the years prior to the award of Government contracts.

(4) The impact of Government contracts on the contractor's business.

(5) Whether the proportion of Government work to the contractor's total business is such as to influence the contractor in favor of incurring the cost, particularly when the services rendered are not of a continuing nature and have little relationship to work under Government contracts.

(6) Whether the service can be performed more economically by employment rather than by contracting.

(7) The qualifications of the individual or concern rendering the service and the customary fee charged, especially on non-Government contracts.

(8) Adequacy of the contractual agreement for the service (*e.g.*, description of the service, estimate of time required, rate of compensation, termination provisions).

(e) Retainer fees, to be allowable, must be supported by evidence that

(1) The services covered by the retainer agreement are necessary and customary;

(2) The level of past services justifies the amount of the retainer fees (if no services were rendered, fees are not automatically unallowable);

(3) The retainer fee is reasonable in comparison with maintaining an in-house capability to perform the covered services, when factors such as cost and level of expertise are considered; and

(4) The actual services performed are documented in accordance with subparagraph (f) of this subsection.

(f) Fees for services rendered shall be allowable only when supported by evidence of the nature and scope of the service furnished. [See also Cost (35)]. However, retainer agreements generally are not based on specific statements of work. Evidence necessary to determine that work performed is proper and does not violate law or regulation shall include

(1) Details of all agreements (*e.g.*, work requirements, rate of compensation, and nature and amount of other expenses, if any) with the individuals or

organizations providing the services and details of actual services performed;

(2) Invoices or billings submitted by consultants, including sufficient detail as to the time expended and nature of the actual services provided; and

(3) Consultants' work products and related documents, such as trip reports indicating persons visited and subjects discussed, minutes of meetings, and collateral memoranda and reports.

**(31)** ***Recruitment Costs.***

(a) Subject to subparagraph (b) of this subsection, the following costs are allowable:

(1) Costs of help-wanted advertising.

(2) Costs of operating an employment office needed to secure and maintain an adequate labor force.

(3) Costs of operating an aptitude and educational testing program.

(4) Travel costs of employees engaged in recruiting personnel.

(5) Travel costs of applicants for interviews.

(6) Costs for employment agencies, not in excess of standard commercial rates.

(b) Help-wanted advertising costs are unallowable if the advertising

(1) Does not describe specific positions or classes of positions; or

(2) Includes material that is not relevant for recruitment purposes, such as extensive illustrations or descriptions of the company's products or capabilities.

***(32) Relocation Costs.***

(a) Relocation costs are costs incident to the permanent change of assigned work location (for a period of 12 months or more) of an existing employee or upon recruitment of a new employee. The following types of relocation costs are allowable as noted, subject to the limitations in paragraphs (b) and (f) of this subsection:

(1) Costs of travel of the employee and members of the employee's immediate family [see Cost (43)] and transportation of the household and personal effects to the new location.

(2) Costs of finding a new home, such as advance trips by the employee or the spouse, or both, to locate living quarters, and temporary lodging during the transition period for the employee and members of the employee's

immediate family.

(3) Closing costs incident to the disposition of the actual residence owned by the employee when notified of the transfer (*e.g.*, brokerage fees, legal fees, appraisal fees, points, and finance charges), except that these costs, when added to the costs described in paragraph (a)(4) of this subsection, shall not exceed 14 percent of the sales price of the property sold.

(4) Continuing costs of ownership of the vacant former actual residence being sold, such as maintenance of building and grounds (exclusive of fixing up expenses), utilities, taxes, property insurance, and mortgage interest, after the settlement date or lease date of a new permanent residence, except that these costs, when added to the costs described in paragraph (a)(3) of this subsection, shall not exceed 14 percent of the sales price of the property sold.

(5) Other necessary and reasonable expenses normally incident to relocation, such as disconnecting and connecting household appliances; automobile registration; driver's license and use taxes; cutting and fitting rugs, draperies, and curtains; forfeited utility fees and deposits; and purchase of insurance against damage to or loss of personal property while in transit.

(6) Costs incident to acquiring a home in the new work location, except that-

(i) These costs are not allowable for existing employees or newly recruited employees who were not homeowners before the relocation; and

(ii) The total costs shall not exceed 5 percent of the purchase price of the new home.

(7) Mortgage interest differential payments, except that these costs are not allowable for existing or newly recruited employees who, before the relocation, were not homeowners and the total payments are limited to an amount determined as follows:

(i) The difference between the mortgage interest rates of the old and new residences times the current balance of the old mortgage times 3 years.

(ii) When mortgage differential payments are made on a lump- sum basis and the employee leaves or is transferred again in less than 3 years, the amount initially recognized shall be proportionately adjusted to reflect payments only for the actual time of the relocation.

(8) Rental differential payments covering situations where relocated employees retain ownership of a vacated home in the old location and rent at the new location. The rented quarters at the new location must be comparable

to those vacated, and the allowable differential payments may not exceed the actual rental costs for the new home, less the fair market rent for the vacated home times 3 years.

(9) Costs of canceling an unexpired lease.

(10) Payments for increased employee income or Federal Insurance Contributions Act (26 U.S.C. chapter 21) taxes incident to allowable reimbursed relocation costs.

(11) Payments for spouse employment assistance.

(b) The costs described in paragraph (a) of this subsection must also meet the following criteria to be considered allowable:

(1) The move must be for the benefit of the employer.

(2) Reimbursement must be in accordance with an established policy or practice that is consistently followed by the employer and is designed to motivate employees to relocate promptly and economically.

(3) The costs must not be otherwise unallowable under Procurement Guidance Section T3.3.2.

(4) Amounts to be reimbursed shall not exceed the employee's actual expenses, except that for miscellaneous costs of the type discussed in paragraph (a)(5) of this subsection, a flat amount, not to exceed $5,000, may be allowed in lieu of actual costs.

(5) Reimbursement on a lump-sum basis may be allowed for any of the following relocation costs when adequately supported by data on the individual elements (*e.g.*, transportation, lodging, and meals) comprising the build-up of the lump-sum amount to be paid based on the circumstances of the particular employee’s relocation:

(i) Costs of finding a new home.

(ii) Costs of travel to the new location (but not costs for the transportation of household goods).

(iii) Costs of temporary lodging.

(iv) When reimbursement on a lump-sum basis is used, any adjustments to reflect actual costs are unallowable.

(c) The following types of costs are unallowable:

(1) Loss on the sale of a home.

(2) Costs incident to acquiring a home in the new location as follows:

(i) Real estate brokers' fees and commissions.

(ii) Costs of litigation.

(iii) Real and personal property insurance against damage or loss of property.

(iv) Mortgage life insurance.

(v) Owner's title policy insurance when such insurance was not previously carried by the employee on the old residence. (However, the cost of a mortgage title policy is allowable.)

(vi) Property taxes and operating or maintenance costs.

(3) Continuing mortgage principal payments on a residence being sold.

(4) Costs incident to furnishing equity or nonequity loans to employees or making arrangements with lenders for employees to obtain lower-than-market rate mortgage loans.

(d) If relocation costs for an employee have been allowed either as an allocable indirect or direct cost, and the employee resigns within 12 months for reasons within the employee's control, the contractor shall refund or credit the relocation costs to the Government.

(e) Subject to the requirements of subparagraphs (a) through (d) of this section, the costs of family movements and of personnel movements of a special or mass nature are allowable. The cost, however, should be assigned on the basis of work (contracts) or time period benefited.

(f) Relocation costs (both outgoing and return) of employees who are hired for performance on specific contracts or long-term field projects are allowable if

(1) The term of employment is 12 months or more;

(2) The employment agreement specifically limits the duration of employment to the time spent on the contract or field project for which the employee is hired;

(3) The employment agreement provides for return relocation to the employee's permanent and principal home immediately prior to the outgoing relocation, or other location of equal or lesser cost; and

(4) The relocation costs are determined under the rules of subparagraphs (a) through (d) of this section. However, the costs to return employees, who are released from employment upon completion of field assignments pursuant to their employment agreements, are not subject to the refund or credit requirement of subparagraph (d).

**(33) *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 A.2.e.(8)(m) requires that assets acquired by means of capital leases, as defined in FAS-13, shall 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 (but see subparagraph (b)(4) of this section).

(b) The following costs are allowable:

(1) Rental costs under operating leases, to the extent that the rates are reasonable at the time of the lease decision, after consideration of

(i) Rental costs of comparable property, if any;

(ii) Market conditions in the area;

(iii) The type, life expectancy, condition, and value of the property leased;

(iv) Alternatives available; and

(v) Other provisions of the agreement.

(2) Rental costs under a sale and leaseback arrangement only up to the amount the contractor would be allowed if the contractor retained title.

(3) Charges in the nature of rent for property between any divisions, subsidiaries, or organizations under common control, to the extent that they do not exceed the normal costs of ownership, such as depreciation, taxes, insurance, facilities capital cost of money, and maintenance (excluding interest or other unallowable costs pursuant to this Procurement Guidance Section T3.3.2), provided that no part of such costs shall duplicate any other allowed cost. Rental cost of personal property leased from any division, subsidiary, or affiliate of the contractor under common control, that has an established practice of leasing the same or similar property to unaffiliated lessees shall be allowed in accordance with subparagraph (b)(1) of this subsection.

(4) Rental costs under leases entered into before March 1, 1970 for the remaining term of the lease (excluding options not exercised before March 1, 1970) to the extent they would have been allowable under Defense Acquisition

Regulation (formerly ASPR) 15-205.34 or Federal Procurement Regulations section 1-15.205-34 in effect January 1, 1969.

(c) The allowability of rental costs under unexpired leases in connection with terminations is treated in (39) of this subsection.

**(34) *Royalties and Other Costs for Use of Patents.***

(a) Royalties on a patent or amortization of the cost of purchasing a patent or patent rights necessary for the proper performance of the contract and applicable to contract products or processes are allowable unless

(1) The Government has a license or the right to a free use of the patent;

(2) The patent has been adjudicated to be invalid, or has been administratively determined to be invalid;

(3) The patent is considered to be unenforceable; or

(4) The patent is expired.

(b) Care should be exercised in determining reasonableness when the royalties may have been arrived at as a result of less-than-arm's-length bargaining; *e.g.*, royalties

(1) Paid to persons, including corporations, affiliated with the contractor;

(2) Paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government contract would be awarded; or

(3) Paid under an agreement entered into after the contract award.

(c) In any case involving a patent formerly owned by the contractor, the royalty amount allowed should not exceed the cost which would have been allowed had the contractor retained title.

(d) See A.1.(i) regarding advance agreements.

**(35) *Selling Costs.***

(a) "Selling" is a generic term encompassing all efforts to market the contractor's products or services, some of which are covered specifically in other subsections of A.2.e. The costs of any selling efforts other than those addressed in this cost principle are unallowable.

(b) Selling activity includes the following broad categories:

(1) *Advertising*. Advertising is defined at Cost (1), and advertising costs

are subject to the allowability provisions of Cost (1)(b).

(2) *Corporate image enhancement*. Corporate image enhancement activities, including broadly targeted sales efforts, other than advertising, are included
within the definition of public relations at Cost (1)(a), and the costs of such efforts are subject to the allowability provisions at Cost (1)(a)

(3) *Bid and proposal costs*. Bid and proposal costs are defined at Cost (15) and are subject to the allowability provisions of that subsection.

(4) *Market planning*. Market planning involves market research and analysis and general management planning concerned with development of the contractor's business. Long-range market planning costs are subject to the allowability provisions of Cost (9). Other market planning costs are allowable.

(5) *Direct selling*. Direct selling efforts are those acts or actions to induce particular customers to purchase particular products or services of the contractor. Direct selling is characterized by person-to-person contact and includes such efforts as familiarizing a potential customer with the contractor's products or services, conditions of sale, service capabilities, etc. It also includes negotiation, liaison between customer and contractor personnel, technical and consulting efforts, individual demonstrations, and any other efforts having as their purpose the application or adaptation of the contractor's products or services for a particular customer's use. The cost of direct selling efforts is allowable.

(c) Notwithstanding any other provision of this subsection, sellers' or agents' compensation, fees, commissions, percentages, retainer or brokerage fees, whether or not contingent upon the award of contracts, are allowable only when paid to bona fide employees or established commercial or selling agencies maintained by the contractor for the purpose of securing business.

**(36)** ***Service and Warranty Costs.*** Service and warranty costs include those arising from fulfillment of any contractual obligation of a contractor to provide services such as installation, training, correcting defects in the products, replacing defective parts, and making refunds in the case of inadequate performance. When not inconsistent with the terms of the contract, such service and warranty costs are allowable. However, care should be exercised to avoid duplication of the allowance as an element of both estimated product cost and risk.

**(37)** ***Special Tooling and Special Test Equipment Costs***.

(a) The terms "special tooling" and "special test equipment" are defined in AMS Procurement Guidance T3.10.3.

(b) The cost of special tooling and special test equipment used in performing one or more Government contracts is allowable and shall be allocated to the specific Government contract or contracts for which acquired, except that the cost of

(1) Items acquired by the contractor before the effective date of the contract (or replacement of such items), whether or not altered or adapted for use in performing the contract, and

(2) Items which the contract schedule specifically excludes, shall be allowable only as depreciation or amortization.

(c) When items are disqualified as special tooling or special test equipment because with relatively minor expense they can be made suitable for general purpose use and have a value as such commensurate with their value as special tooling or special test equipment, the cost of adapting the items for use under the contract and the cost of returning them to their prior configuration are allowable.

***(38) Taxes.***

(a) The following types of costs are allowable:

(1) Federal, State, and local taxes, except as otherwise provided in subparagraph (b) of this section that are required to be and are paid or accrued in accordance with generally accepted accounting principles. Fines and penalties are not considered taxes.

(2) Taxes otherwise allowable under subparagraph (a)(1) of this section, but upon which a claim of illegality or erroneous assessment exists; provided the contractor, before paying such taxes

(i) Promptly requests instructions from the contracting officer concerning such taxes; and

(ii) Takes all action directed by the contracting officer arising out of subparagraph (2)(1) of this section or an independent decision of the Government as to the existence of a claim of illegality or erroneous assessment, to

(A) Determine the legality of the assessment or

(B) Secure a refund of such taxes.

(3) Pursuant to subparagraph (a)(2) of this section, the reasonable costs of any action taken by the contractor at the direction or with the concurrence of the contracting officer. Interest or penalties incurred by the contractor for non-payment of any tax at the direction of the contracting officer or by reason of the failure of the contracting officer to ensure timely direction after a prompt request.

(4) The Environmental Tax found at section 59A of the Internal Revenue Code, also called the "Superfund Tax."

(b) The following types of costs are not allowable:

(1) Federal income and excess profits taxes.

(2) Taxes in connection with financing, refinancing, refunding operations, or reorganizations [see Costs (17) and (24)].

(3) Taxes from which exemptions are available to the contractor directly, or available to the contractor based on an exemption afforded the Government, except when the contracting officer determines that the administrative burden incident to obtaining the exemption outweighs the corresponding benefits accruing to the Government. When partial exemption from a tax is attributable to Government contract activity, taxes charged to such work in excess of that amount resulting from application of the preferential treatment are unallowable. These provisions intend that tax preference attributable to Government contract activity be realized by the Government. The term "exemption" means freedom from taxation in whole or in part and includes a tax abatement or reduction resulting from mode of assessment, method of calculation, or otherwise.

(4) Special assessments on land that represent capital improvements.

(5) Taxes (including excises) on real or personal property, or on the value, use, possession or sale thereof, which is used solely in connection with work other than on Government contracts (see subparagraph (c) of this section).

(6) Any excise tax in subtitle D, chapter 43 of the Internal Revenue Code of 1986, as amended. That chapter includes excise taxes imposed in connection with qualified pension plans, welfare plans, deferred compensation plans, or other similar types of plans.

(7) Income tax accruals designed to account for the tax effects of differences between taxable income and pretax income as reflected by the books of account and financial statements.

(8) Any tax imposed under 26 U.S.C. 5000C (Imposition of Tax on Certain Foreign Procurements)

(c) Taxes on property used solely in connection with either non-Government or Government work should be considered directly applicable to the respective category of work unless the amounts involved are insignificant or comparable results would otherwise be obtained; *e.g.*, taxes on contractor-owned work-in-process which is used solely in connection with non-Government work should be allocated to such work; taxes on contractor-owned work-in-process inventory (and Government-owned work-in-process inventory when taxed) used solely in connection with Government work should be charged to such work. The cost of taxes incurred on property used in both Government and non-Government work shall be apportioned to all such work based upon the use of such property on the respective final cost objectives.

(d) Any taxes, interest, or penalties that were allowed as contract costs and are refunded to the contractor shall be credited or paid to the Government in the manner it directs. If a contractor or subcontractor obtains a foreign tax credit that reduces its U.S. Federal income tax because of the payment of any tax or duty allowed as contract costs, and if those costs were reimbursed by a foreign government, the amount of the reduction shall be paid to the Treasurer of the United States at the time the Federal income tax return is filed. However, any interest actually paid or credited to a contractor incident to a refund of tax, interest, or penalty shall be paid or credited to the Government only to the extent that such interest accrued over the period during which the contractor had been reimbursed by the Government for the taxes, interest, or penalties.

**(39)** ***Termination Costs.*** Contract terminations generally give rise to the incurrence of costs or the need for special treatment of costs that would not have arisen had the contract not been terminated. The following cost principles peculiar to termination situations are to be used in conjunction with the other cost principles in this Procurement Guidance Section T3.3.2:

(a) *Common items.* The costs of items reasonably usable on the contractor's other work shall not be allowable unless the contractor submits evidence that the items could not be retained at cost without sustaining a loss. The contracting officer should consider the contractor's plans and orders for current and planned production when determining if items can reasonably be used on other work of the contractor. Contemporaneous purchases of common items by the contractor shall be regarded as evidence that such items are reasonably usable on the contractor's other work. Any acceptance of common items as allocable to the terminated portion of the contract should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

(b) *Costs Continuing After Termination.* Despite all reasonable efforts by the contractor, costs which cannot be discontinued immediately after the effective date of termination are generally allowable. However, any costs continuing after the effective date of the termination due to the negligent or willful failure of the contractor to discontinue the costs shall be unallowable.

(c) *Initial Costs.* Initial costs, including starting load and preparatory costs, are allowable as follows:

(1) Starting load costs not fully absorbed because of termination are nonrecurring labor, material, and related overhead costs incurred in the early part of production and result from factors such as

(i) Excessive spoilage due to inexperienced labor;

(ii) Idle time and subnormal production due to testing and changing production methods;

(iii) Training; and

(iv) Lack of familiarity or experience with the

product, materials, or manufacturing processes.

(2) Preparatory costs incurred in preparing to perform the terminated contract include such costs as those incurred for initial plant rearrangement and alterations, management and personnel organization, and production planning. They do not include special machinery and equipment and starting load costs.

(3) When initial costs are included in the settlement proposal as a direct charge, such costs shall not also be included in overhead. Initial costs attributable to only one contract shall not be allocated to other contracts.

(4) If initial costs are claimed and have not been segregated on the contractor's books, they shall be segregated for settlement purposes from cost reports and schedules reflecting that high unit cost incurred during the early stages of the contract.

(5) If the settlement proposal is on the inventory basis, initial costs should normally be allocated on the basis of total end items called for by the contract immediately before termination; however, if the contract includes end items of a diverse nature, some other equitable basis may be used, such as machine or labor hours.

(d) *Loss of Useful Value.* Loss of useful value of special tooling, and special machinery and equipment is generally allowable, provided

(1) The special tooling, or special machinery and equipment is not reasonably capable of use in the other work of the contractor;

(2) The Government's interest is protected by transfer of title or by other means deemed appropriate by the contracting officer; and

(3) The loss of useful value for any one terminated contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the contract bears to the entire terminated contract and other Government contracts for which the special tooling, or special machinery and equipment was acquired.

(e) *Rental Under Unexpired Leases.* Rental costs under unexpired leases, less the residual value of such leases, are generally allowable when shown to have been reasonably necessary for the performance of the terminated contract, if

(1) The amount of rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable; and

(2) The contractor makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease.

(f) *Alterations of Leased Property.* The cost of alterations and reasonable restorations required

by the lease may be allowed when the alterations were necessary for performing the contract.

(g) *Settlement Expenses.*

(1) Settlement expenses, including the following, are generally allowable:

(i) Accounting, legal, clerical, and similar costs reasonably necessary for

(A) The preparation and presentation, including supporting data, of settlement claims to the contracting officer; and

(B) The termination and settlement of subcontracts.

(ii) Reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract.

(iii) Indirect costs related to salary and wages incurred as settlement expenses in (i) and (ii); normally, such indirect costs shall be limited to payroll taxes, fringe benefits, occupancy costs, and immediate supervision costs.

(2) If settlement expenses are significant, a cost account or work order shall be established to separately identify and accumulate them.

(h) *Subcontractor Claims.* Subcontractor claims, including the allocable portion of the claims common to the contract and to other work of the contractor, are generally allowable. An appropriate share of the contractor's indirect expense may be allocated to the amount of settlements with subcontractors; provided, that the amount allocated is reasonably proportionate to the relative benefits received and is otherwise consistent with Procurement Guidance T3.3.2. The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

**(40)** ***Trade, Business, Technical and Professional Activity Costs***. The following types of costs are allowable:

(a) Memberships in trade, business, technical, and professional organizations.

(b) Subscriptions to trade, business, professional, or other technical periodicals.

(c) When the principal purpose of a meeting, convention, conference, symposium, or seminar is the dissemination of trade, business, technical or professional information or the stimulation of production or improved productivity

(1) Costs of organizing, setting up, and sponsoring the meetings, conventions,

symposia, etc., including rental of meeting facilities, transportation, subsistence, and incidental costs;

(2) Costs of attendance by contractor employees, including travel costs [see Cost (43)]; and

(3) Costs of attendance by individuals who are not employees of the contractor, provided

(i) Such costs are not also reimbursed to the individual by the employing company or organization, and

(ii) The individuals attendance is essential to achieve the purpose of the conference, meeting, convention, symposium, etc.

**(41)*Training and Education Costs.***

(a) *Allowable Costs.* Training and education costs are allowable to the extent indicated

below.

(b) *Vocational Training.* Costs of preparing and maintaining a noncollege level program of instruction, including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees, are allowable. These costs include

(1) Salaries or wages of trainees (excluding overtime compensation),

(2) Salaries of the director of training and staff when the training program is conducted by the contractor,

(3) Tuition and fees when the training is in an institution not operated by the contractor, and/or

(4) Training materials and textbooks.

(c) *Part-time College Level Education.* Allowable costs of part-time college education at an undergraduate or postgraduate level, including that provided at the contractor's own facilities, are limited to

(1) Fees and tuition charged by the educational institution, or, instead of tuition, instructors' salaries and the related share of indirect cost of the educational institution, to the extent that the sum thereof is not in excess of the tuition that would have been paid to the participating educational institution;

(2) Salaries and related costs of instructors who are employees of the contractor;

(3) Training materials and textbooks; and

(4) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year where circumstances do not permit the operation of classes or attendance at classes after regular working hours. In unusual cases, the period may be extended (see subparagraph (h) of this subsection).

(d) *Full-time Education.* Costs of tuition, fees, training materials and textbooks (but not subsistence, salary, or any other emoluments) in connection with full-time education, including that provided at the contractor's own facilities, at a postgraduate but not undergraduate college level, are allowable only when the course or degree pursued is related to the field in which the employee is working or may reasonably be expected to work and are limited to a total period not to exceed 2 school years or the length of the degree program, whichever is less, for each employee so trained.

(e) *Specialized Programs.* Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of managers or to prepare employees for such positions are allowable. Such costs include enrollment fees and related charges and employees' salaries, subsistence, training materials, textbooks, and travel. Costs allowable under this paragraph do not include costs for courses that are part of a degree- oriented curriculum, which are only allowable pursuant to subparagraphs (c) and (d) of this subsection.

(f) *Other Expenses.* Maintenance expense and normal depreciation or fair rental on facilities owned or leased by the contractor for training purposes are allowable in accordance with Costs (8), (14), (21) and (33).

(g) *Grants.* Grants to educational or training institutions, including the donation of facilities or other properties, scholarships, and fellowships are considered contributions and are unallowable.

(h) *Advance Agreements.*

(1) Training and education costs in excess of those otherwise allowable under subparagraphs (c) and (d) of this subsection, including subsistence, salaries or any other emoluments, may be allowed to the extent set forth in an advance agreement. To be considered for an advance agreement, the contractor must demonstrate that the costs are consistently incurred under an established managerial, engineering, or scientific training and education program, and that the course or degree pursued is related to the field in which the employees are now working or may reasonably be expected to work. Before entering into the advance agreement, the contracting officer shall give consideration to such factors as

(i) The length of employees' service with the contractor;

(ii) Employees' past performance and potential;

(iii) Whether employees are in formal development programs; and

(iv) The total number of participating employees.

(2) Any advance agreement must include a provision requiring the contractor to refund to the Government training and education costs for employees who resign within 12 months of completion of such training or education for reasons within an employee's control.

(i) *Training or Education Costs for Other Than Bona Fide Employees.* Costs of tuition, fees, textbooks, and similar or related benefits provided for other than bona fide employees are unallowable, except that the costs incurred for educating employee dependents (primary and secondary level studies) when the employee is working in a foreign country where public education is not available and where suitable private education is inordinately expensive may be included in overseas differential.

(j) *Employee Dependent Education Plans.* Costs of college plans for employee dependents are unallowable.

***(42) RESERVED***

**(43) *Travel Costs.***

(a) *Costs for Transportation, Lodging, Meals, and Incidental Expenses.*

(1) Costs incurred by contractor personnel on official company business are allowable, subject to the limitations contained in this subsection. Costs for transportation may be based on mileage rates, actual costs incurred, or on a combination thereof, provided the method used results in a reasonable charge. Costs for lodging, meals, and incidental expenses may be based on per diem, actual expenses, or a combination thereof, provided the method used results in a reasonable charge.

(2) Except as provided in subparagraph (a)(3) of this subsection, costs incurred for lodging, meals, and incidental expenses (as defined in the regulations cited in (a)(2)(i) through (iii) of this subparagraph) shall be considered to be reasonable and allowable only to the extent that they do not exceed on a daily basis the maximum per diem rates in effect at the time of travel as set forth in the

(i) Federal Travel Regulations, (Stock No. 922-002-00000-2) prescribed by the General Services Administration, for travel in the conterminous 48 United States, available on a subscription basis from the: Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402;

(ii) Department of Defense Per Diem, Travel and Transportation Allowance Committee (PDTATAC) bulletins, for travel in Alaska, Hawaii, The

Commonwealth of Puerto Rico, and territories and possessions of the United States, available in the Federal Register (or in the Section 925 Supplement to the guidance cited under (a)(2)(iii) below); or

(iii) Standardized Regulations (Government Civilians, Foreign Areas), Section 925, "Maximum Travel Per Diem Allowances for Foreign Areas," (Stock No. 744-008-00000-0) prescribed by the Department of State, for travel in areas not covered in (a)(2)(i) and (ii) of this subparagraph, available on a subscription basis from the: Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

(3) In special or unusual situations, actual costs in excess of the above-referenced maximum per diem rates are allowable provided that such amounts do not exceed the higher amounts authorized for Federal civilian employees as permitted in the regulations referenced in (a)(2)(i), (ii), or (iii) of this subsection. For such higher amounts to be allowable, all of the following conditions must be met:

(i) One of the conditions warranting approval of the actual expense method, as set forth in the regulations referenced in subparagraphs (a)(2)(i), (ii), or (iii) of this subsection, must exist.

(ii) A written justification for use of the higher amounts must be approved by an officer of the contractor's organization or designee to ensure that the authority is properly administered and controlled to prevent abuse.

(iii) If it becomes necessary to exercise the authority to use the higher actual expense method repetitively or on a continuing basis in a particular area, the contractor must obtain advance approval from the contracting officer.

(iv) Documentation to support actual costs incurred shall be in accordance with the contractor's established practices, subject to subparagraph (a)(7) of this subsection, and provided that a receipt is required for each expenditure of $75.00 or more. The approved justification required by subparagraph (a)(3)(ii) and, if applicable, subparagraph (a)(3)(iii) of this subsection must be retained.

(4) Subparagraphs (a)(2) and (a)(3) of this subsection do not incorporate the regulations cited in subdivisions (a)(2)(i), (ii), and (iii) of this subsection in their entirety. Only the maximum per diem rates, the definitions of lodging, meals, and incidental expenses, and the regulatory coverage dealing with special or unusual situations are incorporated herein.

(5) An advance agreement with respect to compliance with subparagraphs (a)(2) and (a)(3) of this subsection may be useful and desirable.

(6) The maximum per diem rates referenced in subparagraph (a)(2) of this subsection generally would not constitute a reasonable daily charge

(i) When no lodging costs are incurred; and/or

(ii) On partial travel days (*e.g.*, day of departure and return). Appropriate downward adjustments from the maximum per diem rates would normally be required under these circumstances. While these adjustments need not be calculated in accordance with the applicable Federal Travel Regulations, they must result in a reasonable charge.

(7) Costs shall be allowable only if the following information is documented

(i) Date and place (city, town, or other similar designation) of the expenses;

(ii) Purpose of the trip; and

(iii) Name of person on trip and that person's title or relationship to the contractor.

(b) Travel costs incurred in the normal course of overall administration of the business are allowable and shall be treated as indirect costs.

(c) Travel costs directly attributable to specific contract performance are allowable and may be charged to the contract.

(d) Airfare costs in excess of the lowest-priced airfare available to the contractor during normal business hours are unallowable except when the lowest priced airfare require circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased cost that would offset transportation savings, are not reasonably adequate for the physical or medical needs of the traveler, or are not reasonably available to meet mission requirements. However, in order for airfare costs in excess of the above airfare to be allowable, the applicable condition(s) set forth above must be documented and justified.

(e)

(1) "Cost of travel by contractor-owned, -leased, or -chartered aircraft," as used in this paragraph, includes the cost of lease, charter, operation (including personnel), maintenance, depreciation, insurance, and other related costs.

(2) The costs of travel by contractor-owned, -leased, or -chartered aircraft are limited to the standard airfare described in subparagraph (d) of this subsection for the flight destination unless travel by such aircraft is specifically required by contract specification, term, or condition, or a higher amount is approved by the

contracting officer. A higher amount may be agreed to when one or more of the circumstances for justifying higher than standard airfare listed in subparagraph (d) of this subsection are applicable, or when an advance agreement under subparagraph (e)(3) of this subsection has been executed. In all cases, travel by contractor-owned, -leased, or -chartered aircraft must be fully documented and justified. For each contractor-owned, -leased, or -chartered aircraft used for any business purpose which is charged or allocated, directly or indirectly, to a Government contract, the contractor must maintain and make available manifest/logs for all flights on such company aircraft. As a minimum, the manifest/log shall indicate

(i) Date, time, and points of departure;

(ii) Destination, date, and time of arrival;

(iii) Name of each passenger and relationship to the contractor;

(iv) Authorization for trip; and

(v) Purpose of trip.

(3) Where an advance agreement is proposed, consideration may be given to the following:

(i) Whether scheduled commercial airlines or other suitable, less costly, travel facilities are available at reasonable times, with reasonable frequency, and serve the required destinations conveniently.

(ii) Whether increased flexibility in scheduling results in time savings and more effective use of personnel that would outweigh additional travel costs.

(f) Costs of contractor-owned or -leased automobiles, as used in this subparagraph, include the costs of lease, operation (including personnel), maintenance, depreciation, insurance, etc. These costs are allowable, if reasonable, to the extent that the automobiles are used for company business. That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is compensation for personal services and is unallowable as stated in Cost (4)(m)(2).

**(44)** ***Costs Related to Legal and Other Proceedings.***

(a) *Definitions*

(1) "Conviction," as used in this subsection, is defined in T3.2.2.7, A.2.e.

(2) "Costs" include, but are not limited to, administrative and clerical expenses; the costs of legal services, whether performed by in-house or private counsel; the costs of the services of accountants, consultants, or others retained by the

contractor to assist it; costs of employees, officers, and directors; and any similar costs incurred before, during, and after commencement of a judicial or administrative proceeding which bears a direct relationship to the proceeding.

(3) "Fraud," as used in this subsection, means

(i) Acts of fraud or corruption or attempts to defraud the Government or to corrupt its agents,

(ii) Acts which constitute a cause for debarment or suspension under Procurement Guidance Section T3.2.2.7 and

(iii) Acts which violate the False Claims Act, 31 U.S.C., sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C. § 8702.

(4) "Penalty," does not include restitution, reimbursement, or compensatory damages.

(5) "Proceeding," includes an investigation.

(b) Costs incurred in connection with any proceeding brought by a Federal, State, local, or foreign government for violation of, or a failure to comply with, law or regulation by the contractor (including its agents or employees), or costs incurred in connection with any proceeding brought by a third party in the name of the United States under the False Claims Act, 31 U.S.C. 3730, are unallowable if the result is

(1) In a criminal proceeding, a conviction;

(2) In a civil or administrative proceeding, either a finding of contractor liability where the proceeding involves an allegation of fraud or similar misconduct or imposition of a monetary penalty where the proceeding does not involve an allegation of fraud or similar misconduct;

(3) A final decision by an appropriate official of an executive agency to

(i) Debar or suspend the contractor;

(ii) Rescind or void a contract; or

(iii) Terminate a contract for default by reason of a violation or failure to comply with a law or regulation.

(4) Disposition of the matter by consent or compromise if the proceeding could have led to any of the outcomes listed in subparagraphs (b)(1) through (3) of this subsection (but see subparagraphs (c) and (d) of this subsection); or

(5) Not covered by subparagraphs (b)(1) through (4) of this subsection, but where the underlying alleged contractor misconduct was the same as that which led to a different proceeding whose costs are unallowable by reason of subparagraphs (b)(1) through (4) of this subsection.

(c)

(1) To the extent they are not otherwise unallowable, costs incurred in connection with any proceeding under subparagraph (b) of this subsection commenced by the United States that is resolved by consent or compromise pursuant to an agreement entered into between the contractor and the United States, and which are unallowable solely because of subparagraph (b) of this subsection, may be allowed to the extent specifically provided in such agreement

(2) In the event of a settlement of any proceeding brought by a third party under the False Claims Act in which the United States did not intervene, reasonable costs incurred by the contractor in connection with such a proceeding, that are not otherwise unallowable by regulation or by separate agreement with the United States, may be allowed if the contracting officer, in consultation with his or her legal advisor, determines that there was very little likelihood that the third party would have been successful on the merits.

(d) To the extent that they are not otherwise unallowable, costs incurred in connection with any proceeding under paragraph (b) of this subsection commenced by a State, local, or foreign government may be allowable when the contracting officer (or other official specified in agency procedures) determines, that the costs were incurred either:

(1) As a direct result of a specific term or condition of a Federal contract; or

(2) As a result of compliance with specific written direction of the cognizant contracting officer.

(e) Costs incurred in connection with proceedings described in subparagraph (b) of this subsection, but which are not made unallowable by that subparagraph, may be allowable to the extent that:

(1) The costs are reasonable in relation to the activities required to deal with the proceeding and the underlying cause of action;

(2) The costs are not otherwise recovered from the Federal Government or a third party, either directly as a result of the proceeding or otherwise; and

(3) The percentage of costs allowed does not exceed the percentage determined to be appropriate considering the complexity of procurement litigation, generally accepted principles governing the award of legal fees in civil actions involving the United States as a party, and such other factors as may be appropriate. Such percentage shall not exceed 80 percent. Agreements reached under subparagraph (c) of this subsection shall be subject to this limitation. If,

however, an agreement described in subparagraph (c)(1) of this subsection explicitly states the amount of otherwise allowable incurred legal fees and limits the allowable recovery to 80 percent or less of the stated legal fees, no additional limitation need be applied. The amount of reimbursement allowed for legal costs in connection with any proceeding described in subparagraph (c)(2) of this subsection shall be determined by the cognizant contracting officer, but shall not exceed 80 percent of otherwise allowable legal costs incurred.

(f) Costs not covered elsewhere in this subsection are unallowable if incurred in connection with:

(1) Defense against Federal Government claims or appeals or the prosecution of claims or appeals against the Federal Government.

(2) Organization, reorganization, (including mergers and acquisitions) or resisting mergers and acquisitions [see also Cost (24)].

(3) Defense of antitrust suits.

(4) Defense of suits brought by employees or ex-employees of the contractor under section 2 of the Major Fraud Act of 1988 where the contractor was found liable or settled.

(5) Costs of legal, accounting, and consultant services and directly associated costs incurred in connection with the defense or prosecution of lawsuits or appeals between contractors arising from either

(i) An agreement or contract concerning a teaming arrangement, a joint venture, or similar arrangement of shared interest; or

(ii) Dual sourcing, coproduction, or similar programs, are unallowable, except when

(A) Incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer, or

(B) When agreed to in writing by the contracting officer.

(6) Patent infringement litigation, unless otherwise provided for in the contract.

(7) Representation of, or assistance to, individuals, groups, or legal entities which the contractor is not legally bound to provide, arising from an action where the participant was convicted of violation of a law or regulation or was found liable in a civil or administrative proceeding.

(8) Protests of Federal Government solicitations or contract awards, or the defense against protests of such solicitations or contract awards, unless the costs of defending against a protest are incurred pursuant to a written request from the cognizant contracting officer.

(g) Costs which may be unallowable under Cost (44), including directly associated costs, shall be segregated and accounted for by the contractor separately. During the pendency of any proceeding covered by subparagraph (b) and subparagraphs (f)(4) and (f)(7) of this subsection, the contracting officer shall generally withhold payment of such costs. However, if in the best interests of the Government, the contracting officer may provide for conditional payment upon provision of adequate security, or other adequate assurance, and agreement by the contractor to repay all unallowable costs, plus interest, if the costs are subsequently determined to be unallowable.

**(45)** ***Research and Development Costs.***

"Research and development," as used in this subsection, means the type of technical effort which is described in Cost (15) but sponsored by a grant or required in performance of a contract . When costs are incurred in excess of either the price of a contract or amount of a grant for research and development effort, the excess is unallowable under any other Government contract.

**(46)** ***Goodwill.***

Goodwill, an unidentifiable intangible asset, originates under the purchase method of accounting for a business combination when the price paid by the acquiring company exceeds the sum of the identifiable individual assets acquired less liabilities assumed, based upon their fair values. The excess is commonly referred to as goodwill. Goodwill may arise from the acquisition of a company as a whole or a portion thereof. Any costs for amortization, expensing, write-off, or write-down of goodwill (however represented) are unallowable.

**(47)** ***Costs of Alcoholic Beverages***.

Costs of alcoholic beverages are unallowable.

**(48)** ***Asset Valuations Resulting from Business Combinations***.

(a) For tangible capital assets, when the purchase method of accounting for a business combination is used, whether or not the contract or subcontract is subject to CAS, the allowable depreciation and cost of money shall be based on the capitalized asset values measured and assigned in accordance with 48 CFR 9904.404-50(d), if allocable, reasonable, and not otherwise unallowable.

(b) For intangible capital assets, when the purchase method of accounting for a business combination is used, allowable amortization and cost of money shall be limited to the total of the amounts that would have been allowed had the combination not taken place.

## 3 Appendix - Definitions Added 7/2007

Applicable definitions for FAA cost principles and guidance are as follows:

"Accrued benefit cost method" means an actuarial cost method under which units of benefits are assigned to each cost accounting period and are valued as they accrue; *i.e.,* based on the services performed by each employee in the period involved. The measure of normal cost under this method for each cost accounting period is the present value of the units of benefit deemed to be credited to employees for service in that period. The measure of the actuarial accrued liability at a plan's inception date is the present value of the units of benefit credited to employees for service prior to that date. (This method is also known as the unit credit cost method without salary projection.).

"Accumulating costs" means collecting cost data in an organized manner, such as through a system of accounts.

"Actual cash value" means the cost of replacing damaged property with other property of like kind and quality in the physical condition of the property immediately before the damage.

"Actual costs" means (except for contracts with State, Local, and Federally-recognized Indian Tribal Governments) amounts determined on the basis of costs incurred, as distinguished from forecasted costs. Actual costs include standard costs properly adjusted for applicable variances.

"Actuarial accrued liability" means pension cost attributable, under the actuarial cost method in use, to years prior to the current period considered by a particular actuarial valuation. As of such date, the actuarial accrued liability represents the excess of the present value of future benefits and administrative expenses over the present value of future normal costs for all plan participants and beneficiaries. The excess of the actuarial accrued liability over the actuarial value of the assets of a pension plan is the unfunded actuarial liability. The excess of the actuarial value of the assets of a pension plan over the actuarial accrued liability is an actuarial surplus and is treated as a negative unfunded actuarial liability.

"Actuarial assumption" means an estimate of future conditions affecting pension cost; *e.g.,* mortality rate, employee turnover, compensation levels, earnings on pension plan assets, and changes in values of pension plan assets.

"Actuarial cost method" means a technique which uses actuarial assumptions to measure the present value of future pension benefits and pension plan administrative expenses, and that assigns the cost of such benefits and expenses to cost accounting periods. The actuarial cost method includes the asset valuation method used to determine the actuarial value of the assets of a pension plan.

"Actuarial gain and loss" means the effect on pension cost resulting from differences between actuarial assumptions and actual experience.

"Actuarial valuation" means the determination, as of a specified date, of the normal cost,

actuarial accrued liability, actuarial value of the assets of a pension plan, and other relevant values for the pension plan.

“Allocate” means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

“Compensated personal absence” means any absence from work for reasons such as illness, vacation, holidays, jury duty, military training, or personal activities for which an employer pays compensation directly to an employee in accordance with a plan or custom of the employer.

“Compensation for personal services” means all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor.

“Cost input” means the cost, except general and administrative (G&A) expenses, which for contract costing purposes is allocable to the production of goods and services during a cost accounting period.

“Cost objective” means (except for contracts with State, Local, and Federally-recognized Indian Tribal Governments) a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

“Deferred compensation” means an award made by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods before the date of the receipt of compensation by the employee. This definition shall not include the amount of year end accruals for salaries, wages, or bonuses that are to be paid within a reasonable period of time after the end of a cost accounting period.

“Defined-benefit pension plan” means a pension plan in which the benefits to be paid, or the basis for determining such benefits, are established in advance and the contributions are intended to provide the stated benefits.

“Defined-contribution pension plan” means a pension plan in which the contributions to be made are established in advance and the benefits are determined thereby.

“Directly associated cost” means any cost which is generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred.

“Estimating costs” means the process of forecasting a future result in terms of cost, based upon information available at the time.

“Expressly unallowable cost” means a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable.

“Final cost objective” means (except for contracts with Educational Institutions, and contracts with State, Local, and Federally-recognized Indian Tribal Governments) a cost objective that has allocated to it both direct and indirect costs and, in the contractor’s accumulation system, is one of the final accumulation points.

“Fiscal year” means the accounting period for which annual financial statements are regularly prepared, generally a period of 12 months, 52 weeks, or 53 weeks.

“Funded pension cost” means the portion of pension cost for a current or prior cost accounting period that has been paid to a funding agency.

“Home office” means an office responsible for directing or managing two or more, but not necessarily all, segments of an organization. It typically establishes policy for, and provides guidance to, the segments in their operations. It usually performs management, supervisory, or administrative functions, and may also perform service functions in support of the operations of the various segments. An organization which has intermediate levels, such as groups, may have several home offices which report to a common home office. An intermediate organization may be both a segment and a home office.

“Immediate-gain actuarial cost method” means any of the several actuarial cost methods under which actuarial gains and losses are included as part of the unfunded actuarial liability of the pension plan, rather than as part of the normal cost of the plan.

“Independent research and development (IR&D) cost” means the cost of effort which is neither sponsored by a grant, nor required in performing a contract, and which falls within any of the following four areas

(a) Basic research,

(b) Applied research,

(c) Development, and

(d) Systems and other concept formulation studies.

“Indirect cost pools” means (except for contracts with Educational Institutions, and contracts with State, Local, and Federally-recognized Indian Tribal Governments) groupings of incurred costs identified with two or more cost objectives but not identified specifically with any final cost objective.

“Insurance administration expenses” means the contractor’s costs of administering an insurance program; *e.g.,* the costs of operating an insurance or risk-management department, processing claims, actuarial fees, and service fees paid to insurance companies, trustees, or technical consultants.

“Intangible capital asset” means an asset that has no physical substance, has more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the benefits it yields.

“Job” means a homogeneous cluster of work tasks, the completion of which serves an enduring purpose for the organization. Taken as a whole, the collection of tasks, duties, and responsibilities constitutes the assignment for one or more individuals whose work is of the same nature and is performed at the same skill/responsibility level—as opposed to a position, which is a collection of tasks assigned to a specific individual. Within a job, there may be pay categories which are dependent on the degree of supervision required by the employee while performing assigned tasks which are performed by all persons with the same job.

“Job class of employees” means employees performing in positions within the same job.

“Labor cost at standard” means a pre-established measure of the labor element of cost, computed by multiplying labor-rate standard by labor-time standard.

“Labor market” means a place where individuals exchange their labor for compensation. Labor markets are identified and defined by a combination of the following factors—

(1) Geography,

(2) Education and/or technical background required,

(3) Experience required by the job,

(4) Licensing or certification requirements,

(5) Occupational membership, and

(6) Industry.

“Labor-rate standard” means a pre-established measure, expressed in monetary terms, of the price of labor.

“Labor-time standard” means a pre-established measure, expressed in temporal terms, of the quantity of labor.

“Material cost at standard” means a pre-established measure of the material elements of cost, computed by multiplying material-price standard by material-quantity standard.

“Material-price standard” means a pre-established measure, expressed in monetary terms, of the price of material.

“Material-quantity standard” means a pre-established measure, expressed in physical terms, of the quantity of material.

“Moving average cost” means an inventory costing method under which an average unit cost is computed after each acquisition by adding the cost of the newly acquired units to the cost of the units of inventory on hand and dividing this figure by the new total number of units.

“Nonqualified pension plan” means any pension plan other than a qualified pension plan as

defined in this part.

“Normal cost” means the annual cost attributable, under the actuarial cost method in use, to current and future years as of a particular valuation date excluding any payment in respect of an unfunded actuarial liability.

“Original complement of low cost equipment” means a group of items acquired for the initial outfitting of a tangible capital asset or an operational unit, or a new addition to either. The items in the group individually cost less than the minimum amount established by the contractor for capitalization for the classes of assets acquired but in the aggregate they represent a material investment. The group, as a complement, is expected to be held for continued service beyond the current period. Initial outfitting of the unit is completed when the unit is ready and available for normal operations.

“Pay-as-you-go cost method” means a method of recognizing pension cost only when benefits are paid to retired employees or their beneficiaries.

“Pension plan” means a deferred compensation plan established and maintained by one or more employers to provide systematically for the payment of benefits to plan participants after their retirements, provided that the benefits are paid for life or are payable for life at the option of the employees. Additional benefits such as permanent and total disability and death payments, and survivorship payments to beneficiaries of deceased employees, may be an integral part of a pension plan.

“Pension plan participant” means any employee or former employee of an employer or any member or former member of an employee organization, who is or may become eligible to receive a benefit from a pension plan which covers employees of such employer or members of such organization who have satisfied the plan’s participation requirements, or whose beneficiaries are receiving or may be eligible to receive any such benefit. A participant whose employment status with the employer has not been terminated is an active participant of the employer’s pension plan.

“Profit center” means (except for contracts with Educational Institutions, and contracts with State, Local, and Federally-recognized Indian Tribal Governments) the smallest organizationally independent segment of a company charged by management with profit and loss responsibilities.

“Projected benefit cost method” means either—

(1) Any of the several actuarial cost methods that distribute the estimated total cost of all of the employees’ prospective benefits over a period of years, usually their working careers; or

(2) A modification of the accrued benefit cost method that considers projected compensation levels.

“Proposal” means any offer or other submission used as a basis for pricing a contract, contract modification, or termination settlement or for securing payments thereunder.

“Qualified pension plan” means a pension plan comprising a definite written program

communicated to and for the exclusive benefit of employees that meets the criteria deemed essential by the Internal Revenue Service as set forth in the Internal Revenue Code for preferential tax treatment regarding contributions, investments, and distributions. Any other plan is a nonqualified pension plan.

“Self-insurance charge” means a cost which represents the projected average loss under a self- insurance plan.

“Service life” means the period of usefulness of a tangible capital asset (or group of assets) to its current owner. The period may be expressed in units of time or output. The estimated service life of a tangible capital asset (or group of assets) is a current forecast of its service life and is the period over which depreciation cost is to be assigned.

“Spread-gain actuarial cost method” means any of the several projected benefit actuarial cost methods under which actuarial gains and losses are included as part of the current and future normal costs of the pension plan.

“Standard cost” means any cost computed with the use of pre-established measures.

“Tangible capital asset” means an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the services it yields.

“Termination of employment gain or loss” means an actuarial gain or loss resulting from the difference between the assumed and actual rates at which pension plan participants separate from employment for reasons other than retirement, disability, or death.

“Variance” means the difference between a pre-established measure and an actual measure.

“Weighted average cost” means an inventory costing method under which an average unit cost is computed periodically by dividing the sum of the cost of beginning inventory plus the cost of acquisitions by the total number of units included in these two categories.