

## FAR Cost Principles Guide

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### **FAR 31.201-1 -- Composition of Total Costs**

#### **1984 FAR (Effective 1 April 1984)**

The total cost of a contract is the sum of the allowable 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 31.205-10. 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. See 31.201-2(b) and (c) for Cost Accounting Standards (CAS) requirements.

#### **FAC 90-23 (Effective 27 February 1995)**

(a) 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 31.205-10. 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. See 31.201-2(b) and (c) for Cost Accounting Standards (CAS) requirements.

(b) While the total cost of a contract includes all costs properly allocable to the contract, the allowable costs to the Government are limited to those allocable costs which are allowable pursuant to Part 31 and applicable agency supplements.

#### **FAC 2001-22 (Effective May 5, 2004 )**

*Revise paragraph (a) to read as follows:*

(a) The total cost, including standard costs properly adjusted for applicable variances, of a contract is the sum of the direct and indirect costs allocable to the contract, incurred or to be incurred, plus any allocable cost of money pursuant to 31.205-10, less any allocable credits. 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.

### **FAR 31.201-2 -- Determining Allowability**

#### **1984 FAR (Effective 1 April 1984)**

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

- (1) Reasonableness.
- (2) Allocability.
- (3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting principles and practices appropriate to the particular circumstances.
- (4) Terms of the contract.

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(5) Any limitations set forth in this subpart.

(b) Certain cost principles in this subpart incorporate the measurement, assignment, and allowability rules of selected CAS and limit the Allowability of costs to the amounts determined using the criteria in those selected standards. Only those CAS or portions of standards specifically made applicable by the cost principles in this subpart are mandatory unless the contract is CAS covered (see Part 30). 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.

(c) When contractor accounting practices are inconsistent with this subpart 31.2, costs resulting from such inconsistent practices shall not be allowed in excess of the amount that would have resulted from using practices consistent with this subpart.

### **FAC 90-12 (Effective 31 August 1992)**

*Revise second sentence of paragraph (b) to read as follows:*

Only those CAS or portions of standards specifically made applicable by the cost principles in this subpart are mandatory unless the contract is CAS covered (see 48 CFR 9903).

### **FAC 90-39 (Effective 19 August 1996)**

*Add paragraph (d) as follows:*

(d) 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 contracting officer may disallow all or part of a claimed cost which is inadequately supported.

### **FAC 2001-22 (Effective May 5, 2004 )**

*Revise paragraph (a) and (c) to read as follows:*

- (a) A cost is allowable only when the cost complies with all of the following requirements:
- (1) Reasonableness.
  - (2) Allocability.
  - (3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
  - (4) Terms of the contract.
  - (5) Any limitations set forth in this subpart.

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(c) When contractor accounting practices are inconsistent with this subpart 31.2, costs resulting from such inconsistent practices in excess of the amount that would have resulted from using practices consistent with this subpart are unallowable.

*Revise paragraph (d) replacing the word "which" with the word "that."*

### **FAR 31.201-3 -- Determining Reasonableness**

#### **1984 FAR (Effective 1 April 1984)**

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of 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. What is reasonable depends upon a variety of considerations and circumstances involving both the nature and amount of the cost in question. In determining the reasonableness of a specific cost, the contracting officer shall consider-

- (a) 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;
- (b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arms-length bargaining, Federal and State laws and regulations, and contract terms and specifications;
- (c) The action that a prudent business person, considering responsibilities to the owners of the business, employees, customers, the Government, and the public at large, would take under the circumstances; and
- (d) Any significant deviations from the established practices of the contractor that may unjustifiably increase the contract costs.

#### **FAC 84-26 (Effective 30 July 1987)**

- (a) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of 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 shall 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 contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.
- (b) 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;

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- (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.

### **FAR 31.201-4 -- Determining Allocability**

#### **1984 FAR (Effective 1 April 1984)**

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 the foregoing, a cost is allocable to a Government contract if it-

- (a) Is incurred specifically for the contract;
- (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

### **FAR 31.201-5 -- Credits**

#### **1984 FAR (Effective 1 April 1984)**

The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.

#### **FAC 84-51 (Effective 20 September 1989)**

The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund. See 31.205-6(j)(4) for rules related to refund or credit to the Government upon termination of an overfunded defined benefit pension plan.

#### **FAC 97-9 (Effective 29 December 1998)**

*Revise the last sentence to read as follows:*

See 31.205-6(j)(4) for rules governing refund or credit to the Government associated with pension adjustments and asset reversions.

### **FAR 31.201-6 -- Accounting for Unallowable Costs**

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### 1984 FAR (Effective 1 April 1984)

(a) Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall 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.

(b) 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 contracting officer shall 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 paragraph or paragraph (a) above.

(c) The detail and depth of records required as backup support for proposals, billings, or claims shall be that which is adequate to establish and maintain visibility of identified unallowable costs, including directly associated costs. Unallowable costs involved in determining rates used for standard costs, or for indirect cost proposals or billing, need be identified only at the time rates are proposed, established, revised, or adjusted. These requirements may be satisfied by any form of cost identification which is adequate for purposes of contract cost determination and verification.

(d) 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 shall 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.

(e) (1) In determining the materiality of a directly associated cost, consideration should be given to the significance of (i) the actual dollar amount, (ii) the cumulative effect of all directly associated costs in a cost pool, or (iii) the ultimate effect on the cost of Government contracts.

(2) 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 (e)(1) above (except when such salary expense 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

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activities during period outside normal working hours as to indicate that such activities are a part of the employee's regular duties.

(3) When a selected item of cost under 31.205 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 subparagraphs (e)(1) and (e)(2) above, except in those situations where allowance of any of the directly associated costs involved would be considered to be contrary to public policy.

### **FAC 90-23 (Effective 27 February 1995)**

*Revise paragraph (c) as follows:*

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

### **FAC 2005-06 (Effective October 31, 2005)**

*Revised "which" to "that" in second sentence of paragraph (a) and first sentence in paragraph (b). Also changed paragraphs (c) and (e)(3) to read as follows:*

(c)(1) The practices for accounting for and presentation of unallowable costs must be those described in 48 CFR 9904.405, Accounting for Unallowable Costs.

(2) Statistical sampling is an acceptable practice for contractors to follow in accounting for and presenting unallowable costs provided the criteria in paragraphs (c)(2)(i), (c)(2)(ii), and (c)(2)(iii) of this subsection are met:

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

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

(iii) The statistical sampling permits audit verification.

(3) For any indirect cost in the selected sample that is subject to the penalty provisions at 42.709, the amount projected to the sampling universe from that sampled cost is also subject to the same penalty provisions.

(4) Use of statistical sampling methods for identifying and segregating unallowable costs should be the subject of an advance agreement under the provisions of 31.109 between the contractor and the cognizant administrative contracting officer or Federal official. The advance agreement should specify the basic characteristics of the sampling process. The cognizant administrative contracting officer or Federal official shall request input from the cognizant auditor before entering into any such agreements.

(5) 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 contracting officer or the contracting officer's representative, the burden of proof shall be on the contractor to establish that such a method meets the criteria in paragraph (c)(2) of this subsection.



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(e) (3) When a selected item of cost under 31.205 provides that directly associated costs be unallowable, such directly associated costs are unallowable only if determined to be material in amount in accordance with the criteria provided in paragraphs (e)(1) and (e)(2) of this subsection, except in those situations where allowance of any of the directly associated costs involved would be considered to be contrary to public policy.

### **FAR 31.201-7 -- Construction and Architect-Engineer Contracts**

#### **1984 FAR (Effective 1 April 1984)**

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 31.105. The applicability of these principles and procedures is set forth in 31.000 and 31.100.

### **FAR 31.202 -- Direct Costs**

#### **1984 FAR (Effective 1 April 1984)**

(a) A direct cost is any cost that can be identified specifically with a particular final cost objective. No final cost objective shall have allocated to it as a direct costs 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.

(b) For reasons of practicality, any direct cost of minor dollar amount may be treated as an indirect cost if the accounting treatment-

- (1) Is consistently applied to all final cost objectives; and
- (2) Produces substantially the same results as treating the cost as a direct cost.

#### **FAC 2001-22 (Effective May 5, 2004 )**

*Revise paragraph (a) and (b) to read as follows:*

(a) No final cost objective shall 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. Direct costs of the contract shall 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.

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(b) For reasons of practicality, the contractor may treat any direct cost of a minor dollar amount as an indirect cost if the accounting treatment-

### FAR 31.203 -- Indirect Costs

#### **1984 FAR (Effective 1 April 1984)**

(a) 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 shall 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.

(b) Indirect costs shall 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 (GA) 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.

(c) Once an appropriate base for distributing indirect costs has been accepted, it shall not be fragmented by removing individual elements. All items properly includable in an indirect cost base should bear a prorata 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 GA 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 GA costs.

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

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

(2) Significant changes occur in the nature of the business, the extent of subcontracting, fixed-asset improvement programs, inventories, the volume of sales and

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production, manufacturing processes, the contractor's products, or other relevant circumstances;  
or

(3) 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.

(e) 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 CAS 406 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 (1) for contracts in which performance involves only a minor portion of the fiscal year or (2) 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.

(f) Special care should be exercised in applying the principles of paragraphs (b), (c), and (d) above when Government-owned contractor-operated (GOCO) plants are involved. The distribution of corporate, division, or branch office GA 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.

### **FAC 84-30 (Effective 30 September 1987)**

*Change the first two sentences of paragraph (e) as follows:*

(e) 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 30.406 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.

### **FAC 90-12 (Effective 31 August 1992)**

*Revise second sentence of paragraph (e) to read as follows:*

The criteria and guidance in 48 CFR 9904.406 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.

### **FAC 2001-22 (Effective May 5, 2004 )**

*Added a new paragraph (a). Revised, restructured, and renumbered the remaining paragraphs to read as follows:*

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- (a) For contracts subject to full CAS coverage, allocation of indirect costs shall be based on the applicable provisions. For all other contracts, the applicable CAS provisions in paragraphs (b) through (h) of this section apply.
- (b) After direct costs have been determined and charged directly to the contract or other work, indirect costs are those remaining to be allocated to intermediate or two or more final cost objectives. No final cost objective shall have allocated to it as an indirect cost any cost, 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.
- (c) The contractor shall accumulate indirect costs by logical cost groupings with due consideration of the reasons for incurring such costs. The contractor shall determine each grouping so as to permit use of an allocation base that is common to all cost objectives to which the grouping is to be allocated. The base selected shall allocate the grouping on the basis of the benefits accruing to intermediate and final 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.
- (d) Once an appropriate base for allocating indirect costs has been accepted, the contractor shall not fragment the base by removing individual elements. All items properly includable in an indirect cost base shall 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 allocation of G&A costs, the contractor shall include in the base all items that would properly be part of the cost input base, whether allowable or unallowable, and these items shall bear their pro rata share of G&A costs.
- (e) The method of allocating indirect costs may require revision when there is a significant change 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.
- (f) 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.
- (g) A base period for allocating indirect costs is the cost accounting period during which such costs are incurred and accumulated for allocation to work performed in that period.
- (1) For contracts subject to full or modified CAS coverage, the contractor shall follow the criteria and guidance in 48 CFR 9904.406 for selecting the cost accounting periods to be used in allocating indirect costs.
  - (2) For contracts other than those subject to paragraph (g)(1) of this section, the base period for allocating indirect costs shall be the contractor's fiscal year used for financial reporting purposes in accordance with generally accepted accounting principles. The fiscal year will normally be 12 months, but a different period may be appropriate (e.g.,

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when a change in fiscal year occurs due to a business combination or other circumstances).

(h) Special care should be exercised in applying the principles of paragraphs (c), (d), and (e) of this section 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.

### **FAR 31.204 -- Application of Principles and Procedures**

#### **1984 FAR (Effective 1 April 1984)**

(a) Costs shall be allowed to the extent they are reasonable, allocable, and determined to be allowable under 31.201, 31.202, 31.203, and 31.205. These criteria apply to all of the selected items that follow, even if particular guidance is provided for certain items for emphasis or clarity.

(b) Costs incurred as reimbursements or payments to a subcontractor under a cost-reimbursement, fixed-price incentive, or price redeterminable type subcontract of any tier above the first firm-fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions are allowable to the extent that allowance is consistent with the appropriate subpart of this Part 31 applicable to the subcontract involved. 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 under 15.805-3, shall be allowable only to the extent that the price was negotiated in accordance with 31.102.

(c) Section 31.205 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 shall be based on the principles and standards in this subpart and the treatment of similar or related selected items.

#### **FAC 84-37 (Effective 17 June 1988)**

*Add the following to the end of paragraph (c):*

When more than one subsection in 31.205 is relevant to a contractor cost, the cost shall be apportioned among the applicable subsections, and the determination of allowability of each portion shall be based on the guidance contained in the applicable subsection. When a cost, to which more than one subsection in 31.205 is relevant, cannot be apportioned, the determination of allowability shall be based on the guidance contained in the subsection that most specifically deals with, or best captures the essential nature of, the cost issue.

#### **FAC 97-2 (Effective 10 October 1997)**

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*Change reference in FAR 31.204(b) from 15.805-3 to 15.404-1(c).*

### **FAC 2001-24 (Effective July 19, 2004)**

*Change (a) from “Costs shall be allowed” to “Costs are allowable”, restructure (b), and move (c) to (d) to read as follows.*

- (a) Costs are allowable to the extent they are reasonable, allocable, and determined to be allowable under 31.201, 31.202, 31.203, and 31.205. These criteria apply to all of the selected items that follow, even if particular guidance is provided for certain items for emphasis or clarity.
- (b)(1) 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 part:
  - (i) Cost-reimbursement.
  - (ii) Fixed-price incentive.
  - (iii) Price redeterminable (*i.e.*, fixed-price contracts with prospective price determination and fixed-ceiling price contracts with retroactive price redetermination).
- (2) The requirements of paragraph (b)(1) of this section apply to any tier above the first firm-fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions.
- (c) Costs incurred as payments under firm-fixed-price subcontracts or fixed-price subcontracts with economic price adjustment provisions or modifications thereto, for which subcontract cost analysis was performed are allowable if the price was negotiated in accordance with 31.102.
- (d) Section 31.205 does not cover every element of cost....

### **FAR 31.205-1 -- Public Relations and Advertising Costs**

#### **1984 FAR (Effective 1 April 1984)**

- (a) "Advertising costs" means the costs of advertising and directly associated costs, 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 includes conventions, exhibits, free goods, samples, magazines, newspapers, trade papers, direct mail, dealer cards, window displays, outdoor advertising, and radio and television programs.
- (b) The only advertising costs allowable are those that arise from requirements of Government contracts and that are for-
  - (1) Recruiting personnel required for performing contractual obligations, when considered in conjunction with all other recruitment costs (but see 31.205-34);
  - (2) Acquiring scarce items for contract performance; or
  - (3) Disposing of scrap or surplus materials acquired for contract performance. Costs of this nature, if incurred for more than one defense contract or both defense work and other work of the contractor, are allowable to the extent that the principles in 31.201-3, 31.201-4, and 31.203 are observed.

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(c) Advertising costs other than those specified in paragraph (b) above are unallowable. Unallowable advertising costs include those related to sales promotion which involve direct payment for using time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing the overall company image to sell the company's products.

### **FAC 84-15 (Effective 7 April 1986)**

(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 paragraphs (a) and (b) of this subsection.

(d) The only advertising costs that are allowable are those specifically required by contract, or that arise from requirements of Government contracts and that are exclusively for-

- (1) Recruiting personnel required for performing contractual obligations, when considered in conjunction with all other recruitment costs (but see 31.205-34);
- (2) Acquiring scarce items for contract performance; or
- (3) Disposing of scrap or surplus materials acquired for contract performance.

Costs of this nature, if incurred for more than one Government contract or both Government work and other work of the contractor, are allowable to the extent that the principles in 31.201-3, 31.201-4, and 31.203 are observed.

(e) Allowable public relations costs include the following:

- (1) Costs specifically required by contract.
- (2) Costs of-

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- (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 (f)(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 advertising costs other than those specified in paragraph (d) of this subsection.
  - (2) Costs of air shows and other special events, such as conventions and trade shows, including-
    - (i) Costs of displays, demonstrations, and exhibits;
    - (ii) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and
    - (iii) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings.
  - (3) Costs of sponsoring meetings, 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 corporate celebrations and 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 (but see 31.205-13(a), Employee morale, health, welfare, food service, and dormitory costs and credits; 31.205-21, Labor relations costs; 31.205-43(c), Trade, business, technical, and professional activity costs; and 31.205-44, Training and educational costs).
  - (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.
  - (8) All public relations costs, other than those specified in paragraph (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 31.205-38(c)), 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. Nothing in this subparagraph (f)(8) modifies the express unallowability of costs listed in subparagraphs (f)(2) through (f)(7). The purpose of this subparagraph is to provide criteria for determining whether costs not specifically identified should be unallowable.



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(g) Costs made specifically unallowable under this subsection 31.205-1 are not made allowable under subsections of Subpart 31.2 such as 31.205-13, Employee morale, health, welfare, food service, and dormitory costs and credits; 31.205-22, Legislative lobbying costs; 31.205-34, Recruitment costs; 31.205-38, Selling costs; 31.205-43, Trade, business, technical, and professional activity costs; or 31.205-44, Training and educational costs. Conversely, costs that are specifically unallowable under these and other subsections of Subpart 31.2 are not made allowable under this subsection.

### **FAC 84-36 (Effective 12 April 1988)**

*Move paragraph (g) to (h) and add a new paragraph (g) as follows:*

(g) Notwithstanding the provisions of paragraph (d) and subparagraph (f)(2) of this subsection, reasonable costs incurred to promote American aerospace exports at domestic and international exhibits, such as air shows, trade shows, and conventions, are allowable. Such reasonable costs include transportation of the aircraft, aerospace parts and equipment, and other associated support cost. However, such allowable costs shall not include the cost of entertainment, hospitality suites or chalets, advertising media other than exhibits, and other costs not necessary to establish, operate or maintain an exhibit, display, or demonstration. This paragraph applies so long as Section 8062 of Pub.L.100-202, or a similar provision in a subsequent act, is in effect.

(h) Costs made specifically unallowable under this subsection 31.205-1 are not made allowable under subsections of Subpart 31.2 such as 31.205-13, Employee morale, health, welfare, food service, and dormitory costs and credits; 31.205-22, Legislative lobbying costs; 31.205-34, Recruitment costs; 31.205-38, Selling costs; 31.205-43, Trade, business, technical, and professional activity costs; or 31.205-44, Training and educational costs. Conversely, costs that are specifically unallowable under these and other subsections of Subpart 31.2 are not made allowable under this subsection.

### **FAC 84-51 (Effective 20 September 1989)**

*Eliminate paragraph (h).*

### **FAC 90-4 (Effective 15 May 1991)**

*Replace paragraphs (d) and (f) as follows:*

(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) Recruiting personnel required for performing contractual obligations, when considered in conjunction with all other recruitment costs (but see 31.205-34);

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- (ii) Acquiring scarce items for contract performance; or
  - (iii) 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 (f)(1) and (3), subdivision (f)(4)(ii), and subparagraph (f)(5) of this subsection, subject to the limits contained in 31.205-38(c)(2). However, such costs do not include the costs of memorabilia (e.g., models, gifts, and souvenirs), alcoholic beverages, entertainment, and physical facilities which are primarily used for entertainment rather than product promotion.

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

(1) All public relations and advertising costs, other than those specified in paragraphs (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 31.205-38(c)), 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, 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 (but see 31.205-13(a), Employee morale, health, welfare, food service, and dormitory costs and credits; 31.205-21, Labor relations costs; 31.205-43(c), Trade, business, technical, and professional activity costs; and 31.205-44, Training and education costs).

(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.

### **FAC 90-31 (Effective 1 October 1995)**

*Replace paragraph (f)(3) as follows:*

(f) (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.

### **FAC 90-43 (Effective 18 February 1997)**

*Delete the parenthetical reference from paragraph (f)(5) as follows:*

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(f) (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.

### **FAC 90-46 (Effective 16 May 1997)**

*Revise paragraph (d) (2) as follows:*

(d) (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 (f)(1) and (f)(3), (f)(4)(ii), and (f)(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 which are primarily used for entertainment rather than product promotion.

### **FAC 97-11 (Effective 3 May 1999)**

*Delete one of three criteria for allowability of advertising. The deletion is the criteria, "recruiting personnel required for performing contractual obligations, when considered in conjunction with all other recruitment costs (but see 31.205-34)". Added (d)(3) as shown.*

- (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.
  - (3) Allowable in accordance with 31.205-34.

### **FAC 2001-15 (Effective August 25, 2003)**

*Amend section 31.205-1 in paragraph (f)(1) by removing from the parenthetical "31.205-38(c)" and adding "31.205-38(b)(5)" in its place.*

## **FAR 31.205-2 -- Automatic Data Processing Equipment Leasing Costs**

### **1984 FAR (Effective 1 April 1984)**

(a) This subsection applies to all contractor-leased automatic data processing equipment (ADPE), as defined in 31.001 (except as components of an end item to be delivered to the Government), acquired under operating leases, as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board. Compliance with 31.205-11(m) requires that ADPE 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

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or over the leased life as amortization charges as appropriate. Allowability of costs related to contractor-owned ADPE is governed by other requirements of this subpart.

(b) (1) If the contractor leases ADPE but cannot demonstrate, on the basis of facts existent at the time of the decision to lease or continue leasing and documented in accordance with paragraph (d) below, that leasing will result in less cost to the Government over the anticipated useful life (see paragraph (c) below), then rental costs are allowable only up to the amount that would be allowed had the contractor purchased the ADPE.

(2) The costs of leasing ADPE are allowable only to the extent that the contractor can annually demonstrate in accordance with paragraph (d) below (whether or not the term of lease is renewed or otherwise extended) that these costs meet the following criteria:

(i) The costs are reasonable and necessary for the conduct of the contractor's business in light of factors such as the contractor's requirements for ADPE, costs of comparable facilities, the various types of leases available, and the terms of the rental agreement.

(ii) The costs do not give rise to a material equity in the facilities (such as an option to renew or purchase at a bargain rental or price other than that normally given to industry at large) but represent charges only for the current use of the equipment, including incidental service costs such as maintenance, insurance, and applicable taxes.

(iii) The contracting officer's approval was obtained for the leasing arrangement (see subparagraph (d)(3) below) when the total cost of leasing-

(A) The ADPE is to be allocated to one or more Government contracts which require negotiating or determining costs, or

(B) ADPE in a single plant, division, or cost center exceeds \$500,000 a year and 50 percent or more of the total leasing costs is to be allocated to one or more Government contracts which require negotiating or determining costs.

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

(4) Allowable rental costs of ADPE leased from any division, subsidiary, or organization under a common control are limited to the cost of ownership (excluding interest or other costs unallowable under this Subpart 31.2 and including the cost of money (see 31.205-10)). When there is an established practice of leasing the same or similar equipment to unaffiliated lessees, rental costs shall be allowed in accordance with subparagraphs (b)(1) and (2) above, except that the purchase price and costs of ownership shall be determined under 31.205-26(e).

(c) (1) An estimate of anticipated useful life of the ADPE may represent the application life (utility in a given function), technological life (utility before becoming obsolete in whole or in part), or physical life (utility before wearing out) depending upon the facts and circumstances and the particular facilities involved. Each case must be evaluated individually. In estimating anticipated useful life, the contractor may use the application life if it can be demonstrated that the ADPE has utility only in a given function and the duration of the function can be determined. Technological life may be used if the contractor can demonstrate that existing ADPE must be replaced because of-

(i) Specific program objectives or contract requirements that cannot be accomplished with the existing ADPE;

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- (ii) Cost reductions that will produce identifiable savings in production or overhead costs;
  - (iii) Increase in workload volume that cannot be accomplished efficiently by modifying or augmenting existing ADPE; or
  - (v) Consistent pattern of capacity operation (2 1/2 -- 3 shifts) on existing ADPE.
- (2) Technological advances will not justify replacing existing ADPE before the end of its physical life if it will be able to satisfy future requirements or demands.
- (3) In estimating the least cost to the Government for useful life, the cumulative costs that would be allowed if the contractor owned the ADPE should be compared with cumulative costs that would be allowed under any of the various types of leasing arrangements available. For the purpose of this comparison, the costs of ADPE exclude interest or other unallowable costs pursuant to this Subpart 31.2; they include but are not limited to the costs of operation, maintenance, insurance, depreciation, facilities capital cost of money, rental, and the cost of machine services, as applicable.
- (d) (1) Except as provided in subparagraph (3) below, the contractor's justification, under paragraph (b) above, of the leasing decisions shall consist of the following supporting data, prepared before acquisition:
- (i) Analysis of use of existing ADPE.
  - (ii) Application of the criteria in paragraph (b) above.
  - (iii) Specific objectives or requirements, generally in the form of a data system study and specifications.
  - (iv) Solicitation of proposals, based on the data system specification, from qualified sources.
  - (v) Proposals received in response to the solicitation and reasons for selecting the equipment chosen and for the decision to lease.
- (2) Except as provided in subparagraph (3) below, the contractor's annual justification, under subparagraph (b)(2) above, of the decision to retain or change existing ADPE capability and the need to continue leasing shall consist of current data as specified in subdivision (d)(1)(i) through (iii) above.
- (3) If the contractor's prospective ADPE lease cost meets the threshold in 31.205-2(b)(2)(iii) above, the contractor shall furnish data supporting the initial decision to lease (see subparagraph (b)(1) above). If the total cost of leasing ADPE in a single plant, division, or cost center exceeds \$500,000 per year and 50 percent or more of the total leasing cost is allocated to Government contracts which require negotiating or determining costs, the contractor shall furnish data supporting the annual justification for retaining or changing existing ADPE capability and the need to continue leasing shall also be furnished (see subparagraph (b)(2) above).

### **FAC 90-44 (Effective 31 December 1996)**

*Interim rule - delete this cost principle.*

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### **FAC 97-1 (Effective 21 October 1997)**

*Final rule - delete this cost principle.*

### **FAR 31.205-3 -- Bad Debts**

#### **1984 FAR (Effective 1 April 1984)**

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

### **FAR 31.205-4 -- Bonding Costs**

#### **1984 FAR (Effective 1 April 1984)**

- (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.

### **FAR 31.205-5 -- Civil Defense Costs**

#### **1984 FAR (Effective 1 April 1984)**

- (a) Civil defense costs are those incurred in planning for, and protecting life and property against, the possible effects of enemy attack. Costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, fire fighting training and equipment, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the contractor's premises pursuant to suggestions or requirements of civil defense authorities are allowable when allocated to all work of the contractor.
- (b) Costs of capital assets acquired for civil defense purposes are allowable through depreciation (see 31.205-11).
- (c) Contributions to local civil defense funds and projects are unallowable.

### **FAC 97-9 (Effective 29 December 1998)**

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*Delete this cost principle.*

### **FAR 31.205-6 -- Compensation for Personal Services**

#### **1984 FAR (Effective 1 April 1984)**

(a) General. Compensation for personal services includes all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor during the period of contract performance (except as otherwise provided for severance pay costs in paragraph (g) below and for pension costs in paragraph (j) below). It includes, but is not limited to, salaries; wages; director's and executive committee member's fees; bonuses (including stock bonuses); incentive awards; employee stock options, stock appreciation rights, and stock ownership plans; employee insurance; fringe benefits; contributions to pension, annuity, and management employee incentive compensation plans; and allowances for off-site pay, incentive pay, location allowances, hardship pay, severance pay, and cost of living differential. 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 31.205-6(g), (h), (j), (k), and (m) below).

(2) The compensation in total must be reasonable for the work performed; however, specific restrictions on individual compensation elements must be observed where they are 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-

(i) Has not notified the cognizant ACO of the changes either before their implementation or within a reasonable period after their implementation, and

(ii) Has not provided the Government, 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 Subpart 31.2 shall not be allowable under this subsection 31.205-6 solely on the basis that they constitute compensation for personal services. (See 31.205-34(c)).

(b) Reasonableness. Compensation for personal services will be considered reasonable if the total compensation conforms generally to compensation paid by other firms of the same size, in the same industry, or in the same geographic area for similar services or work performed. This does not preclude the Government from challenging the reasonableness of an individual element of compensation where costs are excessive in comparison with compensation paid by other firms of the same size, same industry, or in the same geographic areas for similar services. In administering this principle, it is recognized that not every compensation case need be subjected in detail to the above tests. The tests need be applied only when a general review reveals

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amounts or types of compensation that appear unreasonable or unjustified. In questionable cases, the contractor has responsibility to support the reasonableness of the compensation in relation to the effort performed. Compensation costs under certain conditions give rise to the need for special consideration. Among such conditions are the following:

(1) Compensation to (i) owners of closely held corporations, partners, sole proprietors, or members of their immediate families, or (ii) persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise. Determination should be made that salaries are reasonable for the personal services rendered rather than being a distribution of profits. Compensation in lieu of salary for services rendered by partners and sole proprietors will be allowed to the extent that it is reasonable and does not constitute a distribution of profits. For closely held corporations, compensation costs covered by this subparagraph shall not be recognized in amounts exceeding those costs that are deductible as compensation under the Internal Revenue Code and regulations under it.

(2) Any change in a contractor's compensation policy that results in a substantial increase in the contractor's level of compensation, particularly when it was concurrent with an increase in the ratio of Government contracts to other business, or any change in the treatment of allowability of specific types of compensation due to changes in Government policy. No presumption of reasonableness will exist where major revisions of existing compensation plans or new plans are introduced by the contractor; and the contractor-

(i) Has not notified the cognizant ACO of the change either before their implementation or within a reasonable period after their implementation; and

(ii) Has not provided the Government, either before implementation or within a reasonable period after it, an opportunity to review the reasonableness of the changes.

(3) The contractor's business is such that its compensation levels are not subject to the restraints that normally occur in the conduct of competitive business.

(4) The contractor incurs costs for compensation in excess of the amounts which are deductible under the Internal Revenue Code and regulations issued under it.

(c) Labor-management agreements. Notwithstanding any other requirements of this subsection 31.205-6, costs of compensation are not allowable to the extent that they result from provisions of labor-management agreements that, as applied to work in performing Government contracts, are determined to be unreasonable because they are either 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. Disallowance of costs will not be made under this paragraph (c) unless-

(1) The contractor has been permitted an opportunity to justify the costs; and



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(2) Due consideration has been given to whether unusual conditions pertain to Government contract work, imposing burdens, hardships, or hazards on the contractor's employees, for which compensation that might otherwise appear unreasonable is required to attract and hold necessary personnel.

(d) Salaries and wages. Salaries and wages for current services include gross compensation paid to employees in the form of cash, stock (see subparagraph (f)(2) below regarding valuation), products, or services, and are allowable.

(e) Domestic and foreign differential pay.

(1) When personal services are performed in a foreign country, compensation may also include a differential that may properly consider all expenses associated with foreign employment such as housing, cost of living adjustments, transportation, bonuses, additional Federal, State, local or foreign income taxes resulting from foreign assignment, and other related expenses.

(2) Although the additional taxes in subparagraph (1) above may be considered in establishing foreign overseas differential, any increased compensation calculated directly on the basis of an employee's specific increase in income taxes is unallowable. Differential allowances for additional Federal, State, or local income taxes resulting from domestic assignments are unallowable.

(f) Bonuses and incentive compensation.

(1) Incentive compensation for management employees, cash bonuses, suggestion awards, safety awards, and incentive compensation based on production, cost reduction, or efficient performance are allowable provided the 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 the basis for the award is supported.

(2) When the costs of bonuses and incentive compensation are paid in the stock of the contractor or of an affiliate, the following additional restriction apply:

(i) Valuation placed on the stock shall be fair market value on the measurement date (i.e., the first date the number of shares awarded is known) determined upon the most objective basis available; and

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

(3) When the bonus and incentive compensation payments are deferred, the costs are subject to the requirements of subparagraph (f)(1) above and of paragraph (k) below.

(g) Severance pay.

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(1) Severance pay, also commonly referred to as dismissal wages, 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 subparagraph (j)(6) below.

(2) Severance pay to be allowable must meet the general allowability criteria in subdivision (g)(2)(i) below, and, depending upon whether the severance is normal or abnormal, criteria in subdivision (g)(2)(ii) for normal severance pay or subdivision (g)(2)(iii) for abnormal severance pay also apply.

(i) Severance pay is allowable only to the extent that, in each case, it is required by (A) law, (B) employer-employee agreement, (C) established policy that constitutes, in effect, an implied agreement on the contractor's part, or (D) circumstances of the particular employment. 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. Severance payments, or amounts paid in lieu thereof, are not allowable when paid to employees in addition to early or normal retirement payments.

(ii) Actual normal turnover severance payments shall be allocated to all work performed in the contractor's plant, or where the contractor provides for accrual pay for normal severances, that method will be acceptable if the amount of the accrual is reasonable in light of payments actually made for normal severances over a representative past period and if amounts accrued are allocated to all work performed in the contractor's plant.

(iii) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, 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, allowability will be considered on a case-by-case basis.

(h) Backpay.

(1) Backpay resulting from violations of Federal labor laws or the Civil Rights Act of 1984. Backpay may result from a negotiated settlement, order, or court decree that resolves a violation of Federal labor laws or the Civil Rights Act of 1984. Such backpay falls into two categories: one requiring the contractor to pay employees additional compensation for work performed for which they were underpaid, and the other resulting from other violations, such as when the employee was improperly discharged, discriminated against, or other circumstances for which the backpay was not additional compensation for work performed. Backpay resulting from underpaid work is compensation for the work performed and is allowable. All other backpay resulting from violation of Federal labor laws or the Civil Rights Act of 1964 is unallowable.

(2) Other backpay. Backpay may also result from payments to union employees (union and non-union) for the difference in their past and current wage rates for working without a contract or labor agreement during labor management negotiations. Such backpay is allowable. Backpay to nonunion employees based upon results of union agreement negotiations is allowable only if (i) a formal agreement or understanding exists between management and the

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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 payment.

(i) Stock options, stock appreciation rights, and phantom stock plans.

(1) The cost of stock options awarded to employees to purchase stock of the contractor or of an affiliate will be treated as deferred compensation and must comply with the requirements of paragraph (k) below and with the allowability criteria contained in subparagraph (i)(2) below. The allowable cost of stock appreciation rights, whether offered separately or combined with stock options, will be determined in the same manner as stock options.

(2) The allowable costs of stock options and stock appreciation rights will be limited to the difference between the option price or stock-appreciation-right price and the market price of the stock on the measurement date (i.e., the first date on which both the number of shares and the option or stock-appreciation-right price are known). Accordingly, when the option or stock-appreciation-right price is equal to or greater than the market price on the measurement date, then no costs are allowed for contract costing purposes.

(3) In phantom-stock-type plans, contractors assign or attribute contingent shares of stock to employees as if the employees own the stock, even though the employees neither purchase the stock nor receive title to it. Under these plans, an employee's account may be increased by the equivalent of dividends issued and any appreciation in the market price of the stock over the price of the stock on the measurement date (i.e., the first date the number of shares awarded is known). Such increases in employee accounts for dividend equivalents and market price appreciation are unallowable.

(j) Pension costs.

(1) A pension plan is a deferred compensation plan that is established and maintained by one or more employers to provide systematically for paying benefits to plan participants after their retirement provided that the benefits are paid for life or are payable for life at the option of the employee. 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 plans. The cost of all defined benefit pension plans shall be measured, allocated, and accounted for in compliance with the provisions of CAS 412, Composition and Measurement of Pension Costs, and CAS 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 CAS 412. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth below in this subparagraph and in subparagraphs (j)(3), (4), (5), (6), and (7) below.

(i) To be allowable in the current year, pension costs must be funded by the time set for filing 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.

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(ii) Pension payments must be reasonable in amount and be paid pursuant to (A) an agreement entered into in good faith between the contractor and employees before the work or services are performed and (B) the terms and conditions of the established plan. The cost of changes in pension plans which 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)(6) below, one-time-only pension supplements not available to all participants of the basis 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 subparagraph 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) Normal costs of pension plans not funded in the year incurred, and all other components of pension costs (see CAS 412.40(a)(1)) assignable 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 part of a pension cost that is computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of the Employee's Retirement Income Security Act of 1974 (ERISA) (see CAS 412.50(c)(3)), will be allowable in those future accounting periods in which the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding occurred in the year the costs would have been assigned except for the waiver.

(ii) Any amount paid or funded before the time it becomes assignable and allowable shall be applied to future years, in order of time, as if actually paid and deductible in those years. The interest earned on such premature funding, based on the valuation rate of return, may be excluded from future years' computations of pension costs in accordance with CAS 412.50(a)(7).

(iii) Increased pension costs caused by a 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 CAS 413.50(c)(5). Determination of unallowable costs shall be made in accordance with the actuarial 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

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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, despite the requirements of 31.205-19(a)(3) and (b), in the indemnification payment to the extent of its fair share.

(4) Defined contribution pension plans. This subparagraph covers those pension plans in which the contributions to be made 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) above.

(i) The pension cost assignable to a cost accounting period is the net contribution required to be made for that period after taking into account dividends and other credits, where applicable. However, any portion of pension cost computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of ERISA (see CAS 412.50(c)(3)) will be allowable in those future accounting periods when the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding been made in the year the costs would have been assigned except for the waiver.

(ii) Any amount paid or funded to the trust before the time it becomes assignable and allowable shall be applied to future years, in order of time, as if actually paid and deductible in such years.

(iii) The provisions of subdivision (j)(3)(iv) above concerning payments to PBGC apply to defined contribution plans.

(5) Pension plans using pay-as-you-go methods. A pension plan using pay-as-you-go methods is a plan in which the contractor recognizes pension cost only when benefits are paid to retired employees or their beneficiaries. Regardless of whether the payment of pension benefits contribution can or cannot be compelled, allowable costs for these types of plans shall not exceed an amount computed as follows:

(i) Compute, by using an actuarial cost method, the plan's actuarial liability for benefits earned by plan participants. This entire liability is always unfunded for a pay-as-you-go plan.

(ii) Compute a level amount which, including an interest equivalent, would amortize the unfunded actuarial liability over a period of no less than 10 or more than 40 years from the inception of the liability.

(iii) Compute, by using an actuarial cost method, a normal cost for the period.

(iv) The sum of (ii) and (iii) above represents the amount of pension costs assignable to the current period. This amount, however, is limited to the amount paid in the year.

(v) For purposes of determining contract cost where a pay-as-you-go plan is initiated as either a supplemental plan or an additional but separate plan to a basic funded plan,

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the plans will be treated as one plan; e.g., the actuarial cost method, past service amortization period, etc., of the basic plan will be used on the supplemental or additional pay-as-you-go plan in determining the proper costs assignable to the current period. Any costs in excess of those determined by using the actuarial cost method and assumptions for the basic plan are allowable. However, where assumption for salary progressions, mortality rates of the participants, and so forth are significantly different, the assumptions used for the basic and supplemental plan may be different.

(vi) The requirements of subdivisions (j)(3)(i) through (iv) above are also applicable to pay-as-you-go plans.

(6) 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 subdivisions (j)(3)(i) through (iv) provided-

(i) The costs are accounted for and allocated in accordance with the contractor's system of accounting for pension costs (see subdivision (j)(5)(v) above for supplemental pension benefits);

(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.

(7) 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

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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 ESOT are or will be at 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 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 subdivision (j)(3)(ii) above are applicable to Employee Stock Ownership Plans.

(k) Deferred compensation.

(1) Deferred compensation is an award given by an employer to compensate an employee in a future cost accounting period or periods for services 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. Subject to 31.205-6(a), deferred awards are allowable when they are based on current or future services. Awards 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 CAS 415, Accounting for the Cost of Deferred Compensation.

(3) Deferred compensation payments to employees under awards made before the effective date of CAS 415 are allowable to the extent they would have been allowable under prior acquisition regulations.

(l) Reserved.

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(m) Fringe benefits. Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. The cost of fringe benefits, including, but not limited to, the cost of vacations, sick leave, holidays, military leave, employee insurance, and supplemental unemployment benefit plans, is allowable if reasonable. The costs of fringe benefits are allowable to the extent that they are required by law, employer-employee agreement, or as an established policy of the contractor.

### **FAC 84-15 (Effective 7 April 1986)**

*Replace paragraphs (b) and (m) as follows:*

(b) Reasonableness.

(1) The compensation for personal services paid or accrued to each employee must be reasonable for the work performed. Compensation will be considered reasonable if each of the allowable elements making up the employee's compensation package is reasonable. In determining the reasonableness of individual elements for particular employees or classes of employees, consideration should be given to all potentially relevant facts. Facts which may be relevant include general conformity with the compensation practices of other firms of the same size, the compensation practices of other firms in the same industry, the compensation practices of other firms in the same geographic area, the compensation practices of firms engaged in predominantly non-Government work, and the cost of comparable services obtainable from outside sources. While all of the above factors, as well as any other relevant ones, should be considered, their relative significance will vary according to circumstances. For example, in the case of secretarial salaries, conformity with the compensation paid by other firms in the same geographic area would likely be a more significant criterion than conformity with the compensation paid by other firms in the same industry wherever located. In administering this principle, it is recognized that not every compensation case need be subjected in detail to the above or other tests. The tests need be applied only when a general review reveals amounts or types of compensation that appear unreasonable or unjustified. Based on an initial review of the facts, contracting officers or their representatives may challenge the reasonableness of any individual element or the sum of the individual elements of compensation paid or accrued to particular employees or classes of employees. In such cases, there is no presumption of reasonableness and, upon challenge, the contractor must demonstrate the reasonableness of the compensation item in question. In doing so, the contractor may introduce, and the contracting officer will consider, not only any circumstances surrounding the compensation item challenged but also the magnitude of other compensation elements which may be lower than would be considered reasonable in themselves. For example, a contractor, if challenged on the amount of base salaries for management, could counter by showing lower than normal end-of-year management bonuses. However, the contractor's right to introduce offsetting compensation elements into consideration is subject to the following limitations:

(i) Offsets will be considered only between the allowable elements of an employee's (or a class of employees') compensation package. For example, excessive management salaries cannot be offset against lower than normal secretarial salaries.



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(ii) Offsets will be considered only between the allowable portion of the following compensation elements of employees or classes of employees:

- (A) Wages and salaries.
- (B) Incentive bonuses.
- (C) Deferred compensation.
- (D) Pension and savings plan benefits.
- (E) Health insurance benefits.
- (F) Life insurance benefits.
- (G) Compensated personal absence benefits.

However, any of the above elements or portions thereof, whose amount is not measurable, shall not be introduced or considered as an offset item.

(iii) In considering offsets, the magnitude of the compensation elements in question must be taken into account. An executive bonus that is excessive by \$100,000 is not fully offset by a base salary that is low by only \$25,000. In determining the magnitude of compensation elements, the timing of receipt by the employee must be considered. For example, a bonus of \$100,000 in the current period will be considered as of greater value than a deferred compensation arrangement to make the same payment in some future period.

(2) Compensation costs under certain conditions give rise to the need for special consideration. Among such conditions are the following:

(i) Compensation to (A) owners of closely held corporations, partners, sole proprietors, or members of their immediate families, or (B) persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise. Determination should be made that salaries are reasonable for the personal services rendered rather than being a distribution of profits. Compensation in lieu of salary for services rendered by partners and sole proprietors will be allowed to the extent that it is reasonable and does not constitute a distribution of profits. For closely held corporations, compensation costs covered by this subdivision shall not be recognized in amounts exceeding those costs that are deductible as compensation under the Internal Revenue Code and regulations under it.

(ii) Any change in a contractor's compensation policy that results in a substantial increase in the contractor's level of compensation, particularly when it was concurrent with an increase in the ratio of Government contracts to other business, or any change in the treatment of allowability of specific types of compensation due to changes in Government policy. Contracting officers or their representatives should normally challenge increased costs where major revisions of existing compensation plans or new plans are introduced by the contractor, and the contractor-

(A) Has not notified the cognizant ACO of the changes either before their implementation or within a reasonable period after their implementation; and

(B) Has not provided the Government, either before implementation or within a reasonable period after it, an opportunity to review the reasonableness of the changes.

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(iii) The contractor's business is such that its compensation levels are not subject to the restraints that normally occur in the conduct of competitive business.

(iv) The contractor incurs costs for compensation in excess of the amounts which are deductible under the Internal Revenue Code and regulations issued under it.

(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 elsewhere in Subpart 31.2, 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 31.205-46(f)).

### **FAC 84-21 (Effective 29 August 1986)**

*Add paragraph (n) as follows:*

(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.

### **FAC 84-26 (Effective 30 July 1987)**

*Replace paragraph (i) as follows:*

(i) Stock options, stock appreciation rights, phantom stock plans, and junior stock conversions.

(1) The cost of stock options awarded to employees to purchase stock of the contractor or of an affiliate will be treated as deferred compensation and must comply with the requirements of paragraph (k) of this subsection. The allowable cost of stock options is limited to the difference between the option price and the market price on the first date on which the option price and the number of shares are known. Accordingly, when the stock option price is equal to or greater than the market price on that date, then no costs are allowable for contract costing purposes.

(2) Stock appreciation rights are rights granted to employees by contractors to receive the increase in value, or appreciation, of company stock even though the employee neither purchases the stock nor receives title to it. Stock appreciation rights will be treated as deferred compensation and must comply with the requirements of paragraph (k) of this subsection. The allowable cost of stock appreciation rights is limited to the difference between the stock-appreciation-right base price from which appreciation will be measured and the market price on the first date on which both the number of shares and the stock-appreciation-right base

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price are known. Accordingly, when the stock-appreciation-right base price is equal to or greater than the market price on that date, then no costs are allowable for contract costing purposes.

(3) In phantom-stock-type plans, contractors assign or attribute contingent shares of stock to employees as if the employees own the stock, even though the employees neither purchase the stock nor receive title to it. Under these plans, an employee's account may be increased by the equivalent of dividends paid and any appreciation in the market price of the stock over the price of the stock on the first date on which the number of shares awarded is known. Such increases in employee accounts for dividend equivalents and market price appreciation are unallowable.

(4) Junior stock is a class of equity stock that (i) is sold to employees at a price below that of the contractor's common stock, (ii) carries reduced dividend voting rights, and (iii) is convertible to common stock upon the attainment of specified corporate goals. Costs associated with the conversion of junior stock into common stock are not allowable, whether or not they are accounted for as compensation costs.

### FAC 84-30 (Effective 30 September 1987)

*Change paragraphs (j)(2), (j)(3)(i), (j)(3)(iii), (j)(4)(i), (k)(2), and (k)(3) as follows:*

(j) (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 30.412, Composition and Measurement of Pension Costs, and 30.413, 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 30.412. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth below in this subparagraph and in subparagraphs (j)(3), (4), (5), (6), and (7) below.

(3) (i) Normal costs of pension plans not funded in the year incurred, and all other components of pension costs (see 30.412.40(a)(1)) assignable 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 part of a pension cost that is computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of the Employee's Retirement Income Security Act of 1974 (ERISA) (see 30.412.50(c)(3)), will be allowable in those future accounting periods in which the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding occurred in the year the costs would have been assigned except for the waiver.

(3) (iii) Increased pension costs caused by a 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

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in 30.413.50(c)(5). Determination of unallowable costs shall be made in accordance with the actuarial method used in calculating pension costs.

(4) (i) The pension cost assignable to a cost accounting period is the net contribution required to be made for that period after taking into account dividends and other credits, where applicable. However, any portion of pension cost computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of ERISA (see 30.412.50(c)(3)) will be allowable in those future accounting periods when the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding been made in the year the costs would have been assigned except for the waiver.

(k) (2) The costs of deferred awards shall be measured, allocated, and accounted for in compliance with the provisions of 30.415, Accounting for the Cost of Deferred Compensation.

(3) Deferred compensation payments to employees under awards made before the effective date of 30.415 are allowable to the extent they would have been allowable under prior acquisition regulations.

### **FAC 84-35 (Effective 4 April 1988)**

*Change paragraph (l) as follows:*

(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.

### **FAC 84-39 (Effective 3 October 1988)**

*Eliminate the following sentence (last sentence, paragraph (g)(2)(i)):*

Severance payments, or amounts paid in lieu thereof, are not allowable when paid to employees in addition to early or normal retirement payments.

### **FAC 84-44 (Effective 28 March 1989)**

*Replace the first sentence in paragraph (g)(2)(i), and also replace paragraphs (j)(2), (j)(3)(i), (j)(5), and (j)(6)(i) as follows:*

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(g) (2) (i) Severance pay is allowable only to the extent that, in each case, it is required by (A) law; (B) employer-employee agreement; (C) established policy that constitutes, in effect, an implied agreement on the contractor's part; or (D) circumstances of the particular employment (but see 37.110(f) regarding services performed outside the United States).

(j) (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 30.412, Composition and Measurement of Pension Costs, and 30.413, 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 30.412. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth in subdivision (j)(2)(i) and in subparagraphs (j)(3), (4), (6), and (7) of this subsection.

(i) Except for unfunded pension plans as defined in 31.001, to be allowable in the current year, pension costs must be funded by the time set for filing 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.

(ii) Pension payments must be reasonable in amount and be paid pursuant to (A) an agreement entered into in good faith between the contractor and employees before the work or services are performed and (B) the terms and conditions of the established plan. The cost of changes in pension plans which 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)(6) below, 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) (i) (A) Except for unfunded pension plans as defined in 31.001, normal costs of pension plans not funded in the year incurred, and all other components of pension costs (see 30.412-40(a)(1)) assignable to 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 part of a pension cost that is computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of the Employee's Retirement Income Security Act of 1974 (ERISA) (see 30.412-50(c)(3)), will be allowable in those future accounting periods in which the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding occurred in the year the costs would have been assigned except for the waiver.

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(B) Allowable costs for unfunded pension plans, as defined in 31.001, are limited to the amount computed in accordance with 30.412 and 30.413.

(5) Pension plans using pay-as-you-go methods. Reserved.

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

### FAC 84-51 (Effective 20 September 1989)

*Replace last sentence in paragraph (j)(2), replace paragraph (j)(2)(iii), add paragraph (j)(4), former (j)(4) becomes (j)(5), former (j)(5) becomes (j)(6), former (j)(6) becomes (j)(7), and former (j)(7) becomes (j)(8) as follows:*

(j) (2) Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth in subdivision (j)(2)(i) and in subparagraphs (j)(3) through (8) of this subsection.

(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.

(4) Termination of defined benefit pension plans. When excess or surplus assets revert to the contractor as a result of termination of a defined benefit pension plan, or such assets are constructively received by it for any reason, the contractor shall make a refund or give a credit to the Government for its equitable share. The Government's equitable share shall reflect the Government's participation in pension costs through those contracts for which certified (see 15.804) cost or pricing data were submitted or which are subject to Subpart 31.2.

(5) Defined contribution pension plans.

(6) Pension plans using pay-as-you go methods.

(7) Early retirement incentive plans.

(8) Employee stock ownership plans (ESOP).

### FAC 90-5 (Effective 25 July 1991)

*Change paragraph (m)(1) and add paragraph (o) as follows:*

(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

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Subpart 31.2, 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.

(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 in the current year, PRB costs must be paid either to (i) an insurer, provider, or other recipient as current year benefits or premiums, or (ii) an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees. The costs in paragraph (o)(2)(ii) of this subsection must also be calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board, and 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.

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

(4) 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 certified cost or pricing data were required or which were subject to subpart 31.2.

### FAC 90-7 (Effective 22 August 1991)

*Add a new paragraph (j)(3)(v), replace paragraphs (j)(4), renumber paragraph (o) (4) as (o)(5), and add a new paragraph at (o) (4) as follows:*

(j) (3) (v) Increased pension costs resulting from the withdrawal of assets from a pension fund and transfer to another employee benefit plan fund are unallowable except to the extent authorized by an advance agreement. The advance agreement shall:

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

(B) Provide that the Government receive a credit equal to the amount of the Government's equitable share of the gross withdrawal. If a transfer is made without such an agreement, paragraph (j)(4) of this subsection will apply to the transfer as a constructive withdrawal and receipt of the funds by the contractor.

(4) Termination of defined benefit pension plans. When excess or surplus assets revert to the contractor as a result of termination of a defined benefit pension plan, or such assets

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are constructively received by it for any reason, the contractor shall 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 certified (see 15.804) cost or pricing data were submitted or which are subject to Subpart 31.2.

(o) (4) Costs of postretirement benefits 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.

(5) 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 certified cost or pricing data were required or which were subject to Subpart 31.2.

### **FAC 90-12 (Effective 31 August 1992)**

*Revise second and third sentences of paragraph (j)(2) as follows:*

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, Composition and Measurement of Pension Costs, and 48 CFR 9904.413, Adjustment and Allocation of Pension Cost. The cost of all defined contribution pension plans shall be measured, allocated, and accounted for in accordance with the provisions of 48 CFR 9904.412.

*Revise subparagraph (j)(3)(i) and (j)(3)(ii) as follows:*

(j) (3) (i) (A) Except for unfunded pension plans as defined in 31.001, normal costs of pension plans not funded in the year incurred, and all other components of pension costs (see 48 CFR 9904.412-40(a)(1)) assignable 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 part of a pension cost that is computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of the Employee's Retirement Income Security Act of 1974 (ERISA) (see 48 CFR 9904.412-50(c)(3)), will be allowable in those future accounting periods in which the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding occurred in the year the costs would have been assigned except for the waiver.

(B) Allowable costs for unfunded pension plans, as denied in 31.001, are limited to the amount computed in accordance with 48 CFR 9904.412 and CFR 9904.413.



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(ii) Any amount paid or funded before the time it becomes assignable and allowable shall be applied to future years, in order of time, as if actually paid and deductible in those years. The interest earned on such premature funding, based on the valuation rate of return, may be excluded from future years' computations of pension costs in accordance with 48 CFR 9904.412-50(a)(7).

*Revise second sentence of subparagraph (j)(3)(iii) as follows:*

(iii) 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)(5).

*Revise second sentence of subparagraph (j)(5)(i) as follows:*

(5) (i) However, any portion of pension cost computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of ERISA (see 48 CFR 9904.412-50(c)(3)) will be allowable in those future accounting periods when the funding does occur.

*Revise paragraph (k)(3) as follows:*

(k) (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.

### **FAC 90-16 (Effective 19 February 1993)**

*Replace the first sentence in paragraph (g)(2)(i) as follows:*

(g) (2) (i) Severance pay is allowable only to the extent that, in each case, it is required by (A) law; (B) employer-employee agreement; (c) established policy that constitutes, in effect, an implied agreement on the contractor's part; or (D) circumstances of the particular employment.

### **FAC 90-23 (Effective 27 February 1995)**

*Revise paragraph (o) as follows:*

(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

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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 paragraphs (o)(2)(i), (ii) or (iii) of this subparagraph.

(i) Cash basis. Costs 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 certified cost or pricing data were required or which were subject to Subpart 31.2.

### **FAC 90-31 (Effective 1 October 1995)**

*Replace paragraph (g)(2) and add paragraph (g)(3) as follows:*

(g) (2) Severance pay to be allowable must meet the general allowability criteria in subdivision (g)(2)(i) below, and, depending upon whether the severance is normal or abnormal, criteria in subdivision (g)(2)(ii) for normal severance pay or subdivision (g)(2)(iii) for abnormal severance pay also apply. In addition, paragraph (g)(3) of this subsection applies if the severance cost is for foreign nationals employed outside the United States.

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(3) Notwithstanding the reference to geographical area in 31.205-6(b)(1), under 10 U.S.C.2324(e)(1)(M) and 41 U.S.C.256(e)(1)(M), 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, under 10 U.S.C.2324(e)(1)(N) and 41 U.S.C.256(e)(1)(N), all such costs of severance payments which 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. 10 U.S.C.2324(e)(3) and 41 U.S.C.256(e)(2) permit the head of the agency, or designee, to waive these cost allowability limitations under certain circumstances (see 37.113 and the solicitation provision at 52.237-8).

### FAC 90-40 (Effective 24 September 1996)

*Delete f(2) and renumber f(3) to f(2). Replace paragraphs (a), (a)(1), (a)(5), (b), (b)(1), (c), (d), (f)(2) and (i) as follows:*

(a) General. Compensation for personal services includes all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor during the period of contract performance (except as otherwise provided for in other paragraphs of this subsection). It includes, but is not limited to, salaries; wages; directors' and executive committee members' fees; bonuses (including stock bonuses); incentive awards; employee stock options, stock appreciation rights, and employee stock ownership plans; employee insurance; fringe benefits; contributions to pension, other post retirement benefits, annuity, and employee incentive compensation plans; and allowances for off-site pay, incentive pay, location allowances, hardship pay, severance pay, and cost of living differential. 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 31.205-6(g), (h), (j), (k), (m), and (o) of this subsection).

(5) Costs that are unallowable under other paragraphs of this Subpart 31.2 shall not be allowable under this subsection 31.205-6 solely on the basis that they constitute compensation for personal services.

(b) Reasonableness. The compensation for personal services paid or accrued to each employee must be reasonable for the work performed. Compensation will be considered reasonable if each of the allowable elements making up the employee's compensation package is reasonable. This paragraph addresses the reasonableness of compensation, except when the compensation is set by provisions of a labor-management agreement under terms of the Federal Labor Relations Act or similar state statutes. The tests for reasonableness of labor-management

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agreements are set forth in paragraph (c) of this section. In addition to the provisions of 31.201-3, in testing the reasonableness of individual elements for particular employees or job classes of employees, consideration should be given to factors determined to be relevant by the contracting officer.

(1) Among others, factors which may be relevant include general conformity with the compensation practices of other firms of the same size, the compensation practices of other firms in the same industry, the compensation practices of firms in the same geographic area, the compensation practices of firms engaged in predominantly non-Government work, and the cost of comparable services obtainable from outside sources. The appropriate factors for evaluating the reasonableness of compensation depend on the degree to which those factors are representative of the labor market for the job being evaluated. The relative significance of factors will vary according to circumstances. In administering this principle, it is recognized that not every compensation case need be subjected in detail to the tests described in this cost principle. The tests need be applied only when a general review reveals amounts or types of compensation that appear unreasonable or unjustified. Based on an initial review of the facts, contracting officers or their representatives may challenge the reasonableness of any individual elements or the sum of the individual elements of compensation paid or accrued to particular employees or job classes of employees. In such cases, there is no presumption of reasonableness and, upon challenge, the contractor must demonstrate the reasonableness of the compensation item in question. In doing so, the contractor may introduce, and the contracting officer will consider, not only any circumstances surrounding the compensation item challenged, but also the magnitude of other compensation elements which may be lower than would be considered reasonable in themselves. However, the contractor's right to introduce offsetting compensation elements into consideration is subject to the following limitations:

(i) Offsets will be considered only between the allowable elements of an employee's (or a job class of employees') compensation package or between the compensation package of employees in jobs within the same job grade or level.

(ii) Offsets will be considered only between the allowable portion of the following compensation elements of employees or job classes of employees:

- (A) Wages and salaries.
- (B) Incentive bonuses.
- (C) Deferred compensation.
- (D) Pension and savings plan benefits.
- (E) Health insurance benefits.
- (F) Life insurance benefits.
- (G) Compensated personal absence benefits.

However, any of the above elements or portions thereof, whose amount is not measurable, shall not be introduced or considered as an offset item.

(iii) In considering offsets, the magnitude of the compensation elements in question must be taken into account. In determining the magnitude of compensation elements, the timing of receipt by the employee must be considered.

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(c) Labor-management agreements. If costs of compensation established under "arm's length" negotiated labor-management agreements are otherwise allowable, the costs are reasonable if, as applied to work in performing Government contracts, they are not determined to be 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. Disallowance of costs will not be made under this paragraph (c) unless --

(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 cash, corporate securities, such as stocks, bonds, and other financial instruments (see paragraph (d)(2) of this subsection regarding valuation), or 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 shall be the fair market value on the measurement date (i.e., 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 shall be 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.

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

(i) 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 this paragraph (i), such payments are also unallowable.

**FAC 90-43 (Effective 20 December 1996)**

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*Replace paragraph (g) as follows:*

(g) (1) Severance pay, also commonly referred to as dismissal wages, 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)(7).

### **FAC 90-44 (Effective 31 December 1996); Finalized Without Change in FAC 97-1, 10/21/97**

*Replace paragraph (e)(2) as follows:*

(e) (2) Differential allowances for additional Federal, State, or local income taxes resulting from domestic assignments are unallowable.

### **FAC 90-45 (Effective 1 January 1997)**

*Add paragraph (p) as follows:*

(p) Limitation on allowability of compensation for certain contractor personnel.  
(1) For contracts awarded during fiscal year 1997, costs incurred from October 1, 1996, through September 30, 1997, for compensation of an officer in a senior management position in excess of \$250,000 per year are unallowable (Section 809 of Public Law 104-201).  
(2) As used in this paragraph:  
(i) "Compensation" means-  
(A) The total amount of taxable wages paid to the employee for the year concerned; plus  
(B) The total amount of elective deferred compensation earned by the employee in the year concerned.  
(ii) "Officer in a senior management position" means-  
(A) The contractor's Chief Executive Officer (CEO) or any individual acting in a similar capacity;  
(B) The contractor's four most highly compensated officers in senior management positions, other than the CEO; and  
(C) If the contractor is organizationally subdivided into intermediate home offices and/or segments, the five most highly compensated individuals in senior management positions at each such intermediate home office and/or segment.

### **FAC 97-2 (Effective 10 October 1997)**

*Change reference in (j)(4) to from "certified (see 15.804) to "(see 15.403-4)".*

### **FAC 97-3 (Effective 9 February 1998)**

*Revise paragraph (p)(1) to read as follows:*

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(p) (1) For contracts awarded during fiscal year 1997, costs incurred from October 1, 1996, through September 30, 1997, for compensation of an officer in a senior management position that exceed \$250,000 per year are unallowable (Section 809 of Public Law 104-201).

### FAC 97-4 (Effective 23 February 1998)

*Revise paragraph (p) to read as follows:*

(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 by the Administrator, Office of Federal Procurement Policy (OFPP), under Section 39 of the OFPP Act (41 U.S.C. 435) are unallowable (10 U.S.C. 2324(e)(1)(P) and 41 U.S.C. 256(e)(1)(P)). 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.

(2) As used in this paragraph:

(i) *Compensation* means the total amount of wages, salary, bonuses, deferred compensation (see paragraph (k) of this subsection), and employer contributions to defined contribution pension plans (see paragraphs (j)(5) and (j)(8) 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) The contractor's Chief Executive Officer (CEO) or any individual acting in a similar capacity;

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

(C) If the contractor has intermediate home offices or segments that report directly to the contractor's corporate headquarters, the five most highly compensated employees in management positions at each such intermediate home office or segment.

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

### FAC 97-9 (Effective 29 December 1998)

(j) Pension costs.

(1) A pension plan, as defined in 31.001, 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

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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 paragraphs (j)(2)(i) and (j)(3) through (8) 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 allocable in accordance with 48 CFR 9904.412-50(d)(3).

(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 paragraph (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-



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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, despite the requirements of 31.205-19(a)(3) and (b), in the indemnification payment to the extent of its fair share.

(v) 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 paragraph (j)(4) 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 Subpart 31.2 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 Subpart 31.2. Excise taxes on pension plan asset reversions or withdrawals under this paragraph (j)(4)(ii) are unallowable in accordance with 31.205-41(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

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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 paragraph (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 paragraphs (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.

### FAC 97-10 (Effective 16 February 1999)

*Revise paragraph (k) heading and paragraph (p)(2)(ii) and adding (p)(2)(iv) to read as follows:*

(k) Deferred compensation other than pensions.

(p) (2) (ii) *Senior executive means--*

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

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

(C) 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.

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

### FAC 97-11 (Effective 4 March 1999; interim rule converted to final rule in FAC 97-14, effective 9/24/99)

*Amends paragraph (p) introductory text by adding a sentence after the heading; by redesignating paragraphs (p)(2)(ii)(A) through (p)(2)(ii)(C) as (p)(2)(ii)(A)(1) through (p)(2)(ii)(A)(3), respectively; and by adding new paragraphs (p)(2)(ii)(A) introductory text and (p)(2)(ii)(B) to read as follows:*

(p) \* \* \* (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.)

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(p) (2) (ii) (A) Prior to January 2, 1999 –

(p) (2) (ii) (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.

### **FAC 97-12 (Effective 17 June 1999)**

*Removes the word "certified" in the second sentence of paragraph (o)(6).*

(o)(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 Subpart 31.2.

### **FAC 2001-15 (Effective August 25, 2003)**

*Removed the word "subdivisions" and added "paragraphs" in last sentence of the introductory text of paragraph (j)(7) and (j)(8)(iii) in its place. Removed the word "section" and added "subsection" in last sentence of the introductory text of paragraph (o)(2) and removed the word "subdivisions" from the first sentence of paragraph (o)(5) and added the word "paragraph" in its place. Removed the colon from the end of the introductory text of paragraph (p)(2) and added " - " in its place. Restructured the paragraphs (a) through (h) by removing unnecessary and duplicative language to read as follows:*

(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 ACO, 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 Subpart 31.2 are not allowable under this subsection 31.205-6 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:

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(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 addition to the provisions of 31.201–3, 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.

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(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 31.205-35(a)(10).)

(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 (ii) 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)(7) 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;

(iii) 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.

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(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) Under 10 U.S.C. 2324(e)(1)(M) and 41 U.S.C. 256(e)(1)(M), 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, under 10 U.S.C. 2324(e)(1)(N) and 41 U.S.C. 256(e)(1)(N), 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. 10 U.S.C. 2324(e)(3) and 41 U.S.C. 256(e)(2) permit the head of the agency to waive these cost allowability limitations under certain circumstances (see 37.113 and the solicitation provision at 52.237-8).

(h) *Backpay*. Backpay is a retroactive adjustment of prior years' salaries or wages. Backpay 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.

### **FAC 2001-18 (Effective January 12, 2004)**

*Paragraph (j), Pensions, was revised for clarity and language was also added to paragraph (j)(6)(iv). Subparagraph (j)(8), ESOPs, was reworded and moved to paragraph (q).*

(j) Pension costs.

(1) Pension plans are normally segregated into two types of plans: defined-benefit and defined-contribution pension plans. The contractor shall measure, assign, and allocate the costs of all defined-benefit pension plans and the costs of all defined-contribution pension plans in compliance with 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. Pension costs are allowable subject to the referenced standards and the cost

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limitations and exclusions set forth in paragraph (j)(1)(i) and in paragraphs (j)(2) through (j)(6) of this subsection.

- (i) Except for nonqualified pension plans using the pay-as-you-go cost method, to be allowable in the current year, the contractor shall fund 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. For nonqualified pension plans using the pay-as-you-go method, to be allowable in the current year, the contractor shall allocate pension costs in the cost accounting period that the pension costs are assigned.
  - (ii) Pension payments 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 to the terms and conditions of the established plan. The cost of changes in pension plans are not allowable if the changes are discriminatory to the Government or are not intended to be applied consistently for all employees under similar circumstances in the future.
  - (iii) Except as provided for early retirement benefits in paragraph (j)(6) 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.
- (2) Defined-benefit pension plans. 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, are not 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 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 in that period and shall be accounted for as set forth at 48 CFR

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- 9904.412-50(a)(4). The excess amount is allowable in the future period to which it is assigned, to the extent it is not otherwise unallowable.
- (iii) Increased pension costs are unallowable if the increase is caused by a delay in funding beyond 30 days after each quarter of the year to which they are assignable. 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). The contractor shall make determinations of unallowable costs in accordance with the actuarial method used in calculating pension costs.
  - (iv) The contracting officer will consider the 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 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, despite the requirements of 31.205-19(c)(3) and (d)(3), in the indemnification payment to the extent of its fair share.
  - (v) 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 paragraph (j)(3) 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 receives a credit equal to the amount of the Government's equitable share of the gross withdrawal or transfer.
- (3) Pension adjustments and asset reversions.
- (i) For segment closings, pension plan terminations, or curtailment of benefits, the amount of the adjustment shall be-
    - (A) For contracts and subcontracts that are subject to full coverage under the Cost Accounting Standards (CAS) Board rules and regulations, the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413-50(c)(12); and
    - (B) For contracts and subcontracts that are not subject to full coverage under the CAS, 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) is the sum of the pension plan costs allocated to all non-CAS-covered contracts and subcontracts that are subject to Subpart 31.2 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



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- 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 Subpart 31.2. Excise taxes on pension plan asset reversions or withdrawals under this paragraph (j)(3)(ii) are unallowable in accordance with 31.205-41(b)(6).
- (4) Defined-contribution pension plans. In addition to defined-contribution pension plans, this paragraph also covers profit sharing, savings plans, and other such plans, provided the plans fall within the definition of a pension plan at 31.001.
- (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 paragraphs (j)(2)(ii) and (iv) of this subsection apply to defined-contribution plans.
- (5) Pension plans using the pay-as-you-go cost method. When using the pay-as-you-go cost method, the contractor shall measure, assign, and allocate the cost of pension plans in accordance with 48 CFR 9904.412 and 9904.413. Pension costs for a pension plan using the pay-as-you-go cost method are allowable to the extent they are not otherwise unallowable.
- (6) Early retirement incentives. An early retirement incentive is an incentive given to an employee to retire early. For contract costing purposes, costs of early retirement incentives are allowable subject to the pension cost criteria contained in paragraphs (j)(2)(i) through (iv) of this subsection provided-
- (i) The contractor measures, assigns, and allocates the costs in accordance with the contractor's accounting practices for pension costs;
- (ii) The incentives are in accordance with the terms and conditions of an early retirement incentive plan;
- (iii) The contractor applies the plan 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 present value of the total incentives given to any employee in excess of the amount of the employee's annual salary for the previous fiscal year before the employee's retirement is unallowable. The contractor shall compute the present value in accordance with its accounting practices for pension costs. The contractor shall account for any unallowable costs in accordance with 48 CFR 9904.412-50(a)(2).
- (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 31.001, the contractor-
- (A) Measures, assigns, and allocates the costs in accordance with 48 CFR 9904.412;

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- (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; and
- (C) Meets the requirements of paragraph (j)(2)(ii) of this subsection.
- (ii) For ESOPs that do not meet the definition of a pension plan at 31.001, 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 of 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 ESOT in excess of fair market value are unallowable; and
  - (B) When stock purchases are in excess of fair market value, the contractor shall 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.
- (vi) 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.

### FAC 2005-04 (Effective July 2005)

*Revises paragraphs (k) and (o) as follows:*

- (k) *Deferred compensation other than pensions.* The costs of deferred compensation awards are allowable subject to the following limitations:
  - (1) The costs shall be measured, assigned, and allocated in accordance with 48 CFR 9904.415, Accounting for the Cost of Deferred Compensation.
  - (2) The costs of deferred compensation awards are unallowable if the awards are made in periods subsequent to the period when the work being remunerated was performed.
- (o) *Postretirement benefits other than pensions (PRB).*
  - \*\*\*\*\*
  - (2) To be allowable, PRB costs shall be incurred pursuant to law, employer-employee agreement, or an established policy of the contractor, and shall comply with paragraphs (o)(2)(i), (ii), or (iii) of this subsection.
  - (i) *Pay-as-you-go.* PRB costs are not accrued during the working lives of employees. Costs are assigned to the period in which—
    - (A) Benefits are actually provided; or

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(B) The costs are paid to an insurer, provider, or other recipient for current year benefits or premiums.

(ii) *Terminal funding*. PRB costs are not accrued during the working lives of the employees.

(A) Terminal funding occurs when the entire PRB liability is paid in a lump sum upon the termination of employees (or upon conversion to such a terminal-funded plan) to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees.

(B) Terminal funded costs shall be amortized over a period of 15 years.

(iii) *Accrual basis*. PRB costs are accrued during the working lives of employees. Accrued PRB costs shall be—

(A) Measured and assigned in accordance with generally accepted accounting principles.

However, the portion of PRB costs attributable to the transition obligation assigned to the current year that is in excess of the amount assignable under the delayed recognition methodology described in paragraphs 112 and 113 of Financial Accounting Standards Board Statement 106 is unallowable. The transition obligation is defined in Statement 106, paragraph 110;

(B) Paid to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRB to retirees; and

(C) Calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

(3) To be allowable, PRB costs must be funded by the time set for filing the Federal income tax return or any extension thereof, or paid to an insurer, provider, or other recipient by the time set for filing the Federal income tax return or extension thereof. PRB costs assigned to the current year, but not funded, paid or otherwise liquidated by the tax return due date as extended are not allowable in any subsequent year.

\*\*\*\*\*

(5) 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 Subpart 31.2.

### FAR 31.205-7 -- Contingencies

#### **1984 FAR (Effective 1 April 1984)**

(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 of 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 past period to give recognition to minor unsettled factors in the interest of expediting settlement.

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- (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 or 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 (See, for example, 31.205-(g), 31.205-19, and 31.205-24.)

### **FAC 2001-24 (Effective July 19, 2004)**

*Change reference at (c) (2) from “31.205-(g), 31.205-19, and 31.205-24” to “31.205-6(g) and 31.205-19”.*

### **FAR 31.205-8 -- Contributions or Donations**

#### **1984 FAR (Effective 1 April 1984)**

Contributions and donations are unallowable.

#### **FAC 84-15 (Effective 7 April 1986)**

Contributions or donations, including cash, property and services, regardless of recipient, are unallowable, except as provided in 31.205-1(e)(3).

### **FAR 31.205-9 -- Reserved**

#### **1984 FAR (Effective 1 April 1984)**

Reserved

### **FAR 31.205-10 -- Cost of Money**

#### **1984 FAR (Effective 1 April 1984)**

- (a) Facilities capital cost of money.
- (1) General
    - (i) Facilities capital cost of money (cost of capital committed to facilities) is an imputed cost determined by applying a cost-of-money rate to facilities capital employed in contract performance. A cost-of-money rate is uniformly imputed to all contractors (see subdivision (ii) below). Capital employed is determined without regard to whether its source is

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equity or borrowed capital. The resulting cost of money is not a form of interest on borrowings (see 31.205-20).

(ii) CAS 414, Cost of Money as an Element of the Cost of Facilities Capital, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to facilities. Cost-of-money factors are developed on Form CASB-CMF, broken down by overhead pool at the business unit, using (A) business-unit facilities capital data, (B) overhead allocation base data, (C) the cost-of-money rate, which is based on interest rates specified by the Secretary of the Treasury under 50 U.S.C.App. 1215(b)(2).

(2) Allowability. Whether or not the contract is otherwise subject to CAS, facilities capital cost of money is allowable if-

(i) The contractor's capital investment is measured, allocated to contracts, and costed in accordance with CAS 414;

(ii) The contractor maintains adequate records to demonstrate compliance with this standard; and

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

(3) Accounting. The facilities capital cost of money need not be entered on the contractor's books of account. However, the contractor shall (i) make a memorandum entry of the cost and (ii) maintain, in a manner that permits audit and verification, all relevant schedules, cost data, and other data necessary to support the entry fully.

(4) Payment. Facilities capital cost of money that is (i) allowable under subparagraph (2) above and (ii) calculated, allocated, and documented in accordance with this cost principle shall be an "incurred cost" for reimbursement purposes under applicable cost-reimbursement contracts and for progress payment purposes under fixed-price contracts.

(b) Cost of money as an element of the cost of capital assets under construction.

(1) General

(i) Cost of money as an element of the cost of capital assets under construction is an imputed cost determined by applying a cost-of-money rate to the investment in tangible and intangible capital assets while they are being constructed, fabricated, or developed for a contractor's own use. Capital employed is determined without regard to whether its source is equity or borrowed capital. The resulting cost of money is not a form of interest on borrowing (see 31.205-20).

(ii) CAS 417, Cost of Money as an Element of the Cost of Capital Assets Under Construction, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to capital assets under construction, fabrication, or development.

(2) Allowability

(i) Whether or not the contract is otherwise subject to CAS, and except as specified in subdivision (ii) below, the cost of money for capital assets under construction, fabrication, or development is allowable if-

(A) The cost of money is calculated, allocated to contracts, and costed in accordance with CAS 417;

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(B) The contractor maintains adequate records to demonstrate compliance with this standard; and

(C) The cost of money for tangible capital assets is included in the capitalized cost that provides the basis for allowable depreciation costs, or, in the case of intangible capital assets, the cost of money is included in the cost of those assets for which amortization costs are allowable.

(ii) Actual interest cost in lieu of the calculated imputed cost of money for capital assets under construction, fabrication, or development is unallowable.

(3) Accounting. The cost of money for capital assets under construction need not be entered on the contractor's books of account. However, the contractor shall (i) make a memorandum entry of the cost and (ii) maintain, in a manner that permits audit and verification, all relevant schedules, cost data, and other data necessary to support the entry fully.

(4) Payment. The cost of money for capital assets under construction that is allowable under subparagraph (2) above of this cost principle shall be an "incurred cost" for reimbursement purposes under applicable cost-reimbursement contracts and for progress payment purposes under fixed-price contracts.

### **FAC 84-3 (Effective 1 October 1984)**

*Add the following as (a)(5) to the cost principle:*

(a) (5) The cost of money resulting from including goodwill (however represented) in the facilities capital employed base is unallowable.

### **FAC 84-30 (Effective 30 September 1987)**

*Change paragraphs (a)(1)(ii), (a)(2)(i), and (b)(1)(ii) as follows:*

(a) (1) (ii) 30.414, Cost of Money as an Element of the Cost of Facilities Capital, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to facilities. Cost-of-money factors are developed on Form CASB-CMF, broken down by overhead pool at the business unit, using (A) business-unit facilities capital data, (B) overhead allocation base data, (C) the cost-of-money rate, which is based on interest rates specified by the Secretary of the Treasury under 50 U.S.C.App. 1215(b)(2).

(2) (i) The contractor's capital investment is measured, allocated to contracts, and costed in accordance with 30.414;

(b) (1) (ii) 30.417, Cost of Money as an Element of the Cost of Capital Assets Under Construction, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to capital assets under construction, fabrication, or development.

### **FAC 84-58 (Effective 23 July 1990)**

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*Replace paragraph (a)(2)(ii), add paragraph (a)(2)(iv), replace paragraphs (a)(5), (b)(2)(B), and (b)(2)(C), and add paragraph (b)(2)(D) as follows:*

(a) (2) (ii) The contractor maintains adequate records to demonstrate compliance with this standard;

(iv) The requirements of 31.205-52, which limit the allowability of facilities capital cost of money, are observed.

(5) The cost of money resulting from including asset valuations resulting from business combinations in the facilities capital employed base is unallowable (see 31.205-32).

(b) (2) (B) The contractor maintains adequate records to demonstrate compliance with this standard;

(C) The cost of money for tangible capital assets is included in the capitalized cost that provides the basis for allowable depreciation costs, or, in the case of intangible capital assets, the cost of money is included in the cost of those assets for which amortization costs are allowable; and

(D) The requirements of 31.205-52, which limit the allowability of cost of money for capital assets under construction, fabrication, or development, are observed.

### **FAC 90-5 (Effective 25 July 1991)**

*Replace paragraph (a)(1)(ii) as follows:*

(a) (1) (ii) CAS 414, Cost of Money as an Element of the Cost of Facilities Capital, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to facilities. Cost-of-money factors are developed on Form CASB-CMF, broken down by overhead pool at the business unit, using (A) business-unit facilities capital data, (B) overhead allocation base data, (C) the cost-of-money rate, which is based on interest rates specified by the Secretary of the Treasury under Public Law 92-41.

### **FAC 90-12 (Effective 31 August 1992)**

*Revise first sentence of subparagraph (a)(1)(ii) as follows:*

(a) (1) (ii) 48 CFR 9904.414, Cost of Money as an Element of the Cost of Facilities Capital, establishes criteria for measuring and allocating, as an element of contract cost, the cost of Capital committed to facilities.

*Revise subparagraph (a)(2)(i) as follows:*

(a) (2) (i) The contractor's capital investment is measured, allocated to contracts, and costed in accordance with 48 CFR 9904.414;

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*Revise subparagraph (b)(1)(ii) as follows:*

(b) (1) (ii) 48 CFR 9904.417, Cost of Money, Cost of Money as an Element of the Cost of Capital Assets Under Construction, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to capital assets under construction, fabrication, or development.

*Revise subparagraph (b)(2)(ii)(A) as follows:*

(b) (2) (ii) (A) The cost of money is calculated, allocated to contracts, and costed in accordance with 48 CFR 9904.417;

### **FAC 90-35 (Effective 14 December 1995)**

*Replace paragraphs (a)(2)(i), (b)(1)(ii), (b)(2)(i)(A) and (b)(2)(i)(B) as follows:*

(a) (2) (i) The contractor's capital investment is measured, allocated to contracts, and costed in accordance with 48 CFR 9904.414;

(b) (1) (ii) 48 CFR 9904.417, Cost of Money as an Element of the Cost of Capital Assets Under Construction, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to capital assets under construction, fabrication, or development.

(2) (i) (A) The cost of money is calculated, allocated to contracts, and costed in accordance with 48 CFR 9904.417;

(B) The contractor maintains adequate records to demonstrate compliance with this standard;

### **FAC 97-4 (Effective 24 April 1998)**

*Revise paragraph (a)(5) to read as follows:*

(a) (5) The requirements of 31.205-52 shall be observed in determining the allowable cost of money attributable to including asset valuations resulting from business combinations in the facilities capital employed base.

### **FAC 2001-14 (Effective June 23, 2003)**

*Replace paragraph (a) and (b) and add paragraph (c) to read as follows:*

(a) General. Cost of money—

(1) Is an imputed cost that is not a form of interest on borrowings (see 31.205-20);



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- (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 31.205-52, 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.

### FAR 31.205-11 -- Depreciation

#### **1984 FAR (Effective 1 April 1984)**

- (a) Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of an asset in a systematic and logical manner. It does not involve a process of valuation. Useful life refers to the prospective period of economic usefulness in a particular contractor's operations as distinguished from physical life; it is evidenced by the actual or estimated retirement and replacement practice of the contractor.
- (b) Contractors having contracts subject to CAS 409, Depreciation of Tangible Capital Assets, must 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 CAS 409 are applicable if the election is made, and its requirements supersede any conflicting requirements of this cost principle. Once electing to adopt CAS 409 for all contracts, contractors must continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts. Paragraphs (c) through (e) below apply to contracts to which CAS 409 is not applied.
- (c) Normal depreciation on a contractor's plant, equipment, and other capital facilities is an allowable contract cost, if the contractor is able to demonstrate that it is reasonable and allocable (but see paragraph (i) below).
- (d) Depreciation shall be considered reasonable if the contractor follows policies and procedures that are-

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- (1) Consistent with those followed in the same cost center for business other than Government;
  - (2) Reflected in the contractor's books of accounts and financial statements; and
  - (3) Both used and acceptable for Federal income tax purposes.
- (e) When the depreciation reflected on a contractor's books of accounts and financial statements differs from that used and acceptable for Federal income tax purposes, reimbursement shall be based on the asset cost amortized over the estimated useful life of the property using depreciation methods (straight line, sum of the years' digits, etc.) acceptable for income tax purposes. Allowable depreciation shall not exceed the amounts used for book and statement purposes and shall be determined in a manner consistent with the depreciation policies and procedures followed in the same cost center on non-Government business.
- (f) Depreciation for reimbursement purposes in the case of tax-exempt organizations shall be determined on the basis described in paragraph (e) immediately above.
- (g) Special consideration are required for assets acquired before the effective date of this cost principle, if, on that date, the undepreciated balance of these assets resulting from depreciation policies and procedures used previously for Government contracts and subcontracts is different from the undepreciated balance on the books and financial statements. The undepreciated balance for contract cost purposes shall be depreciated over the remaining life using the methods and lives followed for book purposes. The aggregate depreciation of any asset allowable after the effective date of this 31.205-11 shall not exceed the cost basis of the asset less any depreciation allowed or allowable under prior acquisition regulations.
- (h) Depreciation should usually be allocated to the contract and other work as an indirect cost. The amount of depreciation allowed in any accounting period may, consistent with the basic objectives in paragraph (a) above, vary with volume of production or use of multishift operations.
- (i) In the case of emergency facilities covered by certificates of necessity, a contractor may elect to use normal depreciation without requesting a determination of "true depreciation," or may elect to use either normal or "true depreciation" after a determination of "true depreciation" has been made by an Emergency Facilities Depreciation Board (EFDB). The method elected must be followed consistently throughout the life of the emergency facility. When an election is made to use normal depreciation, the criteria in paragraphs (c), (d), (e), and (f) above shall apply for both the emergency period and the post-emergency period. When an election is made to use "true depreciation", the amount allowable as depreciation-
- (1) With respect to the emergency period (five years), shall be computed in accordance with the determination of the EFDP and allocated ratably over the full five year emergency period; provided no other allowance is made which would duplicate the factors, such as extraordinary obsolescence, covered by the Board's determination; and
  - (2) After the end of the emergency period, shall be computed by distributing the remaining undepreciated portion of the cost of the emergency facility over the balance of its useful

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life provided the remaining undepreciated portion of such cost shall not include any amount of unrecovered "true depreciation."

(j) No depreciation, rental, or use charge shall be allowed on property acquired at no cost from the Government, by the contractor or by any division, subsidiary, or affiliate of the contractor under common control.

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

(l) No depreciation or rental shall be allowed on property fully depreciated by the contractor or by any division, subsidiary, or affiliate of the contractor under common control. However, a reasonable charge for using fully depreciated property may be agreed upon and allowed (but see 31.109(h)(2)). In determining the charge, consideration shall be given to the 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.

(m) CAS 404, Capitalization of Tangible Assets, applies to assets acquired by a "capital lease" as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board (FASB). Compliance with CAS 404 and FAS-13 requires that such leased assets (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. Assets whose leases are classified as capital leases under FAS-13 are subject to the requirements of 31.205-11 while assets acquired under leases classified as operating leases are subject to the requirements on rental costs in 31.205-36. The standards of financial accounting and reporting prescribed by FAS-13 are incorporated into this principle and shall govern its application, except as provided in subparagraphs (1), (2), and (3) below.

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

(2) Capital leases, as defined in FAS-13, for all real and personal property, between any related parties are subject to the requirements of this subparagraph 31.205-11(m). If it is determined that the terms of the lease have been significantly affected by the fact that the lessee and lessor are related, depreciation charges shall not be allowed in excess of those which would have occurred if the lease contained terms consistent with those found in a lease between unrelated parties.

(3) Assets acquired under leases that the contractor must capitalize under FAS-13 shall not be treated as purchased assets for contract purposes if the leases are covered by 31.205-36(b)(4).

### **FAC 84-30 (Effective 30 September 1987)**

*Change paragraphs (b) and (m) as follows:*

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(b) Contractors having contracts subject to 30.409, Depreciation of Tangible Capital Assets, must 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 30.409 are applicable if the election is made, and its requirements supersede any conflicting requirements of this cost principle. Once electing to adopt 30.409 for all contracts, contractors must continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts. Paragraphs (c) through (e) below apply to contracts to which 30.409 is not applied.

(m) 30.404, Capitalization of Tangible Assets, applies to assets acquired by a "capital lease" as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board (FASB). Compliance with 30.404 and FAS-13 requires that such leased assets (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. Assets whose leases are classified as capital leases under FAS-13 are subject to the requirements of 31.205-11 while assets acquired under leases classified as operating leases are subject to the requirements on rental costs in 31.205-36. The standards of financial accounting and reporting prescribed by FAS-13 are incorporated into this principle and shall govern its application, except as provided in subparagraphs (1), (2), and (3) below.

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

(2) Capital leases, as defined in FAS-13, for all real and personal property, between any related parties are subject to the requirements of this subparagraph 31.205-11(m). If it is determined that the terms of the lease have been significantly affected by the fact that the lessee and lessor are related, depreciation charges shall not be allowed in excess of those which would have occurred if the lease contained terms consistent with those found in a lease between unrelated parties.

(3) Assets acquired under leases that the contractor must capitalize under FAS-13 shall not be treated as purchased assets for contract purposes if the leases are covered by 31.205-36(b)(4).

### **FAC 84-58 (Effective 23 July 1990)**

*Add paragraph (n) as follows:*

(n) Whether or not the contract is otherwise subject to CAS, the requirements of 31.205-52, which limit the allowability of depreciation, shall be observed.

### **FAC 90-12 (Effective 31 August 1992)**

*Revise paragraphs (b) as follows:*

(b) Contractors having contracts subject to 48 CFR 9904.409, Depreciation of Tangible Capital Assets, must adhere to the requirement of that standard for all fully CAS-covered

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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 its requirements supersede any conflicting requirements of this cost principle. Once electing to adopt 48 CFR 9904.409 for all contracts, contractors must continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts. Paragraphs (c) through (e) below apply to contracts to which 48 CFR 9904.409 is not applied.

*Revise first two sentences of paragraph (m) as follows:*

(m) 48 CFR 9904.404, Capitalization of Tangible Assets, applies to assets acquired by a "capital lease" as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board (FASB). Compliance with 48 CFR 9904.404 and FAS-13 requires that such leased assets (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.

### **FAC 90-35 (Effective 14 December 1995)**

*Replace paragraphs (b) and (e) and add paragraph (o) as follows:*

(b) Contractors having contracts subject to 48 CFR 9904.409, Depreciation of Tangible Capital Assets, must 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 its requirements supersede any conflicting requirements of this cost principle. Once electing to adopt 48 CFR 9904.409 for all contracts, contractors must continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts. Paragraphs (c) through (e) below apply to contracts to which 48 CFR 9904.409 is not applied.

(e) When the depreciation reflected on a contractor's books of accounts and financial statements differs from that used and acceptable for Federal income tax purposes, reimbursement shall be based on the asset cost amortized over the estimated useful life of the property using depreciation methods (straight line, sum of the years' digits, etc.) acceptable for income tax purposes. Allowable depreciation shall not exceed the amounts used for book and statement purposes and shall be determined in a manner consistent with the depreciation policies and procedures followed in the same cost center on non-Government business (but see paragraph (o) of this subsection).

(o) 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, depreciation of the impaired assets shall not exceed the amounts established on depreciation schedules in use prior to the write-down (see 31.205-16(g)).

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### FAC 90-43 (Effective 18 February 1997)

*Replace paragraph (o) as follows:*

(o) 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 shall be limited to the amounts that would have been allowed had the assets not been written down (see 31.205-16(g)). However, this does not preclude a change in depreciation resulting from other causes such as permissible changes in estimates of service life, consumption of services, or residual value.

### FAC 2001-18 (Effective January 12, 2004)

(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 31.205-26(e) may be based on that price, provided the same policies and procedures are used for costing all business of the using division, subsidiary, or organization under common control.

(f) No depreciation or rental is allowed on property fully depreciated by the contractor or by any division, subsidiary, or affiliate of the contractor under common control. However, a reasonable charge for using fully depreciated property may be agreed upon and allowed (but, see 31.109(h)(2)). In determining the charge, 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 31.205-52 shall be observed.

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

(i) A “capital lease,” as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, is subject to the requirements of this cost principle. (See 31.205-36 for Operating Leases.) 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.

### FAC 2005-04 (Effective July 8, 2005)

*Replace Paragraph (i)(1) as follows:*

(1) Lease costs under a sale and leaseback arrangement are allowable only up to the amount that would be allowed if the contractor retained title, computed based on the net book value of the asset on the date the contractor becomes a lessee of the property adjusted for any gain or loss recognized in accordance with 31.205-16(b); and

### FAC 2005-10 (Effective July 28, 2006)

*Revise paragraph (g) by re-designating paragraph (h) as paragraph (g)(2) and adding paragraph (g)(3) as follows. In addition, paragraph (i) is re-designated as paragraph (h).*

(g) Whether or not the contract is otherwise subject to CAS, the following apply:

(1) The requirements of 31.205-52 shall be observed.

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

(3)(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—

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(A) Adjusted for any allowable gain or loss determined in accordance with 31.205-16(b); and

(B) Less any amount of depreciation expense included in the calculation of the amount that would have been allowed had the contractor retained title under 31.205-11(h)(1) and 31.205-36(b)(2).

(ii) As used in this paragraph (g)(3), “reacquired property” is property that generated either any depreciation expense or any cost of money considered in the calculation of the limitations under 31.205-11(h)(1) and 31.205-36(b)(2) during the most recent accounting period prior to the date of reacquisition.

### **FAR 31.205-12 -- Economic Planning Costs**

#### **1984 FAR (Effective 1 April 1984)**

(a) This category includes costs of generalized 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 do not include organization or reorganization costs covered by 31.205-27.

(b) Economic planning costs are allowable as indirect costs to be properly allocated.

(c) Research and development and engineering costs designed to lead to new products for sale to the general public are not allowable under this principle.

#### **FAC 2001-15 (Effective August 25, 2003)**

*Amend section 31.205-12 in paragraph (a) by removing the word “generalized” and adding “general” in its place.*

#### **FAC 2001-16 (Effective October 31, 2003)**

*Replace paragraph (a), (b), and (c) to read as follows:*

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 31.205-27. See 31.205-38 for market planning costs other than economic planning costs.

### **FAR 31.205-13 -- Employee Morale, Health, Welfare, Food Service, And Dormitory Costs and Credits**



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### 1984 FAR (Effective 1 April 1984)

- (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, except as limited by paragraph (b) immediately below, and to the extent that the net amount is reasonable. Some examples are house publications, health clinics, recreation, employee counseling services, and food and dormitory services, which include operating or furnishing facilities for cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations, or similar types of services for the contractor's employees at or near the contractor's facilities.
- (b) Losses from operating food and dormitory services may be included as costs only if the contractor's objective is to operate such services on a break-even basis. Losses sustained because food services or lodging accommodations are furnished without charge or at prices or rates which would not accomplish the above objective are not allowable. A loss may be allowed, however, to the extent the contractor can demonstrate that unusual circumstances exist (e.g., (i) where the contractor must provide food or dormitory services at remote locations where adequate commercial facilities are not reasonably available or (ii) where it is necessary to operate a facility at a lower volume than the facility could economically support) 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. Cost of food and dormitory services shall include an allocable share of indirect expenses pertaining to these activities.
- (c) 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 paragraph (d) immediately below).
- (d) Contributions by the contractor to an employee organization, including funds from vending machine receipts or similar sources, may be included as costs incurred under paragraph (a) above 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.

### FAC 84-15 (Effective 7 April 1986)

*Replace paragraph (b) as follows:*

- (b) Losses from operating food and dormitory services may be included as costs only if the contractor's objective is to operate such services on a break-even basis. 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 above objective are not allowable. A loss may be allowed, however, to the extent that the contractor can demonstrate that unusual circumstances exist (e.g., (i) where the contractor must provide food or dormitory

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services at remote locations where adequate commercial facilities are not reasonably available, or (ii) where charged but unproductive labor costs would be excessive but for the services provided or where cessation or reduction of food or dormitory operations will not otherwise yield net cost savings) 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 area. Costs of food and dormitory services shall include an allocable share of indirect expenses pertaining to these activities.

### **FAC 90-31 (Effective 1 October 1995)**

*Renumber paragraphs (b), (c) and (d) to (d), (e) and (f), add new paragraphs (b) and (c), and replace paragraphs (a), (e) and (f) as follows:*

- (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, except as limited by paragraphs (b), (c), and (d) of this subsection. Some examples of allowable activities are house publications, health clinics, wellness/fitness centers, employee counseling services, and food and dormitory services which include operating or furnishing facilities for cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations, or similar types of services for the contractor's employees at or near the contractor's facilities.
- (b) Costs of gifts are unallowable. (Gift do not include awards for performance made pursuant to 31.205-6(f) 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) Losses from operating food and dormitory services may be included as costs only if the contractor's objective is to operate such services on a break-even basis. 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 above objective are not allowable. A loss may be allowed, however, to the extent that the contractor can demonstrate that unusual circumstances exist (e.g., where the contractor must provide food or dormitory services at remote locations where adequate commercial facilities are not reasonably available; or where charged but unproductive labor costs would be excessive but for the services provided or where cessation or reduction of food or dormitory operations will not otherwise yield net cost savings) 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. Costs of food and dormitory services shall include an allocable share of indirect expenses pertaining to these activities.

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- (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 paragraph (f) of this subsection).
- (f) Contributions by the contractor to an employee organization, including funds from vending machine receipts or similar sources, may be included as costs incurred under paragraph (a) of this subsection 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.

### FAC 2001-16 (Effective October 31, 2003)

*Restructure all paragraphs to read as follows:*

- (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 made pursuant to 31.205-6(f) 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

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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 paragraph (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.

### **FAR 31.205-14 -- Entertainment Costs**

#### **1984 FAR (Effective 1 April 1984)**

Costs of amusement, diversion, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable (but see 31.205-13 and 31.205-43).

#### **FAC 84-15 (Effective 7 April 1986)**

Costs of amusement, diversion, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable (but see 31.205-1 and 31.205-13). 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.

#### **FAC 90-31 (Effective 1 October 1995)**

Costs of amusement, diversion, 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

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having the same purposes are also unallowable, regardless of whether the cost is reported as taxable income to the employees.

### **FAR 31.205-15 -- Fines and Penalties, and Mischarging Costs**

#### **1984 FAR (Effective 1 April 1984)**

Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, Federal, State, or local 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.

#### **FAC 84-15 (Effective 7 April 1986)**

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.

#### **FAC 84-44 (Effective 17 April 1989)**

(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. Such costs include those incurred to identify, measure, or otherwise determine the magnitude of the improper charging, and costs incurred to remedy or correct the mischarging, such as the costs to rescreen and reconstruct records.

#### **FAC 90-3 (Effective 22 January 1991)**

*Replace paragraph (b) as follows:*

(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.

### **FAR 31.205-16 -- Gains and Losses On Disposition or Impairment Of Depreciable Property Or Other Capital Assets**

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### 1984 FAR (Effective 1 April 1984)

(a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) 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 paragraph (d) below).

(b) Gains and losses on disposition of tangible capital assets, including those acquired under capital leases (see 31.205-11(m)), shall be considered as adjustments of depreciation costs previously recognized. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds from involuntary conversions, and its undepreciated balance. 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) below).

(c) Special considerations apply to an involuntary conversion 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 (c)(1) above.

(d) 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 31.205-11; 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.

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

(f) 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.

### FAC 84-58 (Effective 23 July 1990)

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*Replace paragraphs (a) and (e) as follows:*

(a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) 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 paragraph (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 31.205-52).

(e) 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.

### **FAC 90-35 (Effective 14 December 1995)**

*Revise the title of the provision as follows:*

FAR 31.205-16 Gains and losses on disposition or impairment of depreciable property or other capital assets.

*Add paragraph (g) as follows:*

(g) With respect to long-lived tangible and identifiable intangible assets held for use, no loss shall be recognized 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.). Depreciation or amortization on pre-write-down carrying value of impaired assets not yet disposed of shall continue to be recoverable under established depreciation or amortization schedules to the extent it is not otherwise unallowable under other provisions of the FAR.

### **FAC 90-43 (Effective 18 February 1997)**

*Replace paragraph (g) as follows:*

(g) 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.

### **FAC 2005-04 (Effective July 8, 2005)**

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*Changed reference in Paragraph (a) from "...see paragraph (d)" to "...see paragraph (f)". Also added two new paragraphs, (b) and (d) below and renumbered the existing paragraphs.*

- (b) Notwithstanding the provisions in paragraph (c) of this subsection, when costs of depreciable property are subject to the sale and leaseback limitations in 31.205-11(i)(1) or 31.205-36(b)(2)—
- (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...

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- (d) 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 paragraphs (e)(2)(i) or (ii) of this subsection).
- (e) Special considerations apply to an involuntary conversion which occurs....

### **FAC 2005-10 (Effective July 28, 2006)**

*Amend paragraph (b) reference to 31.205-11(i)(1) by replacing the reference with 31.205-11(h)(1) and revising paragraph (c) reference to 31.205-11(i) and replacing with 31.205-11(h).*

### **FAR 31.205-17 -- Idle Facilities and Idle Capacity Costs**

#### **1984 FAR (Effective 1 April 1984)**

(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.

"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.

"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



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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.

"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 economics, 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 31.205-42)).
- (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.

### **FAC 1999-403 (Effective March 12, 2001, delayed until May 11, 2001 by executive order)**

- a. Add an introductory paragraph;
- b. Remove the paragraph designation from paragraph "(a)";
- c. Redesignate paragraphs (b) through (d) as (1) through (3), respectively; and in newly designated paragraph (1), redesignate paragraphs (1) and (2) as (i) and (ii), respectively; and
- d. Remove "`, as used in this subsection," from the definitions "Costs of idle facilities or idle capacity", "Facilities", "Idle capacity", and "Idle facilities";. The added text reads as follows:

#### **31.205-17 Idle facilities and idle capacity costs.**

As used in this subsection--

### **FAC 2001-04 (Effective February 8, 2002)**

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Amend section 31.205-17 by designating the undesignated introductory paragraph as ``(a) Definitions.`"; and in the definition ``Idle facilities" by redesignating paragraphs (1), (i), (ii), (2), and (3) as (b), (b)(1), (b)(2), (c), and (d), respectively.

### **FAR 31.205-18 -- Independent Research And Development and Bid And Proposal Costs**

#### **1984 FAR (Effective 1 April 1984)**

(a) Definitions.

"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 below.

"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.

"Bid and proposal (B&P) costs," as used in this subdivision, 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 contract performance.

"Company," as used in this subsection, means all divisions, subsidiaries, and affiliates of the contractor under common control.

"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: (1) subcontracted technical effort which is for the sole purpose of developing an additional source for an existing product, or (2) development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for sale.

"Independent research and development (IR&D)" means a contractor's IR&D cost that is not sponsored by, or required in performance of, a contract or grant and 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. IR&D effort shall not include technical effort expended in developing and preparing technical data specifically to support submitting a bid or proposal.

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"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, equipments or components, or modifications and improvements to existing systems, equipments, or components.

(b) Composition and allocation of costs. The requirements of CAS 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 CAS 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 CAS 420 except 4 CFR 420.50(e)(2) and 4 CFR 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 CAS 420, shall be subject to all the requirements of CAS 420. When the requirements of 4 CFR 420.50(e)(2) and 4 CFR 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 (see 31.001) 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 paragraph (d) below, costs for IR&D and B&P are allowable only in accordance with the following:

(1) Companies required to negotiate advance agreements.

(i) Any company that received payments for IR&D and B&P costs in a fiscal year, either as a prime contractor or subcontractor, exceeding \$4 million from Government agencies, is required to negotiate with the Government an advance agreement which establishes a ceiling for allowability of IR&D and B&P costs for the following fiscal year. This agreement is binding on all Government agencies, unless prohibited by statute. The requirements of Section 203 of Pub.L.91-441 necessitate that the Department of Defense (DOD) be the lead negotiating agency when the contractor has received more than \$4 million in payments for IR&D and B&P from DOD. Computation of IR&D and B&P costs to determine whether the threshold criterion was reached shall include only recoverable IR&D and B&P costs allocated during the company's previous fiscal year to prime contracts and subcontracts for which the submission and certification of cost or pricing data were required. (Also see paragraph (b) above and 15.804.) The computation shall include full burdening pursuant to CAS 420.

(ii) When a company meets the criterion in (i) above, required advance agreements may be negotiated at the corporate level and/or with those profit centers that contract directly with the Government and that in the preceding year allocated recoverable IR&D and B&P costs exceeding \$500,000, including burdening, to contracts and subcontracts for which the

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submission and certification of cost or pricing data were required (also see paragraph (b) above and 15.804). When ceilings are negotiated for separate profit centers of the company, the allowability of IR&D and B&P costs for any center that in its previous fiscal year did not reach the \$500,000 threshold may be determined in accordance with subparagraph (c)(2) below.

(iii) Ceilings are the maximum dollar amounts of total IR&D and B&P costs that will be allowable for allocation over the appropriate base for that part of the company's operation covered by an advance agreement.

(iv) No IR&D and B&P costs shall be allowable if a company fails to initiate negotiation of a required advance agreement before the end of the fiscal year for which the agreement is required.

(v) When negotiations are held with a company meeting the \$4 million criterion or with separate profit centers (when negotiations are held at that level under (ii) above), and if no advance agreement is reached, payment for IR&D and B&P costs shall be reduced below that which the company or profit center would have otherwise received. The amount of such reduced payment shall not exceed 75 percent of the amount which, in the opinion of the contracting officer, the company or profit center would be entitled to receive under an advance agreement. Written notification of the contracting officer's determination of a reduced amount shall be provided the contractor. In the event that an advance agreement is not reached before the end of the contractor's fiscal year for which the agreement is to apply, negotiations shall immediately be terminated, and the contracting officer shall furnish a determination of the reduced amount.

(vi) Contractors may appeal decisions of the contracting officer to reduce payment. The appeal shall be filed with the contracting officer within 30 days of receipt of the contracting officer's determination. (Also see Subpart 42.10.)

(2) Companies not required to negotiate advance agreements. Ceilings for allowable IR&D and B&P costs for companies not required to negotiate advance agreements in accordance with subparagraph (c)(1) above shall be established by a formula, either on a company-wide basis or by profit centers, computed as follows:

(i) Determine the ratio of IR&D/B&P costs to total sales (or other base acceptable to the contracting officer) for each of the preceding three years and average the two highest of these ratios; this average is the IR&D/B&P historical ratio;

(ii) Compute the average annual IR&D/B&P costs (hereafter called average), using the two highest of the preceding three years;

(iii) IR&D/B&P costs for the center for the current year which are not in excess of the product of the center's actual total sales (or other accepted base) for the current year and the IR&D/B&P historical ratio computed under (i) above (hereafter called product) shall be considered allowable only to the extent the product does not exceed 120 percent of the average. If the product is less than 80 percent of the average, costs up to 80 percent of the average shall be allowable.

(iv) However, at the discretion of the contracting officer, an advance agreement may be negotiated when the contractor can demonstrate that the formula would produce a clearly inequitable cost recovery.

(d) Deferred IR&D and B&P costs.

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(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 RD 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 provisions 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.

### FAC 84-1 (Effective 1 April 1984)

*Make the following changes to the cost principle:*

Change amounts in paragraph (c)(1)(i) from \$4 million to \$4,400,000.

Change amounts in paragraph (c)(1)(ii) from \$500,000 to \$550,000.

Change amount in paragraph (c)(1)(v) from \$4 million to \$4,400,000.

### FAC 84-30 (Effective 30 September 1987)

*Change paragraphs (b) and (c)(1)(i) as follows:*

(b) Composition and allocation of costs. The requirements of 30.420, 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 30.420.

(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 30.420 except 4 CFR 420.50(e)(2) and 4 CFR 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 30.420, shall be subject to all the requirements of 30.420. When the requirements of 4 CFR 420.50(e)(2) and 4 CFR 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 (see 31.001) in which the costs are incurred. However, when IR&D and B&P costs clearly benefit other profit

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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) (1) (i) Any company that received payments for IR&D and B&P costs in a fiscal year, either as a prime contractor or subcontractor, exceeding \$4,400,000 from Government agencies, is required to negotiate with the Government an advance agreement which establishes a ceiling for allowability of IR&D and B&P costs for the following fiscal year. This agreement is binding on all Government agencies, unless prohibited by statute. The requirements of Section 203 of Pub.L.91-441 necessitate that the Department of Defense (DOD) be the lead negotiating agency when the contractor has received more than \$4,400,000 in payments for IR&D and B&P from DOD. Computation of IR&D and B&P costs to determine whether the threshold criterion was reached shall include only recoverable IR&D and B&P costs allocated during the company's previous fiscal year to prime contracts and subcontracts for which the submission and certification of cost or pricing data were required. (Also see paragraph (b) above and 15.804.) The computation shall include full burdening pursuant to 30.420.

### **FAC 84-58 (Effective 23 July 1990)**

*Make the following changes to the cost principle:*

Change amounts in paragraph (c)(1)(i) from \$4,400,000 to \$5,400,000.

Change amounts in paragraph (c)(1)(ii) from \$550,000 to \$675,000.

Change amount in paragraph (c)(1)(v) from \$4,400,000 to \$5,400,000.

### **FAC 90-13 (Effective 5 November 1990)**

*Change amounts in paragraph (c)(1)(i) from \$5,400,000 to \$7,000,000.*

### **FAC 90-12 (Effective 31 August 1992)**

*Change paragraph (b)(1) and (b)(2) as follows:*

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.

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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:

*Change last sentence of subparagraph (c)(1)(i) as follows:*

The computation shall include full burdening pursuant to 48 CFR 9904.420.

### **FAC 90-13 (Effective 24 September 1992)**

(a) Definitions.

"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.

"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.

"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.

"Company," as used in this subsection, means all divisions, subsidiaries, and affiliates of the contractor under common control.

"Contractor," as used in paragraph (c)(2) of this subsection, includes all divisions, subsidiaries, and affiliates under common control.

"Covered contract," as used in paragraph (c)(2) of this subsection, means a prime contract entered into by a Government agency for an amount more than \$100,000, except for a fixed-price contract without cost incentives. It also includes a subcontract for an amount more than \$100,000, except for a fixed-price subcontract without cost incentives under such a prime contract.

"Covered segment," as used in paragraph (c)(2) of this subsection, means a product division of the contractor that allocated more than \$1,000,000 in IR&D/B&P costs to covered contracts during the preceding fiscal year. In the case of a contractor that has no product divisions, such term means that contractor as a whole. A product division of the contractor that allocated less than \$1,000,000 in IR&D/B&P costs to covered contracts during the preceding

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fiscal year shall not be subject to the limitations for major contractors set forth in 31.205-18(c)(2)(i) and (ii).

"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: (1) subcontracted technical effort which is for the sole purpose of developing an additional source for an existing product, or (2) development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for sale.

"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.

"Major contractor," as used in paragraph (c)(2) of this subsection, means any contractor whose covered segments allocated to covered contracts a total of more than \$10,000,000 in IR&D/B&P costs in the preceding fiscal year. For purposes of calculating the dollar threshold amounts to determine whether a contractor meets the definition of "major contractor," contractor segments allocating less than \$1,000,000 of IR&D/B&P costs to covered contracts in the preceding year shall not be included.

"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:



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(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 (see 31.001) 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.

(1) This subparagraph (c)(1) implements section 824 of the National Defense Authorization Act for Fiscal Year 1991 (Pub.L.101-510). Except as provided in paragraphs (c)(2), (d), and (e) of this subsection, or as provided in agency regulations, costs for IR&D and B&P are allowable only in accordance with the following:

(i) Companies required to negotiate advance agreements.

(A) Any company that received payments for IR&D and B&P costs in a fiscal year, either as a prime contractor or subcontractor, exceeding \$7,000,000 from Government agencies, is required to negotiate with the Government an advance agreement which establishes a ceiling for allowability of IR&D and B&P costs for the following fiscal year. This agreement is binding on all Government agencies, unless prohibited by statute. The requirements of section 203 of Public Law 91-441 necessitate that the Department of Defense (DOD) be the lead negotiating agency when the contractor has received more than \$7,000,000 in payments for IR&D and B&P from DoD. Computation of IR&D and B&P costs to determine whether the threshold criterion was reached shall include only recoverable IR&D and B&P costs allocated during the company's previous fiscal year to prime contracts and subcontracts for which the submission and certification of cost or pricing data were required. (See also paragraph (b) of this subsection and 15.804.) The computation shall include full burdening pursuant to 48 CFR 9904.420.

(B) When a company meets the criterion in (c)(1)(i)(A) of this subsection, required advance agreements may be negotiated at the corporate level and/or with those profit centers that contract directly with the Government and that in the preceding year allocated recoverable IR&D and B&P costs exceeding \$700,000, including burdening, to contracts and subcontracts for which the submission and certification of cost or pricing data were required (see also paragraph (b) of this subsection and 15.804). When ceilings are negotiated for separate profit centers of the company, the allowability of IR&D and B&P costs for any center that in its previous fiscal year did not reach the \$700,000 threshold may be determined in accordance with paragraph (c)(1)(ii) of this subsection.

(C) Ceilings are the maximum dollar amounts of total IR&D and B&P costs that will be allowable for allocation over the appropriate base for that part of the company's operation covered by an advance agreement.

(D) No IR&D and B&P cost shall be allowable if a company fails to initiate negotiation of a required advance agreement before the end of the fiscal year for which the agreement is required.

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(E) When negotiations are held with a company meeting the \$7,000,000 criterion or with separate profit centers (when negotiations are held at that level under (c)(1)(i)(B) of this subsection), and if no advance agreement is reached, payment for IR&D and B&P costs shall be reduced below that which the company or profit center would have otherwise received. The amount of such reduced payment shall not exceed 75 percent of the amount which, in the opinion of the contracting officer, the company or profit center would be entitled to receive under an advance agreement. Written notification of the contracting officer's determination of a reduced amount shall be provided the contractor. In the event that an advance agreement is not reached before the end of the contractor's fiscal year for which the agreement is to apply, negotiations shall immediately be terminated, and the contracting officer shall furnish a determination of the reduced amount.

(F) Contractors may appeal decisions of the contracting officer to reduce payment. The appeal shall be filed with the contracting officer within 30 days of receipt of the contracting officer's determination. (See also Subpart 42.10).

(ii) Companies not required to negotiate advance agreements. Costs for IR&D and B&P are allowable as indirect expenses on contracts to the extent that those costs are allocable and reasonable.

(2) This subparagraph (c)(2) implements section 802 of the National Defense Authorization Act for Fiscal Years 1992 and 1993 (Pub.L.102-190) and is effective for IR&D and B&P costs incurred by a contractor during fiscal years of that contractor that begin on or after October 1, 1992. Except as provided in paragraph (d) 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. The following limitations apply to major contractors-

(i) For the first three contractor fiscal years beginning on or after October 1, 1992, the total maximum allowable amount of IR&D/B&P costs shall not exceed the sum of:

(A) The total amount of allowable IR&D/B&P costs in the preceding fiscal year (i.e., the lower of the previous year's ceiling or actual costs incurred); plus

(B) Five percent of the amount in (c)(2)(i)(A) of this subsection; plus

(C) If the total amount of IR&D/B&P costs for a fiscal year is greater than the total amount of IR&D/B&P costs for the preceding fiscal year, the amount that is determined by multiplying the amount in (c)(2)(i)(A) of this subsection by the lesser of-

(1) The percentage by which the total amount of IR&D/B&P costs for a fiscal year exceeds the total amount of such costs for the preceding fiscal year; or

(2) The percentage rate of inflation from the end of the preceding fiscal year to the end of the fiscal year for which the amount of the limitation is being computed. The rate of inflation shall be the price escalation index for the Research, Development, Test Evaluation (RDTE) account, Total Obligation Authority (TOA) which is published annually (normally in January) by the Department of Defense Comptroller and used in preparation of the annual submission of the Defense budget. This rate will be published in the Federal Register on an annual basis.

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(ii) Major contractors shall submit, in accordance with agency guidance, financial and technical information to support their IR&D/B&P costs.

(iii) A waiver may be granted, in accordance with agency procedures, to increase the amount prescribed in (c)(2)(i) of this subsection for the following special circumstances:

(A) To ensure that the contractor's allowable IR&D/B&P costs are at least the same amount that would have been allowed under this subpart which was in effect prior to enactment of Public Law 102-190; or

(B) When it is in the best interest of the Government.

(d) Deferred IR&D and B&P 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. IR&D effort may be performed 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 effort may also be performed by contractors pursuant to cooperative research and development agreements, or similar arrangements, entered into under (1) section 12 of the Stevenson-Wydler Technology Transfer Act of 1980 (15 U.S.C.3710(a)); (2) 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)), when there is no transfer of Federal appropriated funds; (3) 10 U.S.C.2371 for the Defense Advanced Research Projects Agency; or (4) other equivalent authority. 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.

### **FAC 90-20 (Effective 9 May 1994)**

*Revise subparagraph (c)(2)(iii)(A) as follows:*

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(c) (2) (iii) (A) To ensure that the contractor's allowable IR&D/B&P costs are at least the same amount that would have been allowed under this subpart which was in effect on 4 December 1991;

### **FAC 90-46 (Effective 16 May 1997)**

*Replace paragraph (e) as follows:*

(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.

### **FAC 97-2 (Effective 10 October 1997)**

*Replace the 15.804 reference in 31.205-18(c)(1)(i)(A) and (B) with 15.403-4.*

### **FAC 97-3 (Effective 9 February 1998)**

*Revise paragraph (a) by removing definitions for “Contractor”, “Covered contract”, “Covered segment”, and “Major contractor”.*

*Revise paragraph (c) and the heading of paragraph (d); and add paragraph (e)(3) to read as follows:*

(c) *Allowability.* Except as provided in paragraphs (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.*

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(e) (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.

### **FAC 97-22 (Effective March 12, 2001, delayed until May 11, 2001 by executive order)**

Amend section 31.205-18 in the heading of paragraph (a) by adding "As used in this subsection-" after the word "Definitions."; removing "as used in this subsection," from the definitions "Applied research", "Bid and proposal (B&P) costs", "Company", "Development", "Independent research and development (IR&D)" and "Systems and other concept formulation studies"; and revising the definition "Basic research" to read as follows:

#### **31.205-18 Independent research and development and bid and proposal costs.**

(a) \* \* \*

Basic research (see 2.101).

\* \* \* \* \*

### **FAR 31.205-19 -- Insurance and Indemnification**

#### **1984 FAR (Effective 1 April 1984)**

(a) Insurance by purchase or by self-insuring includes coverage the contractor is required to carry, or to have approved, under the terms of the contract and any other coverage the contractor maintains in connection with the general conduct of its business. Any contractor desiring to establish a program of self-insurance applicable to contracts that are not subject to CAS 416, Accounting for Insurance Costs, shall comply with the self-insurance requirements of that standard as well as with Part 28 of this Regulation. However, approval of a contractor's insurance program in accordance with Part 28 does not constitute a determination as to the allowability of the program's cost. The amount of insurance costs which may be allowed is subject to the cost limitations and exclusions in the following subparagraphs.

(1) Costs of insurance required or approved, and maintained by the contractor 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 must be reasonable.

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

(iii) 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

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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 that 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) Contractors operating under a program of self-insurance must obtain approval of the program when required by 28.308(a).

(vi) Costs of insurance on the lives of officers, partners, or proprietors are allowable only to the extent that the insurance represents additional compensation (see 31.205-6).

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

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(i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable for contracts not subject to CAS 416 and when the contractor did not establish a self-insurance program. Such contracts are not subject to the self-insurance requirements of CAS 416. For contracts subject to CAS 416, and for those made subject to the self-insurance requirements of that Standard as a result of the contractor's having established a self-insurance program (see paragraph (a) above), actual losses may be used as a basis for charges under a self-insurance program when the actual amount of losses will not differ significantly from the projected average losses for the accounting period (see 4 CFR 416.50(a)(2)(ii)).

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

(4) The cost of insurance to protect the contractor against the costs of correcting its own defects in materials or 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.

(b) If purchased insurance is available, the charge for any self-insurance coverage plus insurance administration expenses shall not exceed the cost of comparable purchased insurance plus associated insurance administration expenses.

(c) Insurance provided by captive insurers (insurers owned by or under the control of the contractor) is considered self-insurance, and charges for it must comply with the self-insurance provisions of CAS 416. 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 insurance will be considered purchased insurance.

(d) The allowability of 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) shall not exceed the amount (plus reasonable fronting company charges for services

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rendered) which the contractor would have been allowed had it insured directly with the captive insurer.

- (e) Self-insurance charges for risks of catastrophic losses are not allowable (see 28.308(e)).
- (f) 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) above.
- (g) 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.

### FAC 84-7 (Effective 30 April 1985)

*Add the following to the end of paragraph (a)(3)(i), and replace paragraph (f) as shown below:*

- (a) (3) (i) In those instances where an actual loss has occurred and the present value of the liability is determined under the provisions of CAS 416.50(a)(3)(ii), the allowable cost shall be limited to an amount computed using as a discount rate the interest rate determined by the Secretary of the Treasury pursuant to 50 U.S.C.App. 1215(b)(2) in effect at the time the loss is recognized. However, the full amount of a lump-sum settlement to be paid within a year of the date of settlement is allowable.
- (f) 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 (a)(3) above.

### FAC 84-21 (Effective 29 August 1986)

*Add the following as paragraph (a)(5):*

- (a) (5) Premiums for retroactive or backdated insurance written to cover occurred and known losses are unallowable.

### FAC 84-30 (Effective 30 September 1987)

*Change the first two sentences of paragraph (a), all of paragraph (a)(3)(i), and the first sentence of paragraph (c) as follows:*

- (a) Insurance by purchase or by self-insuring includes coverage the contractor is required to carry, or to have approved, under the terms of the contract and any other coverage the contractor maintains in connection with the general conduct of its business. Any contractor desiring to establish a program of self-insurance applicable to contracts that are not subject to 30.416, Accounting for Insurance Costs, shall comply with the self-insurance requirements of that standard as well as with Part 28 of this Regulation.

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(3) (i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable for contracts not subject to 30.416 and when the contractor did not establish a self-insurance program. Such contracts are not subject to the self-insurance requirements of 30.416. For contracts subject to 30.416, and for those made subject to the self-insurance requirements of that Standard as a result of the contractor's having established a self-insurance program (see paragraph (a) above), actual losses may be used as a basis for charges under a self-insurance program when the actual amount of losses will not differ significantly from the projected average losses for the accounting period (see 4 CFR 416.50(a)(2)(ii)). In those instances where an actual loss has occurred and the present value of the liability is determined under the provisions of 30.416.50(a)(3)(ii), the allowable cost shall be limited to an amount computed using as a discount rate the interest rate determined by the Secretary of the Treasury pursuant to 50 U.S.C.App. 1215(b)(2) in effect at the time the loss is recognized. However, the full amount of a lump-sum settlement to be paid within a year of the date of settlement is allowable.

(c) Insurance provided by captive insurers (insurers owned by or under the control of the contractor) is considered self-insurance, and charges for it must comply with the self-insurance provisions of 30.416.

### **FAC 90-12 (Effective 31 August 1992)**

*Revise second sentence of paragraph (a) as follows:*

Any contractor desiring to establish a program of self-insurance applicable to contracts that are not subject to 48 CFR 9904.416, Accounting for Insurance Costs, shall comply with the self-insurance requirements of that standard as well as with Part 28 of this Regulation.

*Revise subparagraph (a)(3)(i) as follows:*

Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable for contracts not subject to 48 CFR 9904.416 and when the contractor did not establish a self-insurance program. Such contracts are not subject to the self-insurance requirements of 48 CFR 9904.416. For contracts subject to 48 CFR 9904.416, and for those made subject to the self-insurance requirements of that Standard as a result of the contractor's having established a self-insurance program (see paragraph (a) above), actual losses may be used as a basis for charges under a self-insurance program when the actual amount of losses will not differ significantly from the projected average losses for the accounting period (see 48 CFR 9904.416.50(a)(2)(ii)). In those instances where an actual loss has occurred and the present value of the liability is determined under the provisions of 48 CFR 9904.416-50(a)(3)(ii), the allowable cost shall be limited to an amount computed using as a discount rate the interest rate determined by the Secretary of the Treasury pursuant to 50 U.S.C. App. 1215(b)(2) in effect at the time the loss is recognized. However, the full amount of a lump-sum settlement to be paid within a year of the date of settlement is allowable.



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### FAC 2001-18 (Effective January 12, 2004)

*Deleted the language previously at (a)(3)(i). Restructured all provisions related to self-insurance into paragraph(c); those related to purchased insurance into paragraph (d); and those provisions that apply to both into paragraph (e) as follows:*

- (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 (48 CFR) Part 28. However, approval of a contractor's insurance program in accordance with Part 28 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 (see 28.308(e)).
- (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.
    - (ii) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of profit.
    - (iii) 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

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- 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 31.205-6).
- (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.

### **FAR 31.205-20 -- Interest and Other Financial Costs**

#### **1984 FAR (Effective 1 April 1984)**

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 31.205-41 (but see 31.205-28).

#### **FAC 97-14 (Effective 23 November 1999)**

*Minor editorial changes made.*

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 are unallowable (but see 31.205-28). However, interest assessed by State or local taxing authorities under the conditions specified in 31.205-41(a)(3) is allowable.

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### **FAR 31.205-21 -- Labor Relations Costs**

#### **1984 FAR (Effective 1 April 1984)**

Costs incurred in maintaining satisfactory relations between the contractor and its employees, including costs of shop stewards, labor management committees, employee publications, and other related activities, are allowable.

**FAC 97-21 (Effective January 19, 2001; stayed by FAC 97-24, effective April 3, 2001; rescinded by FAC 2001-03, effective December 27, 2001)**

Added paragraph (b) as follows:

(b) Costs incurred for activities that assist, promote, or deter unionization are unallowable.

### **FAR 31.205-22 -- Lobbying and Political Activity Costs**

#### **1984 FAR (Effective 1 April 1984)**

(a) Lobbying is defined as any activity or communication that is intended or designed (1) to directly influence members of the U.S. Congress or State and local legislatures, their staffs, or the staffs of committees of these bodies to favor or oppose pending, proposed, or existing legislation, appropriations, or other official actions of these bodies, their members, or their committees, or (2) to engage in any campaign to directly encourage others to do so. Except as provided in paragraph (c) below, lobbying includes, but is not limited to, appearances before any legislative committee or subcommittee and written or oral communications, including face-to-face discussions or conferences, telephone conversations, paid advertisements, and the sending of telegrams or letters.

(b) The costs of lobbying, including the applicable portion of the salaries and fees of those individuals engaged in lobbying efforts on behalf of a contractor, whether or not the individuals are registered as lobbyists under any applicable law, are unallowable.

(c) Legislative liaison activities, such as attendance at committee hearings and gathering information regarding pending legislation, are not lobbying and are allowable. In addition, written or oral communications, appearances before legislative committees and subcommittees, and meetings with legislative representatives are allowable legislative liaison activities when such efforts are undertaken in conjunction with a legislative public hearing or meeting in response to a public notice, or a specific invitation or request from a legislative source, and the notice, invitation, or request is documented. However, for the costs to be allowable, the contractor shall maintain and make available to the Government records and documentation sufficient to identify the costs and clearly establish the nature and purpose of the legislative liaison activity to which the costs relate.

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### FAC 84-2 (Effective 27 April 1984)

- (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 or state legislation, or (ii) the enactment or modification of any pending Federal or state 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 or state legislation, or (ii) the enactment or modification of any pending Federal or state 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; or
  - (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.
- (b) The following activities are excepted from the coverage of (a) above:
- (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 (a)(3) above to influence state 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.

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- (d) Contractors shall submit as part of their annual indirect cost rate proposals a certification that the requirements and standards of this subsection have been complied with.
- (e) Contractors shall maintain adequate records to demonstrate that the certification of costs as being allowable or unallowable pursuant to this subsection complies with the requirements of this subsection.
- (f) Time logs, calendars, or similar records documenting the portion of an employee's time that is treated as an indirect cost shall not be required for the purposes of complying with this subsection, and the absence of such records which are not kept pursuant to the discretion of the contractor will not serve a basis for disallowing allowable costs by contesting estimates of unallowable lobbying time spent by employees during any calendar month unless: (1) the employee engages in lobbying, as defined in (a) and (b) above, more than 25% of the employee's compensated hours of employment during that calendar month; or (2) the organization has materially misstated allowable or unallowable costs within the preceding five year period.
- (g) Existing procedures should be utilized to resolve in advance any significant questions or disagreements concerning the interpretation or application of this subsection.

### **FAC 84-15 (Effective 7 April 1986)**

*Change title of this provision as follows:*

FAR 31.205-22 Legislative Lobbying Costs

### **FAC 84-26 (Effective 30 July 1987)**

*Replace paragraph (f) as follows:*

- (f) Time logs, calendars, or similar records shall not be required to be created for purposes of complying with this subsection during any particular calendar month when-
- (1) The employee engages in lobbying (as defined in paragraphs (a) and (b) of this subsection) 25 percent or less of the employee's compensated hours of employment during that calendar month; and
  - (2) Within the preceding 5-year period, the organization has not materially misstated allowable or unallowable costs of any nature, including legislative lobbying costs. When conditions of subparagraphs (f)(1) and (2) of this subsection are met, contractors are not required to establish records to support the allowability of claimed costs in addition to records already required or maintained. Also, when conditions of subparagraphs (f)(1) and (2) of this subsection are met, the absence of time logs, calendars, or similar records will not serve as a basis for disallowing costs by contesting estimates of lobbying time spent by employees during a calendar month.

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### FAC 90-31 (Effective 1 October 1995)

*Replace paragraph (a)(3) and (a)(4) as follows:*

(a) (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, 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; or

### FAC 90-39 (Effective 19 August 1996)

*Change the title of this provision as follows:*

FAR 31.205-22 Lobbying and political activity costs.

*Delete paragraph (f), renumber paragraph (g) to (f), move "or" at the end of paragraph (a)(4) to the end of (a)(5) and add paragraph (a)(6) as follows:*

(a) (4) Any attempt to influence (i) the introduction of Federal or state legislation, or (ii) the enactment or modification of any pending Federal or state 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 (see 3.401), 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.

### FAC 90-43 (Effective 20 December 1996); Interim Rule Finalized in FAC 97-1 (Effective 21 October 1997)

*Replace paragraph (b)(2) as follows:*

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(b) (2) Any lobbying made unallowable by paragraph (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.

### FAC 90-45 (Effective 1 January 1997)

*Delete paragraph (d). Renumber (e) and (f) to (d) and (e), respectively, and revise new paragraph (d) as follows:*

(d) Contractors shall maintain adequate records to demonstrate that the certification of costs as being allowable or unallowable (see 42.703-2) pursuant to this subsection complies with the requirements of this subsection.

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

### FAR 31.205-23 -- Losses on Other Contracts

#### 1984 FAR (Effective 1 April 1984)

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

### FAR 31.205-24 -- Maintenance and Repair Costs

#### 1984 FAR (Effective 1 April 1984)

(a) Costs necessary for the upkeep of property (including Government property, unless otherwise provided for) that neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are to be treated as follows (but see 31.205-11):

- (1) Normal maintenance and repair costs are allowable.
- (2) Extraordinary maintenance and repair costs are allowable, provided those costs are allocated to the applicable periods for purposes of determining contract costs (but see 31.109).

(b) Expenditures for plant and equipment, including rehabilitation which should be capitalized and subject to depreciation, according to generally accepted accounting principles as applied under the contractor's established policy or, when applicable, according to CAS 404, Capitalization of Tangible Assets, are allowable only on a depreciation basis.

### FAC 84-30 (Effective 30 September 1987)

*Change paragraph (b) as follows:*

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(b) Expenditures for plant and equipment, including rehabilitation which should be capitalized and subject to depreciation, according to generally accepted accounting principles as applied under the contractor's established policy or, when applicable, according to 30.404, Capitalization of Tangible Assets, are allowable only on a depreciation basis.

### **FAC 90-12 (Effective 31 August 1992)**

*Change paragraph (b) as follows:*

(b) Expenditures for plant and equipment, including rehabilitation which should be capitalized and subject to depreciation, according to generally accepted accounting principles as applied under the contractor's established policy or, when applicable, according to 48 CFR 9904.404, Capitalization of Tangible Assets, are allowable only on a depreciation basis.

### **FAC 2001-24 (Effective July 19, 2004)**

*Delete the Cost Principle and mark as reserved.*

**[Reserved]**

## **FAR 31.205-25 -- Manufacturing and Production Engineering Costs**

### **1984 FAR (Effective 1 April 1984)**

(a) The costs of manufacturing and production engineering effort as described in (1) through (4) below 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 31.205-18(a)) related to new technology, materials, systems, processes, methods, equipment, tools and techniques. Such technical effort is governed by 31.205-18, Independent research and development 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 31.205-18.



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(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 31.205-11, Depreciation.

### **FAR 31.205-26 -- Material Costs**

#### **1984 FAR (Effective 1 April 1984)**

(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 intransit insurance. In computing material costs, consideration shall be given to reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provisions relating to inspecting and correcting defective work). These costs are allowable, subject to the requirements of paragraphs (b) through (e) below.

(b) Costs of material shall be adjusted 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. Such income and other credits shall either be credited directly to the cost of the material or be allocated as a credit to indirect costs. When the contractor can demonstrate that failure to take cash discounts was reasonable, lost discounts need not be credited.

(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 an 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. When estimates of future material costs are required, current market price or anticipated acquisition cost may be used, but the basis of pricing must be disclosed.

(e) Allowance for all materials, supplies, and services that are sold or transferred between any divisions, 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 a price when 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 when the price-

(1) Is or is based on an "established catalog or market price of commercial items sold in substantial quantities to the general public" in accordance with 15.804; or

(2) Is the result of "adequate price competition" in accordance with 15.804 and is the price at which an award was made to the affiliated organization after obtaining quotations on an

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equal basis from such organization and one or more outside sources that produce the item or its equivalent in significant quantity.

- (3) Provided, that in either subparagraph (1) or (2) above --
- (i) The price is not in excess of the transferor's current sales price to its most favored customer (including any division, subsidiary or affiliate of the contractor under a common control) for a like quantity under comparable conditions; and
  - (ii) The contracting officer has not determined the price to be unreasonable.

(f) The price determined in accordance with subparagraph (e)(1) above should be adjusted to reflect the quantities' being acquired and may be adjusted to reflect actual cost of any modifications necessary because of contract requirements.

### FAC 90-27 (Effective 31 May 1995)

*Replace paragraph (e) as follows:*

(e) Allowance for all materials, supplies, and services that are sold or transferred between any divisions, 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 a price when 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 when-

- (1)
  - (i) The price is based on an "established catalog or market price of commercial items sold in substantial quantities to the general public in accordance with 15.804-3;
  - (ii) The price is based on "adequate price competition" in accordance with 15.804-3; or
  - (iii) A waiver is granted in accordance with 15.804-3(i); and
- (2) The contracting officer has not determined the price to be unreasonable.

### FAC 90-32 (Effective 1 October 1995)

*Replace paragraphs (e) and (f) as follows:*

(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 a price when 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 when the item being transferred qualifies for an exception under 15.804-1 and the contracting officer has not determined the price to be unreasonable.

(f) When a catalog or market price exception under 15.804-1(a)(1)(ii) applies under paragraph (e) of this subsection, the price should be adjusted to reflect the quantities being

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acquired and may be adjusted to reflect the actual cost of any modifications necessary because of contract requirements.

### **FAC 90-45 (Effective 1 January 1997)**

*Replace paragraph (f) as follows:*

(f) When a commercial item under paragraph (e) of this subsection is transferred at a price based on a catalog or market price, the price should be adjusted to reflect the quantities being acquired and may be adjusted to reflect the actual cost of any modifications necessary because of contract requirements.

### **FAC 97-2 (Effective 10 October 1997)**

*Change reference in (e) from 15.804-1 to 15.403-1(b)*

### **FAC 2001-24 (Effective July 19, 2004)**

- (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—

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- (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 under 15.403-1(b) 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.

### FAR 31.205-27 -- Organization Costs

#### **1984 FAR (Effective 1 April 1984)**

(a) Except as provided in paragraph (b) below, expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, or (2) 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 31.205-6. These activities include acquiring stock for (1) executive bonuses, (2) employee savings plans, and (3) employee stock ownership plans.

#### **FAC 84-35 (Effective 4 April 1988)**

*Replace paragraph (a) as follows:*

(a) Except as provided in paragraph (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

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borrowings for working capital, resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised.

### **FAR 31.205-28 -- Other Business Expenses**

#### **1984 FAR (Effective 1 April 1984)**

The following types of recurring costs are allowable when allocated on an equitable basis:

- (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.

#### **FAC 2001-14 (Effective June 23, 2003)**

*Revise introduction paragraph to read as follows:*

The following types of recurring costs are allowable:

### **FAR 31.205-29 -- Plant Protection Costs**

#### **1984 FAR (Effective 1 April 1984)**

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.

### **FAR 31.205-30 -- Patent Costs**

#### **1984 FAR (Effective 1 April 1984)**

- (a) The following patent costs are allowable to the extent that they are incurred as requirements of a Government contract (but see 31.205-33):

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- (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 31.205-33).
- (c) Other than those for general counseling services, patent costs not required by the contract are unallowable. (See also 31.205-37.)

### **FAR 31.205-31 -- Plant Reconversion Costs**

#### **1984 FAR (Effective 1 April 1984)**

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.

### **FAR 31.205-32 -- Precontract Costs**

#### **1984 FAR (Effective 1 April 1984)**

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 (see 31.109).

#### **FAC 97-22 (Effective March 12, 2001, delayed until May 11, 2001 by executive order)**

Amend section 31.205-32 in the first sentence by removing "are those" and adding "means costs" in its place; and in the second sentence by removing "Such" and adding "These" in its place.

### **FAR 31.205-33 -- Professional and Consultant Service Costs**

#### **1984 FAR (Effective 1 April 1984)**

- (a) Costs of professional and consultant 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 are allowable subject to paragraphs (b), (c), (d), and (e) below when reasonable in

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relation to the services rendered and when not contingent upon recovery of the costs from the Government (but see 31.205-30).

(b) 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 following factors, among others, should be considered:

- (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 such 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).

(c) 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); and
- (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.

(d) Costs of legal, accounting, and consulting services and directly associated costs incurred in connection with organization and reorganization (also see 31.205-27), defense of antitrust suits, or the prosecution of claims against the Government are unallowable. Such costs incurred in connection with patent infringement litigation are unallowable unless otherwise provided for in the contract.

(e) Except for retainers, fees for services rendered shall be allowable only when supported by evidence of the nature and scope of the service furnished. (Also see 31.205-38(c)).

### **FAC 84-15 (Effective 7 April 1986)**

*Replace paragraph (d) and add paragraph (f) as follows:*

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(d) Costs of legal, accounting, and consultant services and directly associated costs incurred in connection with organization and reorganization (also see 31.205-27), defense of antitrust suits, defense against Government claims or appeals, or the prosecution of claims or appeals against the Government (see 33.201) are unallowable (but see 31.205-47). Such costs incurred in connection with patent infringement litigation are unallowable unless otherwise provided for in the contract.

(f) 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 (1) an agreement or contract concerning a teaming arrangement, a joint venture, or similar arrangement of shared interest; or (2) dual sourcing, co-production, or similar programs, are unallowable, except when (i) incurred as a result of compliance of specific terms and conditions of the contract or written instructions from the contracting officer, or (ii) when agreed to in writing by the contracting officer.

### **FAC 84-44 (Effective 17 April 1989)**

*Replace paragraphs (a) and (d) as shown below, and eliminate paragraphs (e) and (f):*

(a) Costs of professional and consultant 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 are allowable subject to paragraphs (b), (c), and (d) 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 31.205-30 and 31.205-47).

(d) Except for retainers, fees for services rendered shall be allowable only when supported by evidence of the nature and scope of the service furnished. (Also see 31.205-38(c)).

### **FAC 84-56 (Effective 7 March 1990)**

(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 paragraph and paragraphs (c) through (h) 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 31.205-30).

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



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- (1) Services to improperly obtain, distribute, or use information or data protected by law or regulation (e.g., FAR 52.215-12, Restriction on Disclosure and Use of Data);
  - (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; or
  - (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) Costs of legal, accounting, and consultant services and directly associated costs incurred in connection with organization and reorganization (see also 31.205-27), defense of antitrust suits, defense against Government claims or appeals, or the prosecution of claims or appeals against the Government (see 33.201) are unallowable (but see 31.205-47). Such costs incurred in connection with patent infringement litigation are unallowable unless otherwise provided for in the contract.
- (e) 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 (1) an agreement or contract concerning a teaming arrangement, a joint venture, or similar arrangement of shared interest, or (2) dual sourcing, co-production, or similar programs, are unallowable, except when (i) incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer, or (ii) when agreed to in writing by the contracting officer.
- (f) 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 nongovernment 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).

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- (g) 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 paragraph (h) of this subsection.

(h) Fees for services rendered shall be allowable only when supported by evidence of the nature and scope of the service furnished. (See also 31.205-38(g)). 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.

### **FAC 90-3 (Effective 22 January 1991)**

(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 paragraph and paragraphs (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 31.205-30 and 31.205-47).

(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 (e.g., 52.215-12, Restriction on Disclosure and Use of Data).

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(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 regulations 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 paragraph (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 31.205-38(g).) 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 individual or organizations providing the services and details of actual services performed;

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(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.

### **FAC 90-16 (Effective 21 December 1992)**

*Revise paragraph (f) as follows:*

(f) Fees for services rendered shall be allowable only when supported by evidence of the nature and scope of the service furnished. (See also 31.205-38(f)). 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-

### **FAC 97-2 (Effective 10 October 1997)**

*Revise reference in (c)(1) from 52.215-12 to 52.215-1(e).*

### **FAC 1999-403 (Effective March 12, 2001, delayed until May 11, 2001 by executive order)**

Amend section 31.205-33 in the first sentence of paragraph (a) by removing ``subpart, are" and adding ``subsection, means" in its place.

### **FAC 2001-15 (Effective August 25, 2003)**

*Update the reference in the first sentence of the introductory text of paragraph (f) to read as follows.*

(f) Fees for services rendered are allowable only when supported by evidence of the nature and scope of the service furnished (see also 31.205-38(c)).

## **FAR 31.205-34 -- Recruitment Costs**

### **1984 FAR (Effective 1 April 1984)**

(a) Subject to paragraphs (b) and (c) below, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, 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.

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- (4) Travel costs of employees engaged in recruiting personnel.
  - (5) Travel costs of applicants for interviews.
  - (6) Costs of employment agencies not in excess of standard commercial rates.
- (b) Help-wanted advertising costs are unallowable if the advertising-
- (1) Is for personnel other than those required to perform obligations under a Government contract;
  - (2) Does not describe specific positions or classes or positions;
  - (3) Is excessive relative to the number and importance of the positions or to the industry practices;
  - (4) Includes material that is not relevant for recruitment purposes, such as extensive illustrations or descriptions of the company's products or capabilities;
  - (5) Is designed to 'pirate' personnel from another Government contractor; or
  - (6) Includes color (in publications).
- (c) Excessive compensation costs offered to prospective employees to 'pirate' them from another Government contractor are unallowable. Such excessive costs may include salaries, fringe benefits, or special emoluments which are in excess of standard industry practices or the contractor's customary compensation practices.

### **FAC 97-11 (Effective 3 May 1999)**

*Revise paragraph (a) introductory text, revise paragraph (b) and remove paragraph (c) to read as follows:*

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

### **FAR 31.205-35 -- Relocation Costs**

#### **1984 FAR (Effective 1 April 1984)**

- (a) Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. The following types of costs are allowable as noted, subject to paragraphs (c) and (d) below:
- (1) Cost of travel of the employee and members of the immediate family (see 31.205-46) and transportation of the household and personal effects to the new location.
  - (2) Cost of finding a new home, such as advance trips by employees and spouses to locate living quarters, and temporary lodging during the transition periods not exceeding separate

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cumulative totals of 60 days for employees and 45 days for spouses and dependents, including advance trip time.

(3) Closing costs (i.e., brokerage fees, legal fees, appraisal fees, points, finance charges, etc.) incident to the disposition of the actual residence owned by the employee when notified of transfer, except that these costs when added to the costs described in subparagraph (a)(4) below 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, mortgage interest, after settlement date or lease date of new permanent residence, except that these costs when added to the costs described in subparagraph (a)(3) above, 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 a new location, except that (i) these costs will not be allowable for existing employees or newly recruited employees who, before the relocation, were not homeowners 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) Cost of canceling an unexpired lease.

(b) The costs described in paragraph (a) above 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 otherwise be unallowable under Subpart 31.2.

(4) Amounts to be reimbursed shall not exceed the employee's actual expenses, except that for miscellaneous costs of the type discussed in subparagraph (a)(5) above, a flat amount, not to exceed \$1,000, may be allowed in lieu of actual costs.

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- (c) The following types of costs are not allowable:
- (1) Loss on sale of a home.
  - (2) Costs incident to acquiring a home in a new location as follows:
    - (i) Real estate brokers fees and commissions.
    - (ii) Cost 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, cost of a mortgage title policy is allowable).
    - (vi) Property taxes and operating or maintenance costs.
  - (3) Continuing mortgage principal payments on residence being sold.
  - (4) Payments for employee income or FICA (social security) taxes incident to reimbursed relocation costs.
  - (5) Payments for job counseling and placement assistance to employee spouses and dependents who are not employees of the contractor at the old location.
  - (6) 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 paragraphs (a) through (d) above, 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.

### **FAC 84-25 (Effective 1 July 1987)**

*Replace paragraph (a) and add paragraph (f) as follows:*

- (a) Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period, but in either event for not less than 12 months) of an existing employee or upon recruitment of a new employee. The following types of relocation costs are allowable as noted, subject to paragraphs (b) and (f) below:
- (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 not less than 12 months;
  - (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 principle home immediately prior to the outgoing relocation, or other location of equal or lesser cost; and

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(4) The relocation costs are determined under the rules of paragraphs (a) through (d) above. 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 paragraph (d).

### **FAC 2001-08 (Effective July 29, 2002)**

(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 paragraphs (b) and (f) of this subsection:

(1) Cost of travel of the employee and members of the immediate family (see 31.205-46) and transportation of the household and personal effects to the new location.

(2) Cost of finding a new home, such as advance trips by 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 (*i.e.*, brokerage fees, legal fees, appraisal fees, points, 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.



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(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 Subpart 31.2.

(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.

(c) The following types of costs are unallowable:

(1) Loss on 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.

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- (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 paragraphs (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 paragraphs (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 paragraph (d).

### FAC 2005-06 (Effective October 31, 2005)

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- (b)
- (4) Amounts to be reimbursed shall not exceed the employee's actual expenses, except as provided for in paragraphs (b)(5) and (b)(6) of this subsection.
- (5) For miscellaneous costs of the type discussed in paragraph (a)(5) of this subsection, a lump-sum amount, not to exceed \$5,000, may be allowed in lieu of actual costs.
- (6)(i) 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:
- (A) Costs of finding a new home, as discussed in paragraph (a)(2) of this subsection.
  - (B) Costs of travel to the new location, as discussed in paragraph (a)(1) of this subsection (but not costs for the transportation of household goods).
  - (C) Costs of temporary lodging, as discussed in paragraph (a)(2) of this subsection.

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

### FAR 31.205-36 -- Rental Costs

#### **1984 FAR (Effective 1 April 1984)**

(a) This subsection is applicable to the cost of renting or leasing real or personal property, except ADPE (see 31.205-2), acquired under "operating leases" as defined in Statement of Financial Accounting Standards No. 13 (FAS-13), Accounting for Leases. Compliance with 31.205-11(l) 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) below).

(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 of 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 organization 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 Part 31), 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) above.

(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 1 January 1969.

(c) The allowability of rental costs under unexpired leases in connection with terminations is treated in 31.205-42(e).

#### **FAC 84-12 (Effective 20 January 1986)**

*Change the first two sentences of paragraph (a) as follows:*

(a) This subsection is applicable to the cost of renting or leasing real or personal property, except ADPE (see 31.205-2), acquired under "operating leases" as defined in Statement of

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Financial Accounting Standards No. 13 (FAS-13), Accounting for Leases. Compliance with 31.205-11(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) below).

### **FAC 90-44 (Effective 31 December 1996); Finalized in FAC 97-1 (Effective 21 October 1997)**

*Replace paragraph (a) as follows:*

(a) This subsection is applicable to the cost of renting or leasing real or personal property, acquired under "operating leases" as defined in Statement of Financial Accounting Standards No.13 (FAS-13), Accounting for Leases. Compliance with 31.205-11(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) below).

### **FAR 31.205-37 -- Royalties and Other Costs For Use Of Patents**

#### **1984 FAR (Effective 1 April 1984)**

(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 31.109 regarding advance agreements.

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### **FAR 31.205-38 -- Selling Costs**

#### **1984 FAR (Effective 1 April 1984)**

- (a) Selling costs arise in the marketing of the contractor's products and include costs of sales promotions, negotiation, liaison between Government representatives and contractor's personnel, and related activities.
- (b) Selling costs are allowable to the extent that they are reasonable and are allocable to Government business (but see 31.109 and 31.205-1). Allocability of selling costs shall be determined in the light of reasonable benefit to the Government arising from such activities as technical, consulting, demonstration, and other services which are for purposes such as application or adaptation of the contractor's products to Government use for its own requirements. Selling costs incurred in connection with potential and actual Foreign Military Sales as defined by the Arms Export Control Act, or foreign sales of military products shall not be allocable to U.S. Government contracts for U.S. Government requirements.
- (c) Notwithstanding paragraph (b) above, seller's or agent's 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 (see subsection 3.408-2).

#### **FAC 84-12 (Effective 20 January 1986)**

*Change paragraph (b) as follows:*

- (b) Selling costs are allowable to the extent that they are reasonable and are allocable to Government business (but see 31.109 and 31.205-1). Allocability of selling costs shall be determined in the light of reasonable benefit to the Government arising from such activities as technical, consulting, demonstration, and other services which are for purposes such as application or adaptation of the contractor's products to Government use for its own requirements. Selling costs incurred in connection with potential and actual Foreign Military Sales as defined by the Arms Export Control Act, or foreign sales of military products are unallowable on U.S. Government contracts for U.S. Government requirements.

#### **FAC 84-15 (Effective 7 April 1986)**

- (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 31.205. Selling activity includes the following broad categories:
- (1) Advertising.
  - (2) Corporate image enhancement including broadly targeted sales efforts, other than advertising.
  - (3) Bid and proposal costs.
  - (4) Market planning.

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(5) Direct selling.

(b) Advertising costs are defined at 31.205-1(b) and are subject to the allowability provisions of 31.205-1(d) and (f). Corporate image enhancement activities are included within the definitions of public relations at 31.205-1(a) and entertainment at 31.205-14 and are subject to the allowability provisions at 31.205-1(e) and (f) and 31.205-14, respectively. Bid and proposal costs are defined at 31.205-18 and have their allowability controlled by that subsection. Market planning involves market research and analysis and generalized management planning concerned with development of the contractor's business. The allowability of long-range market planning costs is controlled by the provisions of 31.205-12. Other market planning costs are allowable to the extent that they are reasonable. Costs of activities which are correctly classified and disallowed under cost principles referenced in this paragraph (b) are not to be reconsidered for reimbursement under any other provisions of this subsection.

(c) 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 activities 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 activities, individual demonstrations, and any other activities having as their purposes 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 if reasonable in amount.

(d) The costs of any selling efforts other than those addressed in paragraphs (b) or (c) of this subsection are unallowable.

(e) Costs of the type identified in paragraphs (b), (c), and (d) of this subsection are often commingled on the contractor's books in the selling expense account because these activities are performed by the sales departments. However, identification and segregation of unallowable costs is required under the provisions of 31.201-6 and CAS 405, and such costs are not allowable merely because they are incurred in connection with allowable selling activities.

(f) Notwithstanding any other provisions of this subsection, selling costs incurred in connection with potential and actual Foreign Military Sales as defined by the Arms Export Control Act, or foreign sales of military products or services are unallowable on U.S. Government contracts for U.S. Government requirements.

(g) 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 (see 3.408-2).

**FAC 84-26 (Effective 30 July 1987)**

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*Replace paragraph (f) as follows:*

(f) Notwithstanding any other provision of this subsection, costs of direct selling efforts, as defined in paragraph (c) of this subsection, incurred in connection with potential and actual Foreign Military Sales, as defined by the Arms Export Contract Act, or foreign sales of military products or services are unallowable on U.S. Government contracts for U.S. Government requirements.

### **FAC 84-30 (Effective 30 September 1987)**

*Change paragraph (e) as follows:*

(e) Costs of the type identified in paragraphs (b), (c), and (d) of this subsection are often commingled on the contractor's books in the selling expense account because these activities are performed by the sales departments. However, identification and segregation of unallowable costs is required under the provisions of 31.201-6 and 30.405, and such costs are not allowable merely because they are incurred in connection with allowable selling activities.

### **FAC 90-4 (Effective 15 May 1991)**

*Replace paragraphs (b), (c), and (g) as follows:*

(b) Advertising costs are defined at 31.205-1(b) and are subject to the allowability provisions of 31.205-1(d) and (f). Corporate image enhancement activities are included within the definitions of public relations at 31.205-1(a) and entertainment at 31.205-14 and are subject to the allowability provisions at 31.205-1(e) and (f) and 31.205-14, respectively. Bid and proposal costs are defined at 31.205-18 and have their allowability controlled by that subsection. Market planning involves market research and analysis and generalized management planning concerned with development of the contractor's business. The allowability of long-range market planning costs is controlled by the provisions of 31.205-12. Other market planning costs are allowable to the extent that they are reasonable and not in excess of the limitations of subparagraph (c)(2) of this subsection. Costs of activities which are correctly classified and disallowed under cost principles referenced in this paragraph (b) are not to be reconsidered for reimbursement under any other provision of this subsection.

(c) (1) 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 activities 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 activities, individual demonstrations, and any other activities having as their purposes 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 if reasonable in amount.

(2) The costs of broadly targeted and direct selling efforts and market planning other than long-range, which are incurred in connection with a significant effort to promote export

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sales of products normally sold to the U.S. Government, including the costs of exhibiting and demonstrating such products, are allowable on contracts with the U.S. Government provided-

(i) The costs are allocable, reasonable, and otherwise allowable under subpart 31.2;

(ii) That, with respect to a business segment which allocates to U.S. Government contracts \$2,500,000 or more of such costs in a given fiscal year of such business segment, a ceiling on allowable costs shall apply. The ceiling on the amount of allowable costs to be allocated over the appropriate base shall be 110 percent of foreign selling costs incurred by the business segment in the previous year; and

(iii) That, in order to comply with Public Law 100-456, the substance of this subparagraph (c)(2) shall also apply to all contracts and subcontracts of the contractor with the Department of Defense being performed by the contractor on the first day of the contractor's first full fiscal year that begins on or after December 22, 1988, whether or not a contract or subcontract contains this subparagraph (c)(2).

(g) 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 agents maintained by the contractor for the purpose of securing business (see 3.408-2).

### **FAC 90-7 (Effective 23 September 1991)**

*Delete paragraph (f) and renumber paragraph (g) as paragraph (f) as follows:*

(f) 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 (see 3.408-2).

### **FAC 90-12 (Effective 31 August 1992)**

*Revise last sentence of paragraph (e) as follows:*

However, identification and segregation of unallowable costs is required under the provisions of 31.201-6 and 48 CFR 9904.405, and such costs are not allowable merely because they are incurred in connection with allowable selling activities.

### **FAC 90-20 (Effective 10 March 1994)**

*Revise subparagraph (c)(2)(iii) as follows:*

(c) (2) (iii) That, in order to comply with Public Law 100-456, the substance of this subparagraph (c)(2) shall also apply to all contracts and subcontracts of the contractor with the



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Department of Defense being performed by the contractor on the first day of the contractor's first full fiscal year that begins on or after December 15, 1988, whether or not a contract or subcontract contains this subparagraph (c)(2).

### **FAC 90-40 (Effective 24 September 1996)**

*Delete the parenthetical reference from paragraph (f) as follows:*

(f) 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.

### **FAC 90-46 (Effective 16 May 1997)**

*Replace paragraph (c)(2) as follows:*

(c) (2) The costs of broadly targeted and direct selling efforts and market planning other than long-range, that are incurred in connection with a significant effort to promote export sales of products normally sold to the U.S. Government, including the costs of exhibiting and demonstrating such products, are allowable on contracts with the U.S. Government provided the costs are allocable, reasonable, and otherwise allowable under subpart 31.2.

### **FAC 2001-15 (Effective August 25, 2003)**

*Revise section 31.205-38 to read as follows:*

- (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 31.205. 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 costs are defined at 31.205-1(b) and are subject to the allowability provisions of 31.205-1(d) and (f).
  - (2) *Corporate image enhancement*. Corporate image enhancement activities including broadly targeted sales efforts, other than advertising, are included within the definitions of public relations at 31.205-1(a) and the costs of such efforts are subject to the allowability provisions at 31.205-1(e) and (f).
  - (3) *Bid and proposal costs*. Bid and proposal costs are defined at 31.205-18 and are subject to the allowability provision 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 31.205-12. Other market planning costs are allowable.

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- (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 activities 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 activities, individual demonstrations, and any other activities 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.

### **FAR 31.205-39 -- Service and Warranty Costs**

#### **1984 FAR (Effective 1 April 1984)**

Service and warranty costs include those arising from fulfillment of any contractual obligations 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.

#### **FAC 1999-403 (Effective March 12, 2001, delayed until May 11, 2001 by executive order)**

Amend the second sentence of section 31.205-39 by removing the word "such".

### **FAR 31.205-40 -- Special Tooling and Special Test Equipment Costs**

#### **1984 FAR (Effective 1 April 1984)**

- (a) The terms "special tooling" and "special test equipment" are defined in 45.101.
- (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.

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(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.

### **FAR 31.205-41 -- Taxes**

#### **1984 FAR (Effective 1 April 1984)**

(a) The following types of costs are allowable:

(1) Federal, State, and local taxes (see Part 29), except as otherwise provided in paragraph (b) below 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) above, 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)(i) above 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) above, 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.

(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 31.205-20 and 31.205-27).

(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.

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(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 paragraph (c) below).

(6) Taxes on accumulated funding deficiencies of, or prohibited transactions involving, employee deferred compensation plans pursuant to Section 4971 or Section 4975 of the Internal Revenue Code of 1954, as amended.

(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.

(c) Taxes on property (see subparagraph (b)(5) above) 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. 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.

### **FAC 84-56 (Effective 7 March 1990)**

*Replace paragraph (d) as follows:*

(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.

### **FAC 90-3 (Effective 22 January 1991)**

*Add paragraph (a)(4) as follows:*

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

### **FAC 90-37 (Effective 26 March 1996)**

*Replace paragraph (b)(6) as follows:*

(b) (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.

### **FAR 31.205-42 -- Termination Costs**

#### **1984 FAR (Effective 1 April 1984)**

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 Subpart 31.2:

(a) Common items. The costs of items reasonably usable on the contractor's other work shall not be allowable unless a 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 at 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 termination due to the negligent or willful failure of the contractor to discontinue the costs shall be unallowable.

(c) Initial costs. Initial costs (see 15.804-6(f)), 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

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- (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

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- (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 31.201-4 and 31.203(c). The indirect expense so allocated shall exclude that same and similar costs claimed directly or indirectly as settlement expenses.

### **FAC 97-2 (Effective 10 October 1997)**

*Remove "(See 15.804-6(f))" from introductory paragraph.*

### **FAC 2001-22 (Effective May 5, 2004)**

*Change reference in (h) from "31.201-4 and 31.203(c)" to "31.201-4 and 31.203(d)".*

### **FAR 31.205-43 -- Trade, business, Technical And Professional Activity Costs**

#### **1984 FAR (Effective 1 April 1984)**

The following types of costs are allowable:

- (a) Memberships in trade, business, technical, and other professional organizations.
- (b) Subscriptions to trade, business, professional, or other technical periodicals.
- (c) Meetings and conferences, including meals, transportation, rental of meeting facilities and other incidental costs when the primary purposes of the incurrence of the costs is the dissemination of technical information or stimulation of production.

#### **FAC 84-38 (Effective 19 August 1988)**

*Replace paragraph (c) as follows:*

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(c) When the principal purpose of a meeting, 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, symposia, etc., including rental of meeting facilities, transportation, subsistence, and incidental costs;
- (2) Costs of attendance by contractor employees, including travel costs (see 31.205-46); 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, symposium, etc.

### FAC 90-31 (Effective 1 October 1995)

*Replace paragraph (c) as follows:*

(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 31.205-46); 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.

### **FAR 31.205-44 -- Training and Educational Costs**

#### **1984 FAR (Effective 1 April 1984)**

(a) Allowable costs. Training and educational costs, including training materials and textbooks, are allowable to the extent indicated below.

(b) Vocational training. Costs of preparing and maintaining a non-college 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, and/or (3) tuition and fees when the training is in an institution not operated by the contractor.



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(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, instructor's 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) 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 paragraph (h) below).

(d) Full-time education. Costs of tuition, fees (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 one school year for each employee so-trained. In unusual cases the period may be extended.

(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 employee's salaries, subsistence, and travel. Costs allowable under this subparagraph do not include costs for courses that are part of a degree-oriented curriculum, which are only allowable pursuant to paragraphs (c) and (d) above.

(f) Other expenses. Maintenance expense and normal depreciation or fair rental on facilities owned or leased by the contractor for training purposes are allowable to the extent prescribed in 31.205-11, 31.205-24, and 31.205-36.

(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. Training and education costs in excess of (1) 156 hours per year per employee for part-time college level training or (2) one academic year for full-time postgraduate studies may be allowed to the extent set forth in an advance agreement negotiated under 31.109. To be considered for an advance agreement, the contractor must demonstrate that the costs are consistently incurred under an established engineering or scientific training and education program and that the course or degree pursued is related to the field in which employees are now working or may reasonably be expected to work.

(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

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unallowable, except that the costs incurred for educating employees 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. Generally, costs for college plans for bona-fide employee dependents are unallowable.

### **FAC 84-25 (Effective 1 July 1987)**

(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 paragraph (h) below).

(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

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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 of courses that are part of a degree-oriented curriculum, which are only allowable pursuant to paragraphs (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 31.205-11, 31.205-17, 31.205-24, and 31.205-36.

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

(h) Advance agreements.

(1) Training and education costs in excess of those otherwise allowable under (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 negotiated under 31.109. 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 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) Employee's past performance and potential;
- (iii) Whether the 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 with 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 employees 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.

### FAC 84-29 (Effective 29 August 1987)

*Change paragraph (i) as follows:*

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- (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 employees 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.

### **FAC 2001-24 (Effective July 19, 2004)**

*Delete reference to 31.205-24 in paragraph (f).*

### **FAC 2005-06 (Effective October 31, 2005)**

Costs of training and education that are related to the field in which the employee is working or may reasonably be expected to work are allowable, except as follows:

- (a) Overtime compensation for training and education is unallowable.
- (b) The cost of salaries for attending undergraduate level classes or part-time graduate level classes during working hours is unallowable, except when unusual circumstances do not permit attendance at such classes outside of regular working hours.
- (c) Costs of tuition, fees, training materials and textbooks, subsistence, salary, and any other payments in connection with full-time graduate level education are unallowable for any portion of the program that exceeds two school years or the length of the degree program, whichever is less.
- (d) Grants to educational or training institutions, including the donation of facilities or other properties, scholarships, and fellowships are considered contributions and are unallowable.
- (e) Training or education costs 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 suitable public education is not available may be included in overseas differential pay.
- (f) Contractor contributions to college savings plans for employee dependents are unallowable.

### **FAR 31.205-45 -- Transportation Costs**

#### **1984 FAR (Effective 1 April 1984)**

Allowable transportation costs include freight, express, cartage, and postage charges relating to goods purchased, in process, or delivered. When these costs can be identified with the items involved, they may be directly costed as transportation costs or added to the cost of such items. When identification with the materials received cannot be made, inbound transportation costs may be charged to the appropriate indirect cost accounts if the contractor follows a consistent

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and equitable procedure. Outbound freight, if reimbursable under the terms of the contract, shall be treated as a direct cost.

### FAC 2001-14 (Effective June 23, 2003)

*Delete the Cost Principle and mark as Reserved:*

[Reserved]

### FAR 31.205-46 -- Travel Costs

#### 1984 FAR (Effective 1 April 1984)

- (a) Costs for transportation, lodging, subsistence, and incidental expenses incurred by contractor personnel in official company business are allowable subject to paragraphs (b) through (f) below. These costs may be based upon (1) actual cost incurred, (2) per diem or mileage, or (3) a combination of (1) and (2) provided the method used does not result in an unreasonable charge.
- (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 under 31.202.
- (d) The difference in cost between first-class air accommodations and less-than-first-class air accommodations is unallowable except when less-than-first-class accommodations are not reasonably available to meet necessary mission requirements (such as when less-than-first-class accommodations would require circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased cost that would offset transportation savings, or would offer accommodations not reasonably adequate for the physical or medical needs of the traveler).
- (e) Costs of travel via contractor-owned, -leased, and -chartered aircraft are subject to the following:
  - (1) "Cost of contractor-owned, -leased, and chartered aircraft," as used in this paragraph, includes the cost of lease, charter, operation (including personnel), maintenance, depreciation, insurance, and other related costs. This cost is allowable, if reasonable, to the extent that the contractor can demonstrate that the use of the aircraft is necessary for the conduct of its business and that the increase in cost, if any, in comparison with alternative means of transportation is commensurate with the advantages gained.
  - (2) Some of the factors to consider in determining the necessity for such aircraft are whether-

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- (i) Scheduled commercial airlines or other suitable less costly travel facilities are available at reasonable times, with reasonable frequency and serving the required destinations conveniently;
  - (ii) It is likely that critical or emergency situations might arise that could not be accommodated as effectively by scheduled commercial airline or other suitable less costly travel facilities;
  - (iii) The increased flexibility in scheduling would result in time savings and more effective use of key personnel;
  - (iv) National or industrial security demands privacy for key personnel who must work enroute; and
  - (v) The contract requires flight testing of equipment.
- (3) When the need for contractor-owned, -leased, or-chartered aircraft has been demonstrated, additional factors such as the following shall be considered in determining the reasonableness of costs:
- (i) The number, type and size of aircraft needed (involved in this determination are matters such as the number and physical aspects of locations to which flights are required, distances of these locations, number of passengers to be carried, and frequency of flights).
  - (ii) The appropriateness of the method of acquisition, i.e., purchase, lease, or charter.
  - (iii) Whether, when the contractor has more than one type or size of aircraft, that available aircraft best suited to the requirements of each individual trip was used.
- (4) Where the need for contractor-owned, -leased, or-chartered aircraft has been demonstrated, optimum use of such aircraft, rather than scheduled commercial service, should be made where a cost advantage will result to the Government.

### **FAC 84-12 (Effective 20 January 1986)**

*Change first sentence in paragraph (a) as follows:*

- (a) Costs for transportation, lodging, subsistence, and incidental expenses incurred by contractor personnel in official company business are allowable subject to paragraphs (b) through (e) below.

### **FAC 84-15 (Effective 7 April 1986)**

- (a) Costs for transportation, lodging, subsistence, and incidental expenses incurred by contractor personnel in official company business are allowable subject to paragraphs (b) through (e) below. These costs may be based upon (1) actual cost incurred, (2) per diem or mileage, or (3) a combination of (1) and (2) provided the method used does not result in an unreasonable charge.
- (b) Travel costs incurred in the normal course of overall administration of the business are allowable and shall be treated as indirect costs.

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(c) Travel costs directly attributable to specific contract performance are allowable and may be charged to the contract under 31.202.

(d) Airfare costs in excess of the lowest customary standard, coach, or equivalent airfare offered during normal business hours are unallowable except when such accommodations require circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased costs 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 standard 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 paragraph (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 paragraph (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 (see 31.109), 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 paragraph, 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 31.205-6(m)(2).

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### FAC 84-19 (Effective 31 July 1986)

*Replace paragraph (a) as follows:*

(a) (1) Costs for transportation, lodging, meals, and incidental expenses incurred by contractor personnel on official company business are allowable subject to paragraphs (b) through (f) of 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 that 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, 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, D.C. 20402, Stock No. 022-001-81003-7;

(ii) Joint Travel Regulations, Volume 2, DoD Civilian Personnel, Appendix A, prescribed by the Department of Defense, for travel in Alaska, Hawaii, The Commonwealth of Puerto Rico, and territories and possessions of the United States, available on a subscription basis from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, Stock No. 906-010-00000-1; or

(iii) Standardized Regulations (Government Civilians, Foreign Areas), Section 925, "Maximum Travel Per Diem Allowances for Foreign Areas," 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, Stock No. 744-008-00000-0.

(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 (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.



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(iv) Documentation to support actual costs incurred shall be in accordance with the contractor's established practices provided that a receipt is required for each expenditure in excess of \$25.00. The approved justification required by (a)(3)(ii) and, if applicable, (a)(3)(iii) of this subparagraph must be retained.

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

(5) An advance agreement (see 31.109) with respect to compliance with subparagraphs (a)(2) and (a)(3) of this subsection may be useful and desirable.

### FAC 84-23 (Effective 30 September 1986)

*Replace subparagraph (a)(2)(ii) with the following:*

(a) (2) (ii) Joint Travel Regulations, Volume 2, DoD Civilian Personnel, Appendix A, prescribed by the Department of Defense, for travel in Alaska, Hawaii, The Commonwealth of Puerto Rico, and territories and possessions of the United States, available on a subscription basis from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, Stock No. 908-010-00000-1; or

### FAC 90-7 (Effective 23 September 1991)

(a) (1) Costs for transportation, lodging, meals, and incidental expenses incurred by contractor personnel on official company business are allowable subject to paragraphs (b) through (f) of 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 that the method used results in a reasonable charge.

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

(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 rate would normally be required under these circumstances. While these adjustments need not be calculated in accordance with the Federal Travel Regulations or Joint Travel Regulations, they must result in a reasonable charge.

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### FAC 90-11 (Effective 12 May 1992)

*Revise subparagraph (a)(6) to change the words "Joint Travel Regulations" to "Joint Travel Regulation".*

### FAC 90-39 (Effective 19 August 1996)

*Replace paragraphs (a) and (a)(3)(iv), and add (a)(7) as follows:*

(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 that the method used results in a reasonable charge.

(3) (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 in excess of \$25.00. The approved justification required by (a)(3)(ii) and, if applicable, (a)(3)(iii) of this subparagraph must be retained.

(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.

### FAC 97-3 (Effective 9 December 1997); Finalized in FAC 97-5, effective 8/21/98

*Revise paragraph (a)(3)(iv) to read as follows:*

(a) (3) (iv) Documentation to support actual costs incurred shall be in accordance with the contractor's established practices, subject to paragraph (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 paragraph (a)(3)(ii) and, if applicable, paragraph (a)(3)(iii) of this subsection must be retained.

### FAC 2001-14 (Effective June 23, 2003)

*Revise paragraph (a)(2)(i) & (ii) to read as follows:*

(i) Federal Travel Regulations, prescribed by the General Services Administration, for travel in the contiguous United States, available on a subscription basis from the—

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- (ii) Joint Travel Regulation, Volume 2, DoD Civilian Personnel, Appendix A, prescribed by the Department of Defense, for travel in Alaska, Hawaii, and outlying areas of the United States, available on a subscription basis from the—

### **FAC 2001-16 (Effective October 31, 2003)**

*Remove paragraphs (b) and (c), and redesignate paragraphs (d), (e), and (f) as (b), (c), and (d), respectively; and in the introductory text of newly designated paragraph (c)(2), remove “paragraph (d)” each time it appears (twice) and add “paragraph (b)” in their place; and remove “subparagraph (e)(3)” and add “paragraph (c)(3)” in its place.*

### **FAR 31.205-47 – Costs Related to Legal and Other Proceedings**

#### **1984 FAR (Effective 1 April 1984)**

(a) Definitions. "Costs," as used in this subsection, include, but are not limited to, administrative and clerical expenses; the cost 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; the salaries and wages of employees, officers, and directors; and any of the foregoing costs incurred before commencing the formal judicial or administrative proceedings which bear a direct relationship to the proceedings.

"Fraud," as used in this subsection, means (1) acts of fraud or corruption or attempts to defraud the Government or to corrupt its agents, (2) acts which constitute a cause for debarment or suspension under 9.406-2(a) and 9.407-2(a) and (3) acts which violate the False Claims Act, 31 U.S.C., sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

(b) Costs incurred in connection with defense of any (1) criminal or civil investigation, grand jury proceeding or prosecution, (2) civil litigation, or (3) suspension, debarment or other administrative proceedings, or any combination of the foregoing, brought by the Government against a contractor, its agent or employee, are unallowable when the charges, which are the subject of the investigation, proceedings, or prosecution, involve fraud on the part of the contractor, its agent or employee, as defined below, and result in conviction (including conviction entered on a plea of nolo contendere), judgment against the contractor, its agent or employees, or decision to debar or suspend, or are resolved by consent or compromise.

(c) In circumstances where the charges of fraud are resolved by consent or compromise, the parties may agree as to the extent of allowability of such costs as a part of such resolution.

(d) Costs which may be unallowable under 31.205-47 shall be differentiated and accounted for by the contractor so as to be separately identifiable. During the pendency of any proceeding or investigation covered by paragraph (b) above, the contracting officer should generally withhold payment of such costs. However, the contracting officer may in appropriate circumstances provide for conditional payment upon provision of adequate security, or other

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adequate assurance, and agreement by the contractor to repay all unallowable costs, plus interest, if a conviction or judgment is rendered against it.

### **FAC 84-12 (Effective 20 January 1986)**

*Change paragraph (b) as follows:*

(b) Costs incurred in connection with defense of any (1) criminal or civil investigation, grand jury proceeding or prosecution, (2) civil litigation, or (3) suspension, debarment or other administrative proceedings, or any combination of the foregoing, brought by the Government against a contractor, its agent or employee, are unallowable when the charges, which are the subject of the investigation, proceedings, or prosecution, involve fraud on the part of the contractor, its agent or employee, as defined above, and result in conviction (including conviction entered on a plea of nolo contendere), judgment against the contractor, its agent or employees, or decision to debar or suspend, or are resolved by consent or compromise.

### **FAC 84-15 (Effective 7 April 1986)**

*Change paragraphs (b) and (d) as follows:*

(b) Costs incurred in connection with defense of any (1) criminal or civil investigation, grand jury proceeding, or prosecution; (2) civil litigation; or (3) administrative proceedings such as suspension or debarment, or any combination of the foregoing, brought by the Government against a contractor, its agents or employees, are unallowable when the charges, which are the subject of the investigation, proceedings, or prosecution, involve fraud or similar offenses (including filing a false certification) on the part of the contractor, its agents or employees, and result in conviction (including conviction entered on a plea of nolo contendere), judgment against the contractor, its agents or employees, or decision to debar or suspend, or are resolved by consent or compromise.

(d) Costs which may be unallowable under 31.205-47, including directly associated costs, shall be differentiated and accounted for by the contractor so as to be separately identifiable. During the pendency of any proceeding or investigation covered by paragraph (b) of this subsection, the contracting officer should generally withhold payment of such costs. However, the contracting officer may in appropriate circumstances 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 a conviction or judgment is rendered against it.

### **FAC 84-44 (Effective 17 April 1989)**

(a) Definitions. "Conviction," as used in this subsection, is defined in 9.403.

"Costs," include, but are not limited to, administrative and clerical expenses; the cost 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; all elements of

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compensation, related costs, and expenses 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 proceedings. "Fraud," as used in this subsection, means (1) acts of fraud or corruption or attempts to defraud the Government or to corrupt its agents, (2) acts which constitute a cause for debarment or suspension under 9.406-2(a) and 9.407-2(a) and (3) acts which violate the False Claims Act, 31 U.S.C. sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

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

"Proceeding," includes an investigation.

(b) Costs incurred in connection with any proceeding brought by Federal, State, local or foreign Government for violation or, or a failure to comply with, law or regulation by the contractor (including its agents or employees) are unallowable if a result is-

(1) In a criminal proceeding, a conviction;  
(2) In a civil or administrative proceeding, either a finding of contractor liability or imposition of a monetary penalty;

(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 paragraphs (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) To the extent they are not otherwise unallowable, costs incurred in connection with any proceeding under paragraph (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 paragraph (b) of this subsection, may be allowed to the extent specifically provided in such agreement.

(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.

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(e) Costs incurred in connection with proceedings described in paragraph (b) of this subsection, but which are not made unallowable by that paragraph, 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. However, if an agreement reached under paragraph (c) of this subsection has explicitly considered this 80 percent rule, then the full amount of costs resulting from that agreement shall be allowable.

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

- (1) Defense against Government claims or appeals or the prosecution of claims or appeals against the Government (see 33.201).
- (2) Organization, reorganization, (including mergers and acquisitions) or resisting mergers and acquisitions (see also 31.205-27).
- (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 (1) an agreement or contract concerning a teaming arrangement, a joint venture, or similar arrangement of shared interest; or (2) dual sourcing, coproduction, or similar programs, are unallowable, except when (i) incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer, or (ii) 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.

(g) Costs which may be unallowable under 31.205-47, including directly associated costs, shall be segregated and accounted for by the contractor separately. During the pendency of any proceeding covered by paragraph (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 the provisions 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.

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### FAC 90-3 (Effective 22 January 1991)

*Replace paragraphs (a), (b), and (f)(1) as follows:*

- (a) Definitions. "Conviction," as used in this subsection, is defined in 9.403.

"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.

"Fraud," as used in this subsection, means (1) acts of fraud or corruption or attempts to defraud the Government or to corrupt its agents, (2) acts which constitute a cause for debarment or suspension under 9.406-2(a) and 9.407-2(a) and (3) acts which violate the False Claims Act, 31 U.S.C. sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

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

"Proceeding," includes an investigation.

- (b) Costs incurred in connection with any proceeding brought by Federal, State, local or foreign Government for violation or, or a failure to comply with, law or regulation by the contractor (including its agents or employees) 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 a 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 paragraphs (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.

- (f) (1) Defense against Federal Government claims or appeals or the prosecution of claims or appeals against the Federal Government (see 33.201).

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### **FAC 90-41 (Effective 7 October 1996)**

*Add paragraph (f)(8) as follows:*

(f) (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.

### **FAC 97-9 (Effective 29 December 1998)**

*Revise the introductory text of paragraph (b); redesignate (c) as (c)(1) and add (c)(2); and revise paragraph (e)(3) to read as follows:*

(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--

(c) (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.

(e) (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 paragraph (c) of this subsection shall be subject to this limitation. If, however, an agreement described in paragraph (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 paragraph (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.

### **FAC 97-21 (Effective January 19, 2001; stayed by FAC 97-24, effective April 3, 2001; rescinded by FAC 2001-03, effective December 27, 2001)**

(b) \* \* \*

(2) In a civil or administrative proceeding, a finding that the contractor violated, or failed to comply with, a law or regulation;



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### FAC 1999-403 (Effective March 12, 2001, delayed until May 11, 2001 by executive order)

*Amend section 31.205-47 in the heading of paragraph (a) by adding ``As used in this subpart--" after ``Definitions.", and by removing the definition ``Conviction"; and in paragraph (f)(5) by redesignating paragraphs (i) & (ii) as (A) and (B), and (1) and (2) as (i) and (ii), respectively. The added text reads as follows:*

#### **31.205-47 Costs related to legal and other proceedings.**

(a) Definitions. As used in this subpart--

\* \* \* \* \*

### **FAR 31.205-48 -- Deferred Research And Development Costs**

#### **1984 FAR (Effective 1 April 1984)**

"Research and development," as used in this subsection, means the type of technical effort which is described in 31.205-18 but which is sponsored by, or required in performance of, a contract or grant. Research and development costs (including amounts capitalized) that were incurred before the award of a particular contract are unallowable except when allowable as precontract costs. In addition, when costs are incurred in excess of either the price of a contract or amount of a grant for research and development effort, such excess may not be allocated as a cost to any other Government contract.

#### **FAC 97-19 (Effective September 25, 2000)**

Research and development, as used in this section, means the type of technical effort described in 31.205-18 but sponsored by a grant or required in the 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.

#### **FAC 2001-14 (Effective June 23, 2003)**

*Revise the title and paragraph to read as follows:*

#### **31.205-48 Research and development costs**

“Research and development,” as used in this subsection, means the type of technical effort described in 31.205-18 but sponsored by a grant or required in the 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.

### **FAR 31.205-49 -- Goodwill**

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### **FAC 84-3 (Effective 1 October 1984)**

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 by a portion thereof. Any costs for amortization, expensing, write-off, or write-down of goodwill (however represented) are unallowable.

### **FAR 31.205-50 -- Executive lobbying Costs**

### **FAC 84-15 (Effective 7 April 1986)**

Costs incurred in attempting to improperly influence (see FAR 3.401), either directly or indirectly, an employee or officer of the executive branch of the Federal Government to give consideration or to act regarding a regulatory or contract matter are unallowable.

### **FAC 90-39 (Effective 19 August 1996)**

*This provision is moved to FAR 31.205-22(a)(6).*

### **FAR 31.205-51 -- Costs of Alcoholic Beverages**

### **FAC 84-15 (Effective 7 April 1986)**

Costs of alcoholic beverages are unallowable.

### **FAR 31.205-52 -- Asset Valuations Resulting From Business Combinations**

### **FAC 84-58 (Effective 23 July 1990)**

When the purchase method of accounting for a business combination is used, allowable amortization, cost of money, and depreciation shall be limited to the total of the amounts that would have been allowed had the combination not taken place.

### **FAC 97-4 (Effective 24 April 1998)**

(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.

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(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.