

(1) Material in amount,
 (2) Accumulated in a separate indirect cost pool, and

(3) Allocated on the basis of an appropriate direct measure of the activity or output of the function during that part of the period.

(b) The practices required by 9904.406-40(b) of this Standard shall include appropriate practices for deferrals, accruals, and other adjustments to be used in identifying the cost accounting periods among which any types of expense and any types of adjustment to expense are distributed. If an expense, such as taxes, insurance or employee leave, is identified with a fixed, recurring, annual period which is different from the contractor's cost accounting period, the Standard permits continued use of that different period. Such expenses shall be distributed to cost accounting periods in accordance with the contractor's established practices for accruals, deferrals, and other adjustments.

(c) Indirect cost allocation rates, based on estimates, which are used for the purpose of expediting the closing of contracts which are terminated or completed prior to the end of a cost accounting period need not be those finally determined or negotiated for that cost accounting period. They shall, however, be developed to represent a full cost accounting period, except as provided in paragraph (a) of this subsection.

(d) A contractor may, upon mutual agreement with the Government, use as his cost accounting period a fixed annual period other than his fiscal year, if the use of such a period is an established practice of the contractor and is consistently used for managing and controlling the business, and appropriate accruals, deferrals or other adjustments are made with respect to such annual periods.

(e) The contracting parties may agree to use an annual period which does not coincide precisely with the cost accounting period for developing the data used in establishing an allocation base: Provided,

(1) The practice is necessary to obtain significant administrative convenience,

(2) The practice is consistently followed by the contractor,

(3) The annual period used is representative of the activity of the cost accounting period for which the indirect costs to be allocated are accumulated, and

(4) The practice can reasonably be estimated to provide a distribution to cost objectives of the cost accounting period not materially different from that which otherwise would be obtained.

(f) When a transitional cost accounting period is required under the provisions of 9904.406-40(a)(3), the contractor may select any one of the following:

(1) The period, less than a year in length, extending from the end of his previous cost accounting period to the beginning of his next regular cost accounting period,

(2) A period in excess of a year, but not longer than 15 months, obtained by combining the period described in paragraph (f)(1) of this subsection with the previous cost accounting period, or

(3) A period in excess of a year, but not longer than 15 months, obtained by combining the period described in paragraph (f)(1) of this subsection with the next regular cost accounting period.

A change in the contractor's cost accounting period is a change in accounting practices for which an adjustment in the contract price may be required in accordance with paragraph (a)(4) (ii) or (iii) of the contract clause set out at 9903.201-4(a).

9904.406-60 Illustrations.

(a) A contractor allocates general management expenses on the basis of total cost input. In a proposal for a covered negotiated fixed-price contract, he estimates the allocable expenses based solely on the estimated amount of the general management expense pool and the amount of the total cost input base estimated to be incurred during the 8 months in which performance is scheduled to be commenced and completed. Such a proposal would be in violation of the requirements of this Standard that the calculation of the amounts of both the indirect cost pools and the allocation bases be based on the contractor's cost accounting period.

(b) A contractor whose cost accounting period is the calendar year, installs

a computer service center to begin operations on May 1. The operating expense related to the new service center is expected to be material in amount, will be accumulated in a separate indirect cost pool, and will be allocated to the benefiting cost objectives on the basis of measured usage. The total operating expenses of the computer service center for the 8-month part of the cost accounting period may be allocated to the benefiting cost objectives of that same 8-month period.

(c) A contractor changes his fiscal year from a calendar year to the 12-month period ending May 31. For financial reporting purposes, he has a 5-month transitional "fiscal year." The same 5-month period must be used as the transitional cost accounting period; it may not be combined as provided in 9904.406-50(f), because the transitional period would be longer than 15 months. The new fiscal year must be adopted thereafter as his regular cost accounting period. The change in his cost accounting period is a change in accounting practices; adjustments of the contract prices may thereafter be required in accordance with paragraph (a)(4) (ii) or (iii) of the contract clause at 9903.201-4(a).

(d) Financial reports to stockholders are made on a calendar year basis for the entire contractor corporation. However, the contracting segment does all internal financial planning, budgeting, and internal reporting on the basis of a "model year." The contracting parties agree to use a "model year" and they agree to overhead rates on the "model year" basis. They also agree on a technique for prorating fiscal year assignment of corporate home office expenses between model years. This practice is permitted by the Standard.

(e) Most financial accounts and contract cost records are maintained on the basis of a fiscal year which ends November 30 each year. However, employee vacation allowances are regularly managed on the basis of a "vacation year" which ends September 30 each year. Vacation expenses are estimated uniformly during each "vacation year." Adjustments are made each October to adjust the accrued liability to actual, and the estimating rates are

modified to the extent deemed appropriate. This use of a separate annual period for determining the amounts of vacation expense is permitted under 9904.406-50(b).

9904.406-61 Interpretation.

(a) Questions have arisen as to the allocation and period cost assignment of certain contract costs (primarily under defense contracts and subcontracts). This section deals primarily with the assignment of restructuring costs to cost accounting periods. In essence, it clarifies whether restructuring costs are to be treated as an expense of the current period or as a deferred charge that is subsequently amortized over future periods.

(b) *Restructuring costs* as used in this Interpretation means costs that are incurred after an entity decides to make a significant nonrecurring change in its business operations or structure in order to reduce overall cost levels in future periods through work force reductions, the elimination of selected operations, functions or activities, and/or the combination of ongoing operations, including plant relocations. Restructuring activities do not include ongoing routine changes an entity makes in its business operations or organizational structure. Restructuring costs are comprised both of direct and indirect costs associated with contractor restructuring activities taken after a business combination is effected or after a decision is made to execute a significant restructuring event not related to a business combination. Typical categories of costs that have been included in the past and may be considered in the future as restructuring charges include severance pay, early retirement incentives, retraining, employee relocation, lease cancellation, asset disposition and write-offs, and relocation and rearrangement of plant and equipment. Restructuring costs do not include the cost of such activities when they do not relate either to business combinations or to other significant nonrecurring restructuring decisions.

(c) The costs of betterments or improvements of capital assets that result from restructuring activities shall