Subpart 31.2 - Contracts with Commercial Organizations

Parent topic: Part 31 - Contract Cost Principles and Procedures

31.201 General.

31.201-1 Composition of total cost.

(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.

(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.

31.201-2 Determining allowability.

(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.

(b) Certain cost principles in this subpart incorporate the measurement, assignment, and allocability rules of selected CAS and limit the allowability of costs to the amounts determined using the criteria in those selected 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 in excess of the amount that would have resulted from using

practices consistent with this subpart are unallowable.

(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 that is inadequately supported.

31.201-3 Determining reasonableness.

(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;

(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.

31.201-4 Determining allocability.

A cost is allocable if it is assignable or chargeable to one or more *cost objectives* on the basis of relative benefits received or other equitable relationship. Subject to 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.

31.201-5 Credits.

The applicable portion of any income, rebate, allowance, or other credit relating to any allowable

cost and received by or accruing to the contractor *shall* be credited to the Government either as a cost reduction or by cash refund. See 31.205-6(j)(3) for rules governing refund or credit to the Government associated with pension adjustments and asset reversions.

31.201-6 Accounting for unallowable costs.

(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 that is generated solely as a result of incurring another cost, and that 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 that 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) of this subsection.

(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.

(d) If a *directly associated cost* is included in a cost pool that 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, and

(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 paragraph (e)(1) of this subsection (except when such salary expenses are, themselves, unallowable). The time spent in proscribed activities *should* be compared to total time spent on company activities to determine if the costs are material. Time spent by employees outside the normal working hours *should* not be considered except when it is evident that an employee engages so frequently in company activities during periods outside normal working hours as to indicate that such activities are a part of the employee's regular duties.

(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.

31.201-7 Construction and architect-engineer contracts.

Specific principles and procedures for evaluating and determining costs in connection with contracts and subcontracts for *construction*, and architect-engineer contracts related to *construction* projects, are in 31.105. The applicability of these principles and procedures is set forth in 31.000 and 31.100.

31.202 Direct costs.

(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.

(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-

(1) Is consistently applied to all *final cost objectives*; and

(2) Produces substantially the same results as treating the cost as a *direct cost*.

31.203 Indirect costs.

(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 CFR9904.406 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.,* 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.

(i) *Indirect costs* that meet the definition of "excessive pass-through charge" in 52.215-23, are unallowable.

31.204 Application of principles and procedures.

(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 redetermination 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. 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. 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 at issue.

31.205 Selected costs.

31.205-1 Public relations and advertising costs.

(a) "Public relations" means all functions and activities dedicated to-

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

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

(b) "Advertising" means the use of media to promote the sale of *products* or services and to accomplish the activities referred to in paragraph (d) of this subsection, regardless of the medium employed, when the advertiser has control over the form and content of what will appear, the media in which it will appear, and when it will appear. Advertising media include but are not limited to conventions, exhibits, free goods, samples, magazines, newspapers, trade papers, direct mail, dealer cards, window displays, outdoor advertising, radio, and television.

(c) Public relations and advertising *costs* include the *costs* of media time and space, purchased services performed by outside organizations, as well as the applicable portion of salaries, travel, and fringe benefits of employees engaged in the functions and activities identified in paragraphs (a) and (b) of this subsection.

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

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

(i) Acquiring scarce items for contract performance; or

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

(2) *Costs* of activities to promote sales of *products* normally sold to the U.S. Government, including trade shows, which contain a significant effort to promote exports from the *United States*. Such *costs* are allowable, notwithstanding paragraphs (f)(1), (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* that are used primarily for entertainment rather than product promotion; or

(3) Allowable in accordance with 31.205-34.

(e) Allowable public relations *costs* include the following:

(1) *Costs* specifically required by contract.

(2) *Costs* of-

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

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

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

(3) *Costs* of participation in community service activities (*e.g.*, blood bank drives, charity drives, savings bond drives, disaster assistance, etc.) (But see paragraph (f)(8) of this section.)

(4) *Costs* of plant tours and open houses (but see paragraph (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 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(b)(5)), or by disseminating messages calling favorable attention to the contractor for purposes of enhancing the *company* image to sell the *company*'s *products* or services.

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

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

(4) *Costs* of ceremonies such as-

(i) Corporate celebrations and

(ii) New product announcements.

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

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

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

(8) *Costs* associated with the donation of excess food to nonprofit organizations in accordance with the Federal Food Donation Act of 2008 (42 U.S.C. 1792, see subpart 26.4).

31.205-2 [Reserved]

31.205-3 Bad debts.

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

legal *costs* are unallowable.

31.205-4 Bonding costs.

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

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

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

31.205-5 [Reserved]

31.205-6 Compensation for personal services.

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

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

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

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

(4) No presumption of allowability will exist where the contractor introduces major revisions of existing compensation plans or new plans and the contractor has not provided the cognizant 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:

(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.

(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)(6) of this subsection.

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

(i) Law;

(ii) Employer-employee agreement;

(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.

(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. 3744(a)(13) and 41 U.S.C. 4304(a)(13), 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. 3744(a)(14) and 41 U.S.C. 4304(a)(14), 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. 3744(b) and 41 U.S.C. 4304(b) 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.

(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.

(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 CFR9904.412-Cost Accounting Standard for Composition and Measurement of Pension Cost, and 48 CFR9904.413-Adjustment and Allocation of Pension Cost. Pension *costs* are allowable subject to the referenced standards and the cost 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 CFR9904.412-40(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 of1974 (ERISA), will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR9904.412-50(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 CFR9904.412-50(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 CFR9904.412-50(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 CFR9904.412-50(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 CFR9904.413-50(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 CFR9904.413-50(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 CFR9904.413-50(c)(12), except the numerator of the fraction at 48 CFR9904.413-50(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 *certified 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 *certified 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 CFR9904.412-50(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 CFR9904.412 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 CFR9904.412-50(a)(2).

(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.

(l) Compensation incidental to business *acquisitions*. The following *costs* are unallowable:

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

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

(m) *Fringe benefits*.

(1) Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. Fringe benefits include, but are not limited to, the cost of vacations, sick leave, holidays, military leave, employee *insurance*, and supplemental unemployment benefit plans. Except as provided otherwise in 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(d)).

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

(o) Postretirement benefits other than pensions (PRB).

(1) PRB covers all benefits, other than cash benefits and life *insurance* benefits paid by *pension plans*, provided to employees, their beneficiaries, and covered dependents during the period

following the employees' retirement. Benefits encompassed include, but are not limited to, postretirement health care; life *insurance* provided outside a *pension plan*; and other welfare benefits such as tuition assistance, *day* care, legal services, and housing subsidies provided after retirement.

(2) To be allowable, PRB *costs 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

(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* comply with the following:

(A) Be measured and assigned in accordance with one of the following two methods described under paragraphs (o)(2)(iii)(A)(1) or (o)(2)(iii)(A)(2) of this subsection:

(1) Generally accepted accounting principles. However, transitions from the pay-as-you-go method to the accrual accounting method *must* be handled according to paragraphs (o)(2)(iii)(A)(1)(i) through (iii) of this subsection.

(i) In the year of transition from the pay-as-you-go method to accrual accounting for purposes of Government contract cost accounting, the transition obligation *shall* be the excess of the accumulated PRB obligation over the fair value of plan assets determined in accordance with subparagraph (E) of this section; the fair value *must* be reduced by the prepayment credit as determined in accordance with subparagraph (o)(2)(iii)(F) of this subsection.

(ii) PRB cost attributable to the transition obligation assigned to the current year that is in excess of the amount assignable to accounting periods on the basis of a straight line amortization of the transition obligation over the average remaining working lives of active employees covered by the PRB plan or a 20-year period, whichever period is longer, is unallowable. However, if the plan is comprised of inactive participants only, the PRB cost attributable to the transition obligation assigned to the current year that is in excess of the amount assignable to accounting periods on a straight line amortization of the transition obligation over the average future life expectancy of the participants is unallowable.

(iii) For a plan that transitioned from pay-as-you-go to accrual accounting for Government contract cost accounting prior to July 22, 2013, the unallowable amount of PRB cost attributable to the transition obligation amortization *shall* continue to be based on the cost principle in effect at the

time of the transition until the original transition obligation schedule is fully amortized.

(2) Contributions to a *welfare benefit fund* determined in accordance with applicable Internal Revenue Code. Allowable PRB *costs* based on such contributions *shall*-

(i) Be measured using reasonable actuarial assumptions, which *shall* include a health care inflation assumption unless prohibited by the Internal Revenue Code provisions governing *welfare benefit funds*;

(ii) Be assigned to accounting periods on the basis of the average working lives of active employees covered by the PRB plan or a 15 year period, whichever period is longer. However, if the plan is comprised of inactive participants only, the cost *shall* be spread over the average future life expectancy of the participants; and

(iii) Exclude Federal income taxes, whether incurred by the fund or the contractor (including any increase in PRB *costs* associated with such taxes), unless the fund holding the plan assets is tax-exempt under the provisions of 26 USC 501(c).

(B) 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 assets *shall* be segregated in the trust, or otherwise effectively restricted, so that they cannot be used by the employer for other purposes.

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

(D) Eliminate from *costs* of current and future periods the accumulated value of any prior period *costs* that were unallowable in accordance with paragraph (o)(3) of this section, adjusted for interest under paragraph (o)(4) of this section.

(E) Calculate the unfunded actuarial liability (unfunded accumulated postretirement benefit obligation) using the market (fair) value of assets that have been accumulated by funding *costs* assigned to prior periods for contract accounting purposes.

(F) Recognize as a prepayment credit the market (fair) value of assets that were accumulated by deposits or contributions that were not used to fund *costs* assigned to previous periods for contract accounting purposes.

(G) Comply with the following when changing from one accrual accounting method to another: the contractor *shall*-

(1) Treat the change in the unfunded actuarial liability (unfunded accumulated postretirement benefit obligation) as a gain or loss; and

(2) Present an analysis demonstrating that all *costs* assigned to prior periods have been accounted for in accordance with paragraphs (o)(2)(iii)(D), (E), and (F) of this section to ensure that no duplicate recovery of *costs* exists. Any duplicate recovery of *costs* due to the change from one method to another is unallowable. The analysis and new accrual accounting method *may* be a subject appropriate for an advance agreement in accordance with 31.109.

(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.

(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) 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.

(p) *Limitation on allowability of compensation*.

Employee Compensation Limits

Contract Award Date	**Applicable Agencies**	**Covered Employees**	**31.205-6**
Before June 24, 2014	*Executive Agencies* Other than DoD, NASA and Coast Guard	Senior Executive	(p)(2)
Before December 31, 2011	DoD, NASA and Coast Guard	Senior Executive	(p)(2)
On/after December 31, 2011, and before June 24, 2014	DoD, NASA, and Coast Guard	All Employees	(p)(3)
On/after June 24, 2014	All *Executive Agencies*	All Employees	(p)(4)

(1) *Definitions*. As used in this paragraph (p)-

(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)(4) and (q) of this subsection), for the *fiscal year*, whether paid, earned, or otherwise accruing, as recorded in the contractor's cost accounting records for the *fiscal year*.

(ii) "Senior executive" means–

(A) Prior to January 2, 1999–

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

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

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

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

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

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

(2) *Senior executive compensation limit for contracts awarded before June 24, 2014*.

(i) *Applicability*. This paragraph (p)(2) applies to the following:

(A) To all *executive agencies*, other than DoD, NASA and the Coast Guard, for contracts awarded before June 24, 2014;

(B) To DoD, NASA, and the Coast Guard for contracts awarded before December 31, 2011;

(ii) *Costs* incurred after January 1, 1998, for the 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 41 U.S.C. 1127 as in effect prior to June 24, 2014, are unallowable (10 U.S.C. 3744(a)(16) and 41 U.S.C. 4304(a)(16), as in effect prior to June 24, 2014). This limitation is the sole statutory limitation on allowable senior executive compensation *costs* incurred after January 1, 1998, under contracts awarded before June 24, 2014, and applies whether or not the affected contracts were previously subject to a statutory limitation on such *costs*. (Note that pursuant to section 804 of Pub. L. 105-261, the definition of "senior executive" in paragraph (p)(1) of this section has been changed for compensation *costs* incurred after January 1, 1999.) See https://www.whitehouse.gov/wp-content/uploads/2017/11/ContractorCompensationCapContractsAwardedBeforeJune24.pdf.

(3) All employee compensation limit for contracts awarded before June 24, 2014.

(i) *Applicability*. This paragraph (p)(3) applies to DOD, NASA, and the Coast Guard for contracts awarded on or after December 31, 2011, and before June 24, 2014.

(ii) *Costs* incurred after January 1, 2012, for the compensation of any contractor employee in excess of the benchmark compensation amount, determined applicable for the contractor *fiscal year* by the Administrator, Office of Federal *Procurement* Policy (OFPP) under 41 U.S.C. 1127 as in effect prior to June 24, 2014 are unallowable (10 U.S.C. 3744(a)(16) as in effect prior to June 24, 2014.) This limitation is the sole statutory limitation on allowable employee compensation *costs* incurred after January 1, 2012, under contracts awarded on or after December 31, 2011 and before June 24, 2014. (Note that pursuant to section 803 of Pub. L. 112-81, 10 U.S.C. 3744, Allowable *costs* under defense contracts, was amended by striking "senior executives" and inserting "any contractor employee", making unallowable the excess compensation *costs* incurred after January 1, 2012, under affected contracts.) See https://www.whitehouse.gov/wp-content/uploads/2017/11/ContractorCompensationCapContractsAwardedBeforeJune24.pdf.

(4) All employee compensation limit for contracts awarded on or after June 24, 2014.

(i) *Applicability*. This paragraph (p)(4) applies to all *executive agency* contracts awarded on or after June 24, 2014, and any subcontracts thereunder.

(ii) *Costs* incurred on or after June 24, 2014, for the compensation of all employees in excess of the benchmark compensation amount determined applicable for the contractor *fiscal year* by the Administrator, Office of Federal *Procurement* Policy (OFPP) are unallowable under 10 U.S.C. 3744(a)(16) and 41 U.S.C 4304(a)(16), as in effect on or after June 24, 2014, pursuant to section 702 of Pub. L. 113-67. This limitation is the sole statutory limitation on allowable employee compensation *costs* incurred on or after June 24, 2014, under contracts awarded on or after June 24, 2014. See http://www.whitehouse.gov/omb/procurement/cecp.

(iii) Exceptions. An *agency head may* establish one or more narrowly targeted exceptions for scientists, engineers, or other specialists upon a determination that such exceptions are needed to ensure that the *executive agency* has continued access to needed skills and capabilities. In making such a determination, the agency *shall* consider, at a minimum, for each contractor employee in a narrowly targeted excepted position-

(A) The amount of taxpayer funded compensation to be received by each employee; and

(B) The duties and services performed by each employee.

(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) The contractor measures, assigns, and *allocates costs* in accordance with 48 CFR 9904.415.

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

(iii) 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.

(iv) 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.

(v) 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.

31.205-7 Contingencies.

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

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

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

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

(2) Those that *may* arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government; *e.g.,* results of pending litigation. Contingencies of this category are to be excluded from cost estimates under the several items of cost, but *should* be disclosed separately (including the basis upon which the contingency is computed) to facilitate the negotiation of appropriate contractual coverage. (See, for example, 31.205-6(g) and 31.205-19.)

31.205-8 Contributions or donations.

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

31.205-9 [Reserved]

31.205-10 Cost of money.

(a) *General*. Cost of money-

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

(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 CFR9904.414); and

(ii) Cost of money as an element of the cost of capital assets under *construction* (48 CFR9904.417).

(b) Cost of money is allowable, provided-

(1) It is measured, assigned, and allocated to contracts in accordance with 48 CFR9904.414 or

measured and added to the cost of capital assets under *construction* in accordance with 48 CFR9904.417, 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.

31.205-11 Depreciation.

(a) *Depreciation* on a contractor's plant, equipment, and other capital *facilities* is an allowable contract cost, subject to the limitations contained in this cost principle. For tangible *personal property*, only estimated *residual values* that exceed 10 percent of the capitalized cost of the asset 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 CFR9904.409, *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 CFR9904.409 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 CFR9904.409 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 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-

(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.

(h) A "capital lease," as defined in Financial Accounting Standards Board's Accounting Standards Codification (FASB ASC) 840, Leases, is subject to the requirements of this cost principle. (See 31.205-36 for Operating Leases.) FASB ASC 840 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 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

(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.

31.205-12 Economic planning costs.

Economic planning *costs* are the *costs* of general long-range management planning that is concerned with the future overall *development* of the contractor's business and that *may* take into account the eventual possibility of economic dislocations or fundamental alterations in those markets in which the contractor currently does business. Economic planning *costs* are allowable. Economic planning *costs* do not include organization or reorganization *costs* covered by 31.205-27. See 31.205-38 for market planning *costs* other than economic planning *costs*.

31.205-13 Employee morale, health, welfare, food service, and dormitory costs and credits.

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

(1) House publications;

(2) Health clinics;

(3) Wellness/fitness centers;

(4) Employee counseling services; and

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

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

(ii) Similar types of services.

(b) *Costs* of gifts are unallowable. (Gifts do not include awards for performance 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 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.

31.205-14 Entertainment costs.

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

31.205-15 Fines, penalties, and mischarging costs.

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

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

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

(a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) of depreciable property *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 (f) 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).

(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(h)(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 capital leases (see 31.205-11(h)), *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.

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

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

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

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

(ii) Recognize the gain or loss in the period of disposition, in which case the Government *shall* participate to the same extent as outlined in paragraph (e)(1) of this subsection.

(f) 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.

(g) 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.

(h) 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*.

(i) 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.

31.205-17 Idle facilities and idle capacity costs.

(a) *Definitions*. As used in this subsection-

Costs of idle facilities or idle capacity means *costs* such as maintenance, repair, housing, rent, and other related *costs*; *e.g.,* property taxes, *insurance*, and *depreciation*.

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

Idle facilities means completely unused *facilities* that are excess to the contractor's current needs.

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

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

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

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

(a) *Definitions.* As used in this subsection-

Applied research 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 (see 2.101).

Bid and proposal (B&P) costs 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 means all divisions, subsidiaries, and *affiliates* of the contractor under common control.

Development 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 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*.

Systems and other concept formulation studies 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 CFR9904.420 except 48 CFR 9904.420-50(e)(2) and 48 CFR 9904.420-50(f)(2) , which are not then applicable. However, non-CAS-covered or modified CAS-covered contracts awarded at a time the contractor has CAS-covered contracts requiring compliance with 48 CFR 9904.420, *shall* be subject to all the requirements of 48 CFR 9904.420. When the requirements of 48 CFR 9904.420-50(e)(2) and 48 CFR 9904.420-50(f)(2) are not applicable, the following apply:

(i) IR&D and *B&P costs shall* be allocated to *final cost objectives* on the same basis of allocation used for the G&A expense grouping of the *profit center* (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 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*.

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

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

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

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

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

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

(e) Cooperative arrangements.

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

(i) Section 12 of the Stevenson-Wydler Technology Transfer Act of1980 (15 U.S.C. 3710(a));

(ii) Sections203(c)(5) and (6) of the National Aeronautics and Space Act of1958, as amended (42 U.S.C. 2473(c)(5) and (6));

(iii) 10 U.S.C. 4021 for the Defense Advanced Research Projects Agency; or

(iv) Other equivalent authority.

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

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

31.205-19 Insurance and indemnification.

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

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

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

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

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

(1) The contractor *shall* measure, assign, and *allocate costs* in accordance with 48 CFR9904.416, 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 CFR9904.416.

(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 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 Government property are allowable to the extent that-

(A) The contractor is liable for such loss;

(B) The *contracting officer* has not revoked the Government's assumption of risk (see 45.104(b)); and

(C) Such *insurance* does not cover loss of Government property that results from willful misconduct or lack of good faith on the part of any of the contractor's managerial personnel (as described in FAR 52.245-1(h)(1)(ii)).

(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 of1974 are unallowable.

31.205-20 Interest and other financial costs.

Interest on borrowings (however represented), bond discounts, *costs* of financing and refinancing capital (net worth plus long-term liabilities), legal and professional fees paid in connection with preparing prospectuses, and *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.

31.205-21 Labor relations costs.

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

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

(1) Preparing and distributing materials;

(2) Hiring or consulting legal counsel or consultants;

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

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

31.205-22 Lobbying and political activity costs.

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

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

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

(3) Any attempt to influence-

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

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

(4) Any attempt to influence-

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

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

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

(6) *Costs* incurred in attempting to improperly influence (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.

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

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

(2) Any lobbying made unallowable by 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.

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

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

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

31.205-23 Losses on other contracts.

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

31.205-24 [Reserved]

31.205-25 Manufacturing and production engineering costs.

(a) The *costs* of manufacturing and production engineering effort as described in (1) through (4) of this paragraph 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* and bid and *proposal costs*; and

(2) *Development* effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques that are intended for sale is also governed by 31.205-18.

(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*.

31.205-26 Material costs.

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

(b) The contractor *shall*-

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

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

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

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

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

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

(2) The item being transferred qualifies for an exception under 15.403-1(b) and the *contracting officer* has not determined the price to be unreasonable.

(f) When a *commercial product* or *commercial service* under paragraph (e) of this section is sold or 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.

31.205-27 Organization costs.

(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 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.

31.205-28 Other business expenses.

The following types of recurring *costs* are allowable:

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

(b) Cost of shareholders' meetings.

(c) Normal proxy *solicitations*.

(d) Preparing and publishing reports to shareholders.

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

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

(g) Other similar *costs*.

31.205-29 Plant protection costs.

Costs of items such as-

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

(b) *Depreciation* on plant protection capital assets, and

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

31.205-30 Patent costs.

(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):

(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.)

31.205-31 Plant reconversion costs.

Plant reconversion *costs* are those incurred in restoring or rehabilitating the contractor's *facilities* to approximately the same condition existing immediately before the start of the Government contract, fair wear and tear excepted. Reconversion *costs* are unallowable except for the cost of removing Government property and the restoration or rehabilitation *costs* caused by such removal. However, in special circumstances where equity so dictates, additional *costs may* be allowed to the extent agreed upon before *costs* are incurred. Care *should* be exercised to avoid duplication through allowance as contingencies, additional profit or fee, or in other contracts.

31.205-32 Precontract costs.

Precontract *costs* means *costs* 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. These *costs* are allowable to the extent that they would have been allowable if incurred after the date of the contract (see 31.109).

31.205-33 Professional and consultant service costs.

(a) *Definition.* "Professional and consultant services," as used in this subsection, means 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.,* 52.215-1(e), 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.

(3) Any other services obtained, performed, or otherwise resulting in violation of any statute or regulation prohibiting improper business practices or conflicts of interest.

(4) Services performed which are not consistent with the purpose and scope of the services contracted for or otherwise agreed to.

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

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

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

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

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

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

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

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

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

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

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

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

(3) The retainer fee is reasonable in comparison with maintaining an in-house capability to perform

the covered services, when factors such as cost and level of expertise are considered; and

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

(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)). However, retainer agreements generally are not based on specific statements of work. Evidence necessary to determine that work performed is proper and does not violate law or regulation *shall* include-

(1) Details of all agreements (*e.g.,* work requirements, rate of compensation, and nature and amount of other expenses, if any) with the individuals or organizations providing the services and details of actual services performed;

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

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

31.205-34 Recruitment costs.

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

(1) *Costs* of help-wanted advertising.

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

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

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

(5) Travel *costs* of applicants for interviews.

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

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

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

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

31.205-35 Relocation costs.

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

(1) *Costs* of travel of the employee and members of the employee's immediate family (see 31.205-46)

and transportation of the household and personal effects to the new location.

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

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

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

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

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

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

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

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

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

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

(8) Rental differential payments covering situations where relocated employees retain ownership of a vacated home in the old location and rent at the new location. The rented quarters at the new location *must* be comparable to those vacated, and the allowable differential payments *may* not exceed the actual rental *costs* for the new home, less the fair market rent for the vacated home times 3 years.

(9) *Costs* of canceling an unexpired lease.

(10) Payments for increased employee income or Federal *Insurance* Contributions Act (26 U.S.C.Chapter21) 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 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.

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

(c) The following types of *costs* are unallowable:

(1) Loss on the sale of a home.

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

(i) Real estate brokers' fees and commissions.

(ii) *Costs* of litigation.

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

(iv) Mortgage life *insurance*.

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

(vi) Property taxes and operating or maintenance *costs*.

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

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

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

(e) Subject to the requirements of 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).

31.205-36 Rental costs.

(a) This subsection is applicable to the cost of renting or leasing real or *personal property* acquired under "operating leases" as defined in Financial Accounting Standards Board's Accounting Standards Codification (FASB ASC) 840, Leases. (See 31.205-11 for Capital Leases.)

(b) The following *costs* are allowable:

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

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

(ii) Market conditions in the area;

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

(iv) Alternatives available; and

(v) Other provisions of the agreement.

(2) Rental *costs* under a sale and leaseback arrangement only up to the amount the contractor would

be allowed if the contractor retained title, 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).

(3) Charges in the nature of rent for property between any divisions, subsidiaries, or organizations under common control, to the extent that they do not exceed the *normal costs* of ownership, such as *depreciation*, taxes, *insurance*, *facilities capital cost of money*, and maintenance (excluding interest or other *unallowable costs* pursuant to 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 paragraph (b)(1) of this subsection.

(c) The allowability of rental *costs* under unexpired leases in connection with terminations is treated in 31.205-42(e).

31.205-37 Royalties and other costs for use of patents.

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

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

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

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

(4) The patent is expired.

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

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

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

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

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

(d) See 31.109 regarding advance agreements.

31.205-38 Selling costs.

(a) "Selling" is a generic term encompassing all efforts to market the contractor's *products* or services, some of which are covered specifically in other subsections of 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 is defined at 31.205-1(b), and advertising *costs* 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 definition 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 provisions of that subsection.

(4) *Market planning*. Market planning involves *market research* and analysis and general management planning concerned with *development* of the contractor's business. Long-range market planning *costs* are subject to the allowability provisions of 31.205-12. Other market planning *costs* are allowable.

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

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

31.205-39 Service and warranty costs.

Service and *warranty costs* include those arising from fulfillment of any contractual obligation of a contractor to provide services such as installation, training, correcting defects in the *products*, replacing defective parts, and making refunds in the case of inadequate performance. When not inconsistent with the terms of the contract, 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.

31.205-40 Special tooling and special test equipment costs.

(a) The terms " *special tooling*" and " *special test equipment*" are defined in 2.101.

(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.

(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.

31.205-41 Taxes.

(a) The following types of *costs* are allowable:

(1) Federal, State, and local taxes (see part 29), except as otherwise provided in paragraph (b) of this section that are required to be and are paid or accrued in accordance with generally accepted accounting principles. Fines and *penalties* are not considered taxes.

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

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

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

(A) Determine the legality of the assessment or

(B) Secure a refund of such taxes.

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

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

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

(1) Federal income and excess profits taxes.

(2) Taxes in connection with financing, refinancing, refunding operations, or reorganizations (see 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.

(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) of this section).

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

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

(8) Any tax imposed under 26 U.S.C. 5000 C.

(c) Taxes on property (see paragraph (b)(5) of this section) used solely in connection with either non-Government or Government work *should* be considered directly applicable to the respective category of work unless the amounts involved are insignificant or comparable results would otherwise be obtained; *e.g.,* taxes on contractor-owned work-in-process which is used solely in connection with non-Government work *should* be allocated to such work; taxes on contractor-owned work-in-process inventory (and Government-owned work-in-process inventory when taxed) used solely in connection with Government work *should* be charged to such work. The cost of taxes incurred on property used in both Government and non-Government work *shall* be apportioned to all such work based upon the use of such property on the respective *final cost objectives*.

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

31.205-42 Termination costs.

Contract terminations generally give rise to the incurrence of *costs* or the need for special treatment of *costs* that would not have arisen had the contract not been terminated. The following cost principles peculiar to termination situations are to be used in conjunction with the other cost principles in subpart 31.2:

(a) *Common items.* The *costs* of items reasonably usable on the contractor’s other work *shall* not be allowable unless the contractor submits evidence that the items could not be retained at cost without sustaining a loss. The *contracting officer should* consider the contractor’s plans and orders

for current and planned production when determining if items can reasonably be used on other work of the contractor. Contemporaneous purchases of *common items* by the contractor *shall* be regarded as evidence that such items are reasonably usable on the contractor's other work. Any acceptance of *common items* as allocable to the *terminated portion of the contract should* be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

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

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

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

(i) Excessive spoilage due to inexperienced labor;

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

(iii) Training; and

(iv) Lack of familiarity or experience with the product, materials, or manufacturing processes.

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

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

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

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

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

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

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

(3) The loss of useful value for any one terminated contract is limited to that portion of the

acquisition cost which bears the same ratio to the total *acquisition* cost as the *terminated portion of the contract* bears to the entire terminated contract and other Government contracts for which the *special tooling*, or special machinery and equipment was acquired.

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

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

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

(f) *Alterations of leased property.* The cost of alterations and reasonable restorations required by the lease *may* be allowed when the alterations were necessary for performing the contract.

(g) Settlement expenses.

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

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

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

(B) The termination and settlement of subcontracts.

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

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

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

(h) *Subcontractor claims.* Subcontractor *claims*, including the allocable portion of the *claims* common to the contract and to other work of the contractor, are generally allowable. An appropriate share of the contractor's indirect expense *may* be allocated to the amount of settlements with subcontractors; provided, that the amount allocated is reasonably proportionate to the relative benefits received and is otherwise consistent with 31.201-4 and 31.203(d). The indirect expense so allocated *shall* exclude the same and similar *costs* claimed directly or indirectly as settlement expenses.

31.205-43 Trade, business, technical and professional activity costs.

The following types of *costs* are allowable:

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

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

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

(1) *Costs* of organizing, setting up, and sponsoring the meetings, conventions, symposia, etc., including rental of meeting *facilities*, transportation, subsistence, and incidental *costs*;

(2) *Costs* of attendance by contractor employees, including travel *costs* (see 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.

31.205-44 Training and education costs.

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.

31.205-45 [Reserved]

31.205-46 Travel costs.

(a) *Costs* for transportation, lodging, meals, and incidental expenses.

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

(2) Except as provided in paragraph (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 section) *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 *contiguous United States*, available on a subscription basis from the-

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Stock No.922-002-00000-2;

(ii) Joint Travel Regulation, Volume2, DoD Civilian Personnel, AppendixA, 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-

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Stock No.908-010-00000-1; 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 paragraph, available on a subscription basis from the-

Superintendent of Documents

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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 section. 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 paragraphs (a)(2)(i), (ii), or (iii) of this section, *must* exist.

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

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

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

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

(5) An advance agreement (see 31.109) with respect to compliance with paragraphs (a)(2) and (3) of this subsection *may* be useful and desirable.

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

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

(ii) On partial travel days (*e.g., day* of departure and return).

Appropriate downward adjustments from the maximum per diem rates would normally be required under these circumstances. While these adjustments need not be calculated in accordance with the Federal Travel Regulation or Joint Travel Regulations, they *must* result in a reasonable charge.

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

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

(ii) Purpose of the trip; and

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

(b) Airfare *costs* in excess of the lowest priced airfare available to the contractor during normal business hours are unallowable except when such accommodations require circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased cost that would offset transportation savings, are not reasonably adequate for the physical or medical needs of the traveler, or are not reasonably available to meet mission requirements. However, in order for

airfare *costs* in excess of the above airfare to be allowable, the applicable condition(s) set forth above *must* be documented and justified.

(c)

(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 allowable airfare described in paragraph (b) of this section 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 allowable airfare listed in paragraph (b) of this section are applicable, or when an advance agreement under paragraph (c)(3) of this section 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*.

(d) *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).

31.205-47 Costs related to legal and other proceedings.

(a) *Definitions*. As used in this subsection-

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 or subcontractor 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 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., sections3729-3731, or 41 U.S.C. chapter 87, Kickbacks.

Penalty does not include restitution, reimbursement, or compensatory damages.

Proceeding includes an investigation.

(b) *Costs* incurred in connection with any *proceeding* brought by: a Federal, State, local, or foreign government for a violation of, or failure to comply with, law or regulation by the contractor or subcontractor (including its agents or employees) (41 U.S.C. 4310 and 10 U.S.C. 3750); a contractor or subcontractor employee submitting a whistleblower complaint of reprisal in accordance with 41 U.S.C. 4712 or 10 U.S.C. 4701; or a third party in the name of the *United States* under the False *Claims* Act, 31 U.S.C.3730, are unallowable if the result is-

(1) In a criminal *proceeding*, a *conviction*;

(2) In a civil or administrative *proceeding*, either a finding of contractor or subcontractor liability where the *proceeding* involves an allegation of *fraud* or similar misconduct; or imposition of a monetary *penalty*, or an order issued by the *agency head* to the contractor or subcontractor to take corrective action under 41 U.S.C. 4712 or 10 U.S.C. 4701, 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 or subcontractor;

(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 paragraphs (b)(1) through (3) of this subsection (but see paragraphs (c) and (d) of this subsection); or

(5) Not covered by paragraphs (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 paragraphs (b)(1) through (4) of this subsection.

(c)

(1) To the extent they are not otherwise unallowable, *costs* incurred in connection with any *proceeding* under 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 or subcontractor 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

(2)

(i) 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 or subcontractor 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.

(ii) In the event of disposition by consent or compromise of a *proceeding* brought by a whistleblower for alleged reprisal in accordance with 41 U.S.C. 4712 or 10 U.S.C. 4701, reasonable *costs* incurred by a contractor or subcontractor in connection with such a *proceeding* that are not otherwise unallowable by regulation or by agreement with the *United States may* be allowed if the *contracting officer*, in consultation with his or her legal advisor, determined that there was very little likelihood that the claimant would have been successful on the merits.

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

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

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

(e) *Costs* incurred in connection with *proceedings* described in 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. 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.

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

(1) Defense against Federal Government *claims* or appeals or the prosecution of *claims* or appeals against the Federal Government (see 2.101).

(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 or subcontractor under section 2 of the Major *Fraud* Act of 1988 where the contractor or subcontractor 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 or subcontractors arising from either—

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

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

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

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

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

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

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

(9) A Congressional investigation or inquiry into an issue that is the subject matter of a *proceeding* resulting in a disposition as described in paragraphs (b)(1) through (5) of this section (see 10 U.S.C. 3744(a)(17)).

(g) *Costs* which *may* be unallowable under 31.205-47, including *directly associated costs*, *shall* be segregated and accounted for by the contractor or subcontractor separately. During the pendency of any *proceeding* covered by paragraph (b) and paragraphs (f)(4) and (f)(7) of this subsection, the *contracting officer shall* generally withhold payment of such *costs*. However, if in the best interests of the Government, the *contracting officer may* provide for conditional payment upon provision of adequate security, or other adequate assurance, and agreement by the contractor or subcontractor to repay all *unallowable costs*, plus interest, if the *costs* are subsequently determined to be unallowable.

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.

31.205-49 Goodwill.

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

31.205-50 [Reserved]

31.205-51 Costs of alcoholic beverages.

Costs of alcoholic beverages are unallowable.

31.205-52 Asset valuations resulting from business combinations.

(a) For *tangible capital assets*, when the purchase method of accounting for a business combination is used, whether or not the contract or subcontract is subject to CAS, the allowable *depreciation* and cost of money *shall* be based on the capitalized asset values measured and assigned in accordance with 48 CFR9904.404-50(d), if allocable, reasonable, and not otherwise unallowable.

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