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Part IV

**Department of Defense
General Services
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**National Aeronautics and
Space Administration**

48 CFR Parts 2 and 31

**Federal Acquisition Regulation; General
Provisions of the Cost Principles;
Proposed Rule**

DEPARTMENT OF DEFENSE**GENERAL SERVICES
ADMINISTRATION****NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION****48 CFR Parts 2 and 31**

[FAR Case 2001-034]

RIN 9000-AJ60

**Federal Acquisition Regulation;
General Provisions of the Cost
Principles**

AGENCIES: Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Proposed rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) are proposing to amend the general provisions of the cost principles contained in the Federal Acquisition Regulation (FAR).

DATES: Interested parties should submit comments in writing on or before April 7, 2003 to be considered in the formulation of a final rule.

ADDRESSES: Submit written comments to—General Services Administration, FAR Secretariat (MVA), 1800 F Street, NW., Room 4035, ATTN: Laurie Duarte, Washington, DC 20405.

Submit electronic comments via the Internet to—farcase.2001-034@gsa.gov. Please submit comments only and cite FAR case 2001-034 in all correspondence related to this case.

FOR FURTHER INFORMATION CONTACT: The FAR Secretariat, Room 4035, GS Building, Washington, DC 20405, at (202) 501-4755 for information pertaining to status or publication schedules. For clarification of content, contact Mr. Ralph De Stefano at (202) 501-1758. Please cite FAR case 2001-034.

SUPPLEMENTARY INFORMATION:**A. Background**

The Councils have performed an analysis of the general provisions at FAR 31.106-2, Exceptions to general rule on allowability and allocability; FAR 31.201-1, Composition of total cost; FAR 31.201-2, Determining allowability; FAR 31.202, Direct costs; and FAR 31.203, Indirect costs, and propose the following revisions:

1. *FAR 31.106-2.* When the contractor's usual method of allocating indirect costs to a facilities contract will

yield inequitable results, the current language at paragraph (b) requires a contractor to vary its usual method and make appropriate adjustments to the indirect cost pool and base. This requirement is intended to provide the special treatment needed to produce an equitable allocation of cost to applicable facilities contracts. Although FAR 31.106-2 requires appropriate adjustments to the indirect cost pool and base, this subsection does not provide sufficient detail as to how the contractor must make the adjustment.

Therefore, the Councils propose to amend this subsection to explicitly recognize the concept of special allocations for application to facilities contracts that are not subject to full Cost Accounting Standards (CAS) coverage. The CAS provide for special allocations in 48 CFR 9904.403—Allocation of Home Office Expenses in Segments (CAS 403), 48 CFR 9904.410—Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives (CAS 410), 48 CFR 9904.418—Allocation of Direct and Indirect costs (CAS 418), and 48 CFR 9904.420—Accounting for Independent Research and Development Costs and Bid and Proposal Costs (CAS 420). The proposed special allocation provisions provide the treatment that the contractor must use to produce an equitable allocation to applicable facilities contracts.

In addition, proposed language has been added to provide the specific methodology to be used when employing the concept of a special allocation. In conjunction with these changes, the Councils propose a new title, "Special allocations," which is more descriptive of the revised subsection.

2. *FAR 31.201-1.* This subsection was revised to delete unnecessary language that is adequately addressed elsewhere in the FAR, CAS, or generally accepted accounting principles (GAAP).

3. *FAR 31.201-2.* The rule revises paragraph (a) to clarify that costs must meet all five requirements in order to be reimbursable by the Government.

4. *FAR 31.202.* The rule adds a definition in FAR Part 2 for direct costs that is virtually identical to the definition at 48 CFR 9904.418-30(a)(2). Consequently, language in FAR Part 31 that duplicates the language in the new definition has been removed from paragraph 31.203(a).

5. *FAR 31.203.* The proposed rule removes the reference to CAS and GAAP since the subject matter is adequately addressed in FAR 31.201-2. The rule revises paragraph (e) of 31.203 to recognize that a transition period

longer or shorter than 12 months may be appropriate in special circumstances. The rule revises paragraphs (c) and (f) to include the concept of a special allocation contained in CAS 403, 410, 418, and 420, since the Councils recognize there are other special situations, in addition to Government-owned contractor-operated facilities, in which the contractor's established accounting practices may not yield an equitable allocation to a particular intermediate or final cost objective. The proposed special allocation provisions provide the treatment that the contractor must use to produce an equitable allocation in these special situations, including the specific methodology for adjusting the indirect cost pool and its applicable allocation base.

6. *Other editorial changes.* The rule makes other editorial changes, including revising the definition of "indirect cost" in FAR 2.101, changing the term "distributing" to "allocating," and changing the phrase "several cost objectives" to "intermediate or final cost objectives" to be consistent with the terminology used in CAS and FAR Part 31.

This is not a significant regulatory action and, therefore, was not subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

B. Regulatory Flexibility Act

The Councils do not expect this proposed rule to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because most contracts awarded to small entities use simplified acquisition procedures or are awarded on a competitive, fixed-price basis, and do not require application of the general provisions relating to cost principles that are discussed in this rule. An Initial Regulatory Flexibility Analysis has, therefore, not been performed. We invite comments from small businesses and other interested parties. The Councils will consider comments from small entities concerning the affected FAR Parts 2 and 31 in accordance with 5 U.S.C. 610. Interested parties must submit such comments separately and should cite 5 U.S.C. 601, *et seq.* (FAR case 2001-034), in correspondence.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the proposed changes to the FAR do not impose information collection requirements that require the

approval of the Office of Management and Budget under 44 U.S.C. 3501, et seq.

List of Subjects in 48 CFR Parts 2 and 31

Government procurement.

Dated: January 30, 2003.

Ralph De Stefano,

Acting Director, Acquisition Policy Division.

Therefore, DoD, GSA, and NASA propose amending 48 CFR parts 2 and 31 as set forth below:

1. The authority citation for 48 CFR parts 2 and 31 continues to read as follows:

Authority: 40 U.S.C. 486(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

PART 2—DEFINITIONS OF WORDS AND TERMS

2. Amend section 2.101(b) by adding, in alphabetical order, the definition "Direct cost"; and by revising the definition "Indirect cost" to read as follows:

2.101 Definitions.

* * * * *

(b) * * *

Direct cost means any cost that is identified specifically with a particular final cost objective. Direct costs are not limited to items that are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.

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Indirect cost means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

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PART 31—CONTRACT COST PRINCIPLES AND PROCEDURES

3. Amend section 31.106-2 by revising the section heading and paragraphs (b) through (e) to read as follows:

31.106-2 Special allocations.

* * * * *

(b) When a facilities contract in relation to other cost objectives receives significantly more or less benefit from an indirect cost pool than would be reflected by an allocation of such costs using the contractor's normal methods, the contractor shall—

(1) Use a special allocation from that indirect cost pool to the facilities

contract commensurate with the benefits received;

(2) Exclude the amount of the special allocation from the indirect cost pool; and

(3) Exclude the allocation base data for the facilities contract from the base used to allocate the pool.

(c) The cognizant Federal agency is responsible for determining whether the conditions necessitating a special allocation exist and negotiating the terms of an advance agreement (see 31.109) implementing an appropriate special allocation.

(d) A special allocation is appropriate for—

(1) The purchase of completed facilities (or services in connection with the facilities) from outside sources. Since such purchases do not involve the contractor's direct labor or indirect plant maintenance personnel, a special allocation is appropriate for indirect manufacturing and plant overhead costs that are primarily incurred or generated by reason of direct labor or maintenance labor operations; and

(2) Contracts providing for the installation of new facilities or the rehabilitation of existing facilities that involve the use of the contractor's plant maintenance labor, as distinguished from direct labor engaged in the production of the company's normal products. A special allocation to a facilities contract that involves the use of plant maintenance labor only should recognize that such a contract receives less benefit from such cost items as direct productive labor supervision, depreciation, and maintenance expense applicable to productive machinery and equipment, or raw material and finished goods storage costs.

(e) A special allocation is not appropriate for a facilities contract that calls for the construction, production, or rehabilitation of equipment or other items that are involved in the regular course of the contractor's business using the contractor's direct labor and manufacturing processes.

4. Amend section 31.201-1 by revising paragraph (a); and by removing the word "which" from paragraph (b) and adding "that" in its place. The revised text reads as follows:

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, including standard costs properly adjusted for applicable variances.

* * * * *

5. Amend section 31.201-2 by—

a. Revising the introductory text of paragraph (a);

b. Revising paragraph (c); and

c. Removing the word "which" from the last sentence of paragraph (d) and adding "that" in its place. The revised text reads as follows:

31.201-2 Determining allowability.

(a) A cost is allowable only when all of the following requirements are met:

* * * * *

(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.

* * * * *

6. Amend section 31.202 by revising paragraph (a) and the introductory text of paragraph (b) to read as follows:

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—

* * * * *

7. Revise section 31.203 to read as follows:

31.203 Indirect costs.

(a) 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 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.

(b) 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 must 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.

(c) 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 must 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 must include in the base all items that would properly be part of the cost input base, whether allowable or unallowable, and these items must bear their pro rata share of G&A costs.

(d) The method of allocating indirect costs may require revision when significant changes occur in the nature

of the business, the extent of subcontracting, fixed-asset improvement programs, inventories, the volume of sales and production, manufacturing processes, the contractor's products, or other relevant circumstances.

(e) Separate indirect 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.

(f)(1) Where a particular cost objective in relation to other cost objectives receives significantly more or less benefit from an indirect cost pool than would be reflected by the allocation of such costs using the provisions in this section (*e.g.*, Government-owned contractor operated plants), the contractor shall—

(i) Use a special allocation from that indirect cost pool to the particular intermediate or final cost objective commensurate with the benefits received;

(ii) Exclude the amount of the special allocation to any such intermediate or final cost objective from the indirect cost pool; and

(iii) Exclude the particular intermediate or final cost objective's allocation base data from the base used to allocate the pool.

(2) The cognizant Federal agency is responsible for determining whether the conditions necessitating a special allocation exist and negotiating the terms of an advance agreement (see 31.109) implementing an appropriate special allocation.

(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 must follow the criteria and guidance in 48 CFR 9904.406 for selecting the cost accounting periods to be used in allocating indirect costs.

(2) For contracts other than those subject to paragraph (g)(1) of this section, the base period for allocating indirect costs shall be the contractor's fiscal year used for financial reporting purposes in accordance with generally accepted accounting principles. The fiscal year will normally be 12 months, but a different period may be appropriate (*e.g.*, when a change in fiscal year occurs due to a business combination or other circumstances).

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