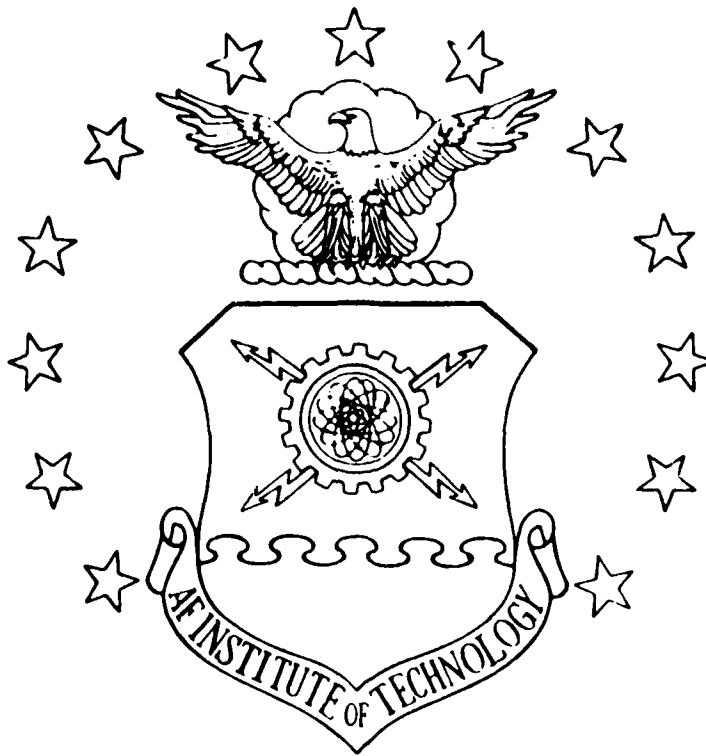


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# ADVANCED CONTRACT ADMINISTRATION

FIRST WEEK

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## AIR FORCE INSTITUTE OF TECHNOLOGY

SCHOOL OF SYSTEMS & LOGISTICS  
 Wright-Patterson Air Force Base, Ohio

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05	01				
19. ABSTRACT (Continue on reverse if necessary and identify by block number) <b>Ethics Data Sources and Modifications.</b>					
The purpose of these textbook is to assist the contracting professional in developing/improving those sources necessary to be proficient in contract administration. <div style="text-align: right; margin-top: 10px;"> <i>Keywords:</i>  <b>COORDINATION</b> </div>					
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## PREFACE

### Contract Administration

#### Cost, Schedule, Performance

The contract management field embraces numerous disciplines. They range from financial matters to delivery verification; from quality procedures to terminations due to performance failures. A professional contract administrator within the contract management field must be responsive to the contractor performing the effort; likewise the contractor must be responsive to the subcontractors in order to insure successful completion of the task.

Contract administration requires the expertise in those key areas, as well as the ability to survey and research the key areas for current and significant developments.

To assist you, the professional, in developing those sources necessary to maintain proficiency in contract administration, we have assembled this book which is a series of papers, articles, readings and reference materials on the subject of contract management.

#### ACKNOWLEDGEMENT

This book is a combination of effort put forth by a number of people. Through their efforts, they have developed a program of instruction for a study in contract administration.

**LCDR Bill Davenport**  
**Professor Eileen Donnelly**  
**LTC Loel Ewart**  
**Professor Jean Jines**  
**Maj Chester Rees**  
**Maj Richard Sand**  
**Professor Edwin J. Smithson**  
**Professor Rita Wells**  
**Professor Wehle-Einhorn**  
**Lt Col David E. Witt**

This textbook has been made possible by the dedicated work of all previous instructors and Course Directors contributing to this course. Their direction has enabled this course to continue to contribute to the development of the professional contract manager.


  
**BILLY C. COX, Maj, USAF**  
Course Director

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Section 1Course Objective

The purpose of PPM 304, Advanced Contract Administration is to provide the student the opportunity for an intensive review of areas of importance in contract management. Additionally, through the use of school and student case problems, this course provides the environment for the student to improve their ability to identify and evaluate relevant facts and analyze alternative solutions. Emphasis is placed on providing students with an opportunity to develop an attitude, a point of view, outlook or frame of mind so that they may become more responsive and responsible in the management of government contracts.

Course Description

This course emphasizes the participative methods of instruction. Lectures will be used sparingly for information and updating purposes. It is expected that students will be prepared to participate in class discussions. Students are also expected to relate and share with one another their practical experiences in order that they may expand their experience horizons. Each student will prepare and submit a written contract management workshop case. The case should be selected from firsthand contract administration experience of the student and may involve any aspect of contract management. This course is oriented toward central procurement rather than local procurement. It treats such subject areas as pricing, production management, procurement organizations, terminations, disputes, subcontractor controls and relationships, etc.

Section 2

Administrative Information

A. Useful Telephone Numbers:

Course Director: Major Billy C. Cox AFIT/LSPA (513) 255-8546  
Course Administrator: Various Instructors AUTOVON 785-8546

B. Attendance Policy:

There may be situations where emergencies occur, which may cause you to be absent from class. If that occurs, you are required to make up that day's lesson. An outline of the day's material is to be submitted for evaluation. This ensures you have obtained the key facts that the instructor discussed in class. This also allows a daily grade to be entered rather than a zero (0) for that day. If however, you miss two (2) class days, you will be disenrolled.

While attending this course, students, including local area students, are in a TDY status to AFIT and are thus responsible to, and under the supervision and administration of the Dean, School of Systems and Logistics. The Dean has prescribed that students:

(1) Will be present in class at the designated hours. The normal class day will consist of seven hours scheduled as follows:

Morning Session                    0800-1130  
Afternoon Session                1230-1600

(2) Will be excused from attendance only if ill, or as otherwise excused by the course director.

(3) Be aware that dental appointments, vehicle maintenance, committee meetings, requirements of a regularly assigned job, etc.; are not normally valid causes for class absence.

(4) Will notify the course director or the class leader of location or destination if leaving the local area during weekends.

C. Classroom dress/decorum

- a. No smoking in classrooms
- b. Do not disturb other classes during breaks
- c. Help keep the classroom clean
- d. Be attentive during class
- e. No shorts/cutoffs or sandals allowed at anytime.

D. Instructional Methods, Academic Freedom, Nonattribution:

Classroom presentations are made by faculty members of the School of Systems and Logistics. Instructional methods include lecture, discussion, demonstration, exercises and other methods of instruction.

Each student, within the bounds of courtesy and propriety, is encouraged to participate and freely discuss the subject matter presented. Case histories or examples of actual practice are for illustration and classroom discussion only and are strictly on a nonattribution basis.

(1) Academic freedom: The privilege of debate with discretion on any subject related to curricula within the school forum.

(2) Non-attribution: Treating statements made in the school forum as privileged information not to be attributed to a specific individual when outside the school forum.

E. Student Preparation: Student are expected to:

- (1) Read scheduled assignments in advance.
- (2) Remain alert and attentive in class
- (3) Take notes. Notes in your own words add greatly to your retention of material presented.
- (4) Participate actively in discussions, but please do not monopolize or sidetrack them.
- (5) Remember that some of the speakers are our guests and are contributing their time and efforts to aid our program. Treat them accordingly.

1/88

Section 4

Student Evaluation Process

Students will be evaluated on the basis of two(2) test for a total of 100 possible points. The test will account for 50% of the final grade. The breakdown is as follows:

Midterm/Final Test	50 %	50pts
Student Case Presentation	20 %	20pts
Class Participation	20 %	20pts
Class Projects	10 %	10pts
Total	<u>100 %</u>	<u>100pts</u>

Grades: Grades will be determined by the Course Director in conjunction with the course administrator and participating faculty based upon the following criteria:

<u>RECOMMEND % OF AVAILABLE POINTS</u>	<u>DEFINITION</u>	<u>GRADE</u>
90 - 100	Excellent	A
80 - 89	Good	B
70 - 79	Fair	C
60 - 69	Poor	D
Below 60	Failure	F
Incomplete		I
Withdrawal		W
Satisfactory		S
Unsatisfactory		U

1. The F grade will be given to students who fail to meet the established course requirements or standards. A student who receives a failing grade will be allowed to retake the course only with the specific permission of the course director. The I or W grades may be given to students who fail to complete a course because of illness or other valid reasons.

2. Honor Graduates: The course director may designate the honor graduate(s). The honor graduate must maintain a grade average of "A" and the selection rate cannot exceed 10% of the class student enrollment.



**STUDENT CASE  
SCORE SHEET**

Topic				Student
<b>Written</b>				
1. Organization	0	1	2	<b>Instructor Comments:</b>
2. Legibility	0	1	2	
3. Documentation	0	1	2	
4. Content	0	1	2	
5. Meets objectives of case	0	1	2	
<b>Oral</b>				
1. Organization	0	1	2	
2. Knowledge of case	0	1	2	
3. Complexity	0	1	2	
4. Clarity	0	1	2	
5. Discussion	0	1	2	

Total \_\_\_\_\_

**FINAL GRADE  
COMPUTATION**

Average Participation	(max 20 pts)	_____	
Case	(max 20 pts)	_____	
Exercise	(max 10 pts)	_____	
1/2 Midterm Test	(max 25 pts)	_____	
Subtotal	(max 75 pts)	_____	
1/2 Final Test	(max 25 pts)	_____	
Total pts	(max 100 pts)	_____	= Final Grade

# STUDENT PRE-COURSE QUESTIONNAIRE

COURSE NUMBER \_\_\_\_\_

The following information is requested to assist the school in compiling statistics and as an administrative aid.

NAME (As desired on course completion certificate)	NICKNAME	RANK OR GRADE
--	----------	---------------

CAREER SPECIALTY (Civ Series, AFSC, MOS, etc.)	PRESENT POSITION TITLE
--	------------------------

DUTY STATION	OFFICIAL MAILING ADDRESS	TELEPHONE NUMBER
--------------	--------------------------	------------------

SUPERVISOR'S NAME	RANK OR GRADE	SUPERVISOR'S ADDRESS
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SHORT DESCRIPTION OF YOUR PRESENT POSITION

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**EDUCATION: BEYOND SECONDARY - COURSES, CIVILIAN AND MILITARY (Include approximate dates) Check Appropriate Response.**

H.S. \_\_\_\_\_ BA/BS/OTHER (SPECIFY) \_\_\_\_\_ Masters \_\_\_\_\_ PhD \_\_\_\_\_ Major \_\_\_\_\_

- \_\_\_\_\_ Contract Administration (Correspondence, Seminar, Resident) Date \_\_\_\_\_
- \_\_\_\_\_ Management of Def Acq Contracts I Date \_\_\_\_\_
- \_\_\_\_\_ Cost & Pricing (Correspondence, Resident) Date \_\_\_\_\_
- \_\_\_\_\_ Management of Def Acq Contracts II Date \_\_\_\_\_
- \_\_\_\_\_ Contract Law (Seminar, Resident) Date \_\_\_\_\_
- \_\_\_\_\_ Negotiation Workshop Date \_\_\_\_\_
- \_\_\_\_\_ Quantitative Techniques/Cost & Pricing Date \_\_\_\_\_
- \_\_\_\_\_ Other (Please Specify): \_\_\_\_\_ Date \_\_\_\_\_

**EXPERIENCE: POSITIONS HELD, TYPE POSITION, ETC.**

	# Years Government	# Years Civilian	Highest Position
_____ Contract Administrator	_____	_____	_____
_____ Cost Monitor	_____	_____	_____
_____ Price Analyst	_____	_____	_____
_____ Negotiator	_____	_____	_____
_____ Industrial Specialist	_____	_____	_____
_____ Quality Specialist	_____	_____	_____
_____ Property Specialist	_____	_____	_____
_____ Engineering	_____	_____	_____
_____ Other (Please Specify)	_____	_____	_____

## Chapter A

### **Contract Administration "A Team Effort"**

You are a professional operating in a field which requires a team of technical experts working in harmony toward a common goal. Thousands of dollars and potentially thousands of people depend on your daily actions.

We are encouraged to show "one face to industry". In reality, this concept becomes disjointed because the team members: do not communicate well; do not know what to expect from each other; work with a limited view of the total administration picture and sometimes fail to realize their personal requirements in the process.

This course is designed to create or recreate familiarity with key contract administration issues. In this chapter, we will discuss CAO responsibilities, functional elements in the CAO Team, the DOD organization for contract administration, ACO/PCO communication and ACO/Contractor communication. The last reading also addresses you as a professional and has applicability regardless of your special skills or assigned duty.

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<u>Topic</u>	<u>Page</u>	<u>Assignment</u>
1. Organization Charts	A2 thru A8	Review
2. Contracting Cycle	A9	Review
3. Team Effort	A10	Review
4. Professionalism	A11 thru A16 (No page 17)	Read
5. ACO Functions	A18 thru A50	Read
6. FAR 42.1 thru 42.5	A51 thru A57	Read
7. DOD FAR Supplements	A58 thru A62	Read
8. ACO-PCO Perspective	A63 thru A67	Reference

SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Organization for Contract Administration Services (CAS)  
and Contracting - Administration Office Interface

TIME: 3.5 Hrs

OBJECTIVE: Comprehend the organization, its environment and  
responsibilities for the performance of CAS.

SAMPLES OF BEHAVIOR:

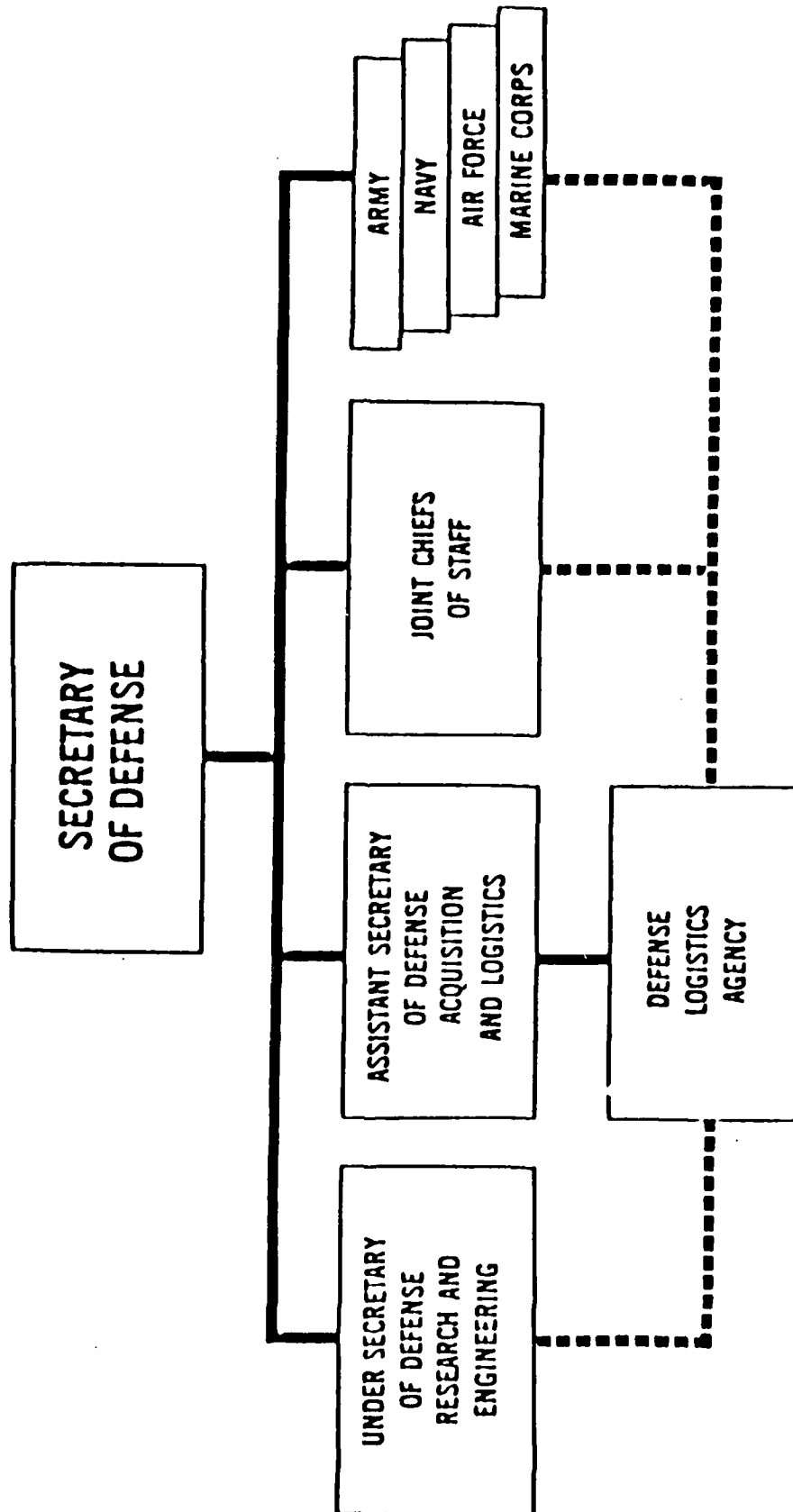
- a. Explain the organization of the Department of Defense and its components for acquisition and contract administration.
- b. Describe the functional components within the contract administration activities.
- c. Define the role of the Administrative Contracting Officer within the organizational framework of acquisition and contract administration.
- d. Summarize the essential nature of communication in the organization of Contract Administration Services and with outside agencies.
- e. Explain the duties of the CAO relative to FAR 42.302(a) & (b).

INSTRUCTIONAL METHODS: Lecture/Discussion

STUDENT INSTRUCTIONAL MATERIALS: Advanced Contract  
Administration (ACA) Textbook

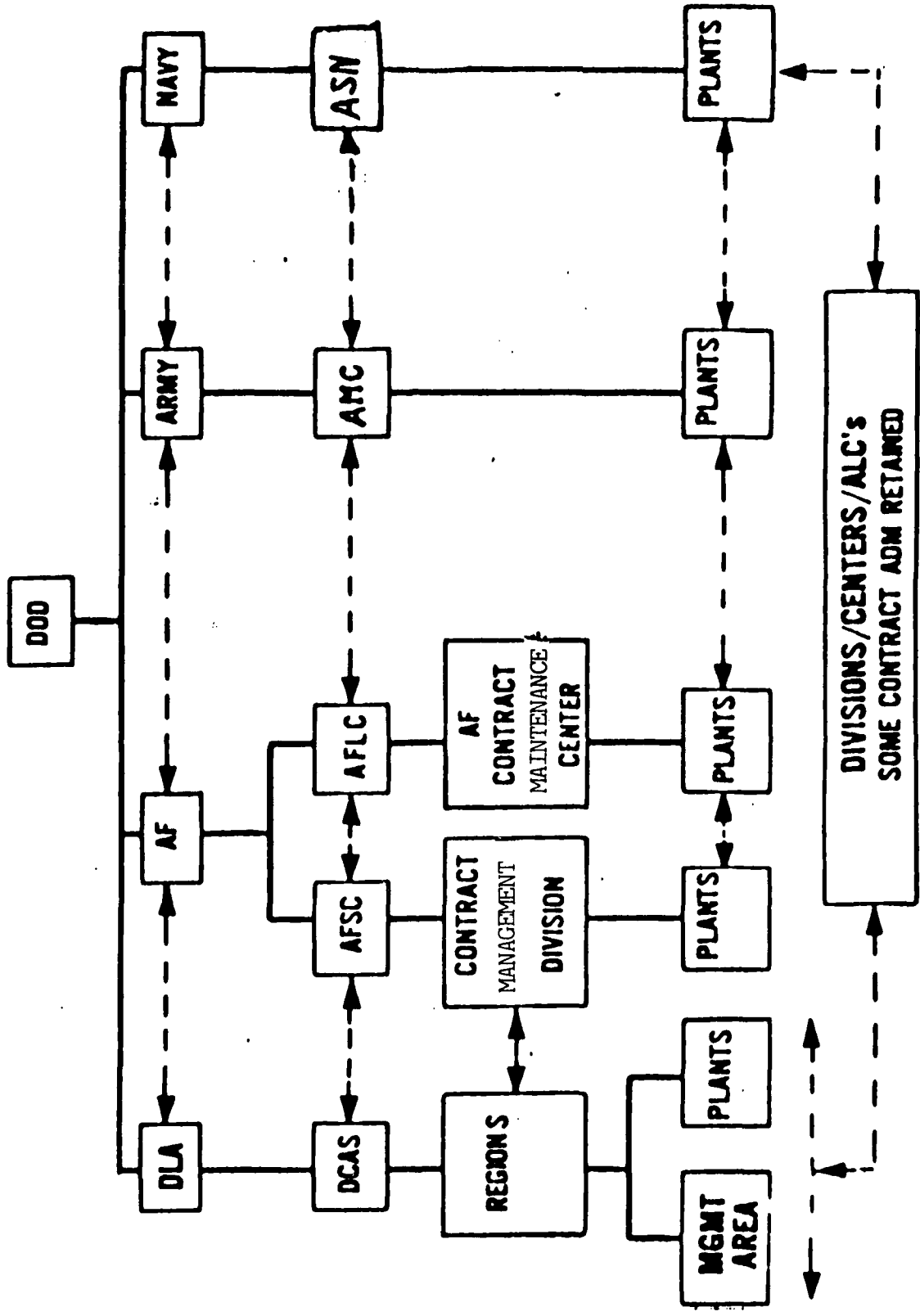
REQUIRED STUDENT PREPARATION: As defined by Chapter "A" of the  
Advanced Contract Administration (ACA) textbook.

# DOD ORGANIZATION

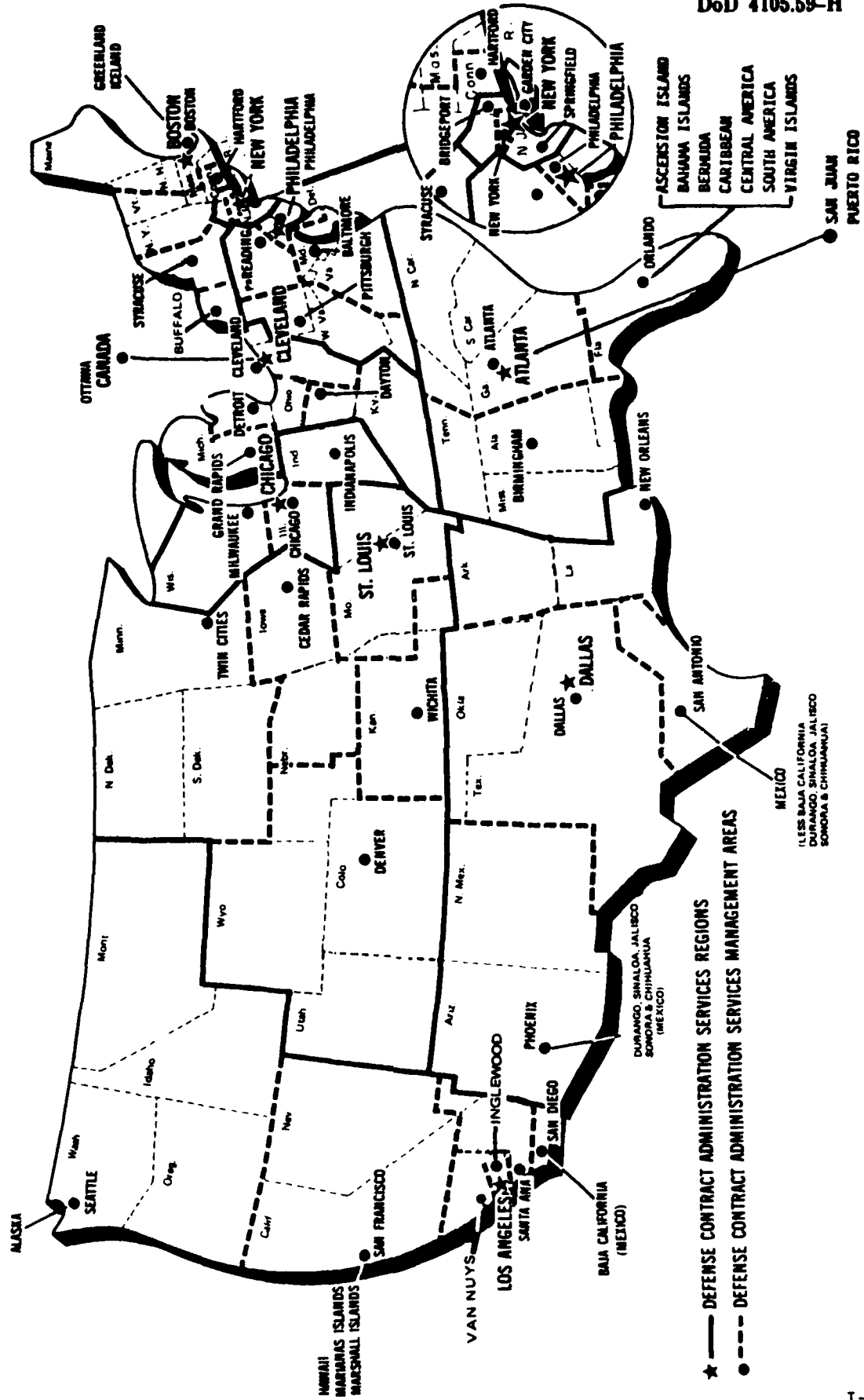


← LIAISON →

# CURRENT POSTURE FOR CONTRACT MANAGEMENT

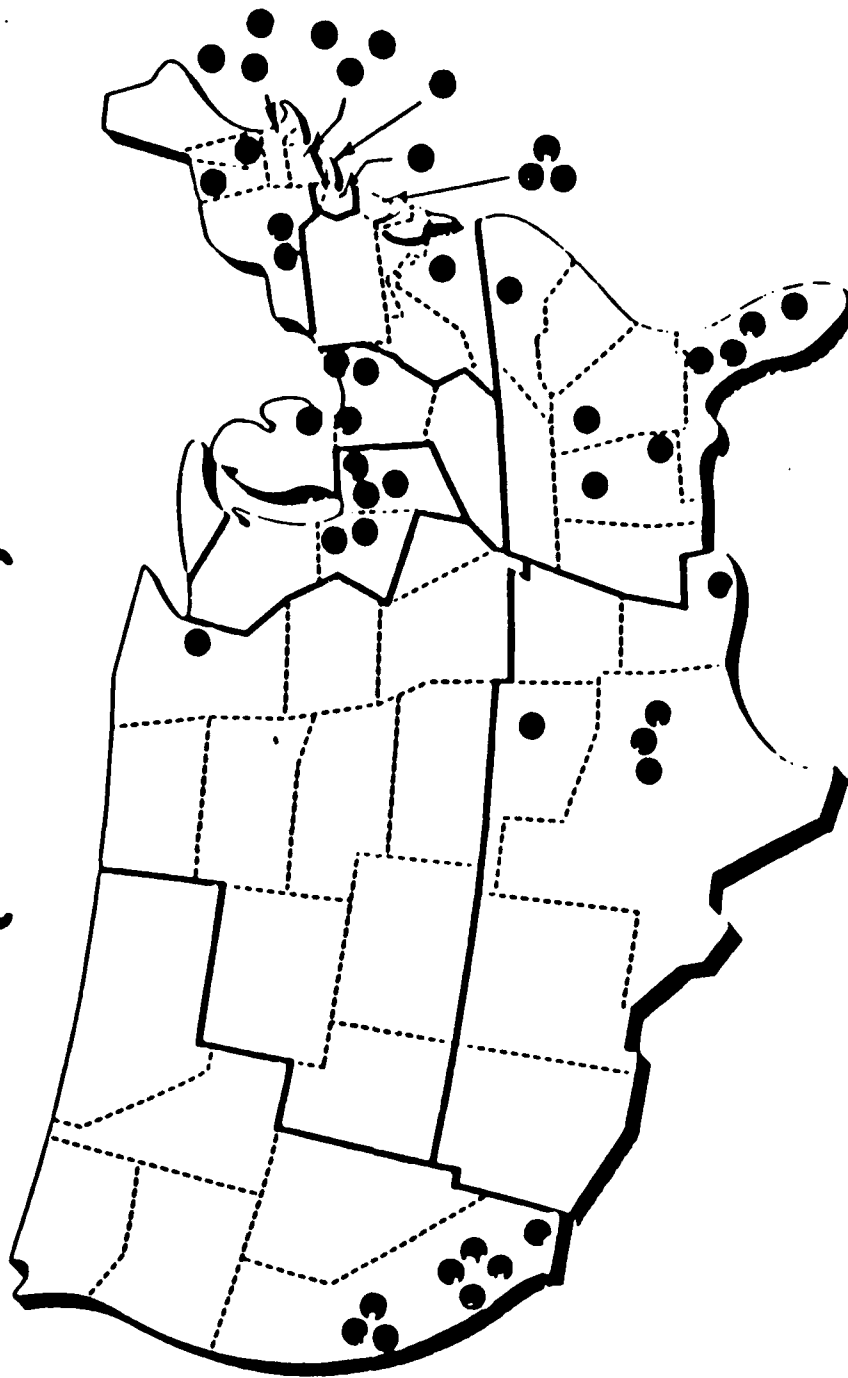


# DCASR GEOGRAPHICAL BOUNDARIES AND COMPONENTS



(LESS BAJA CALIFORNIA  
DURANGO, SINALOA, JALISCO  
SONORA & CHIHUAHUA)

**PLANT REPRESENTATIVE OFFICES  
(DCASPROs)**





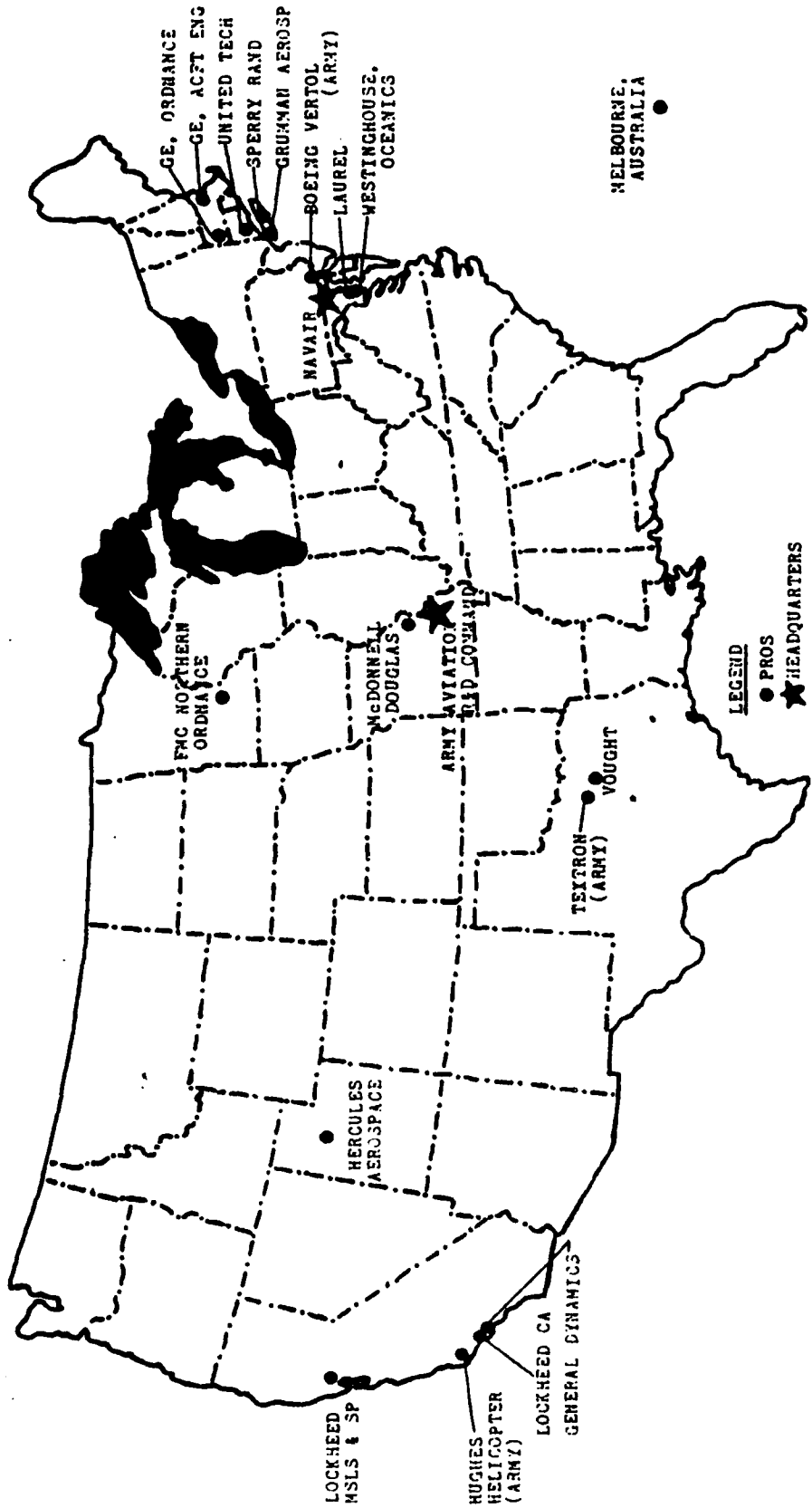
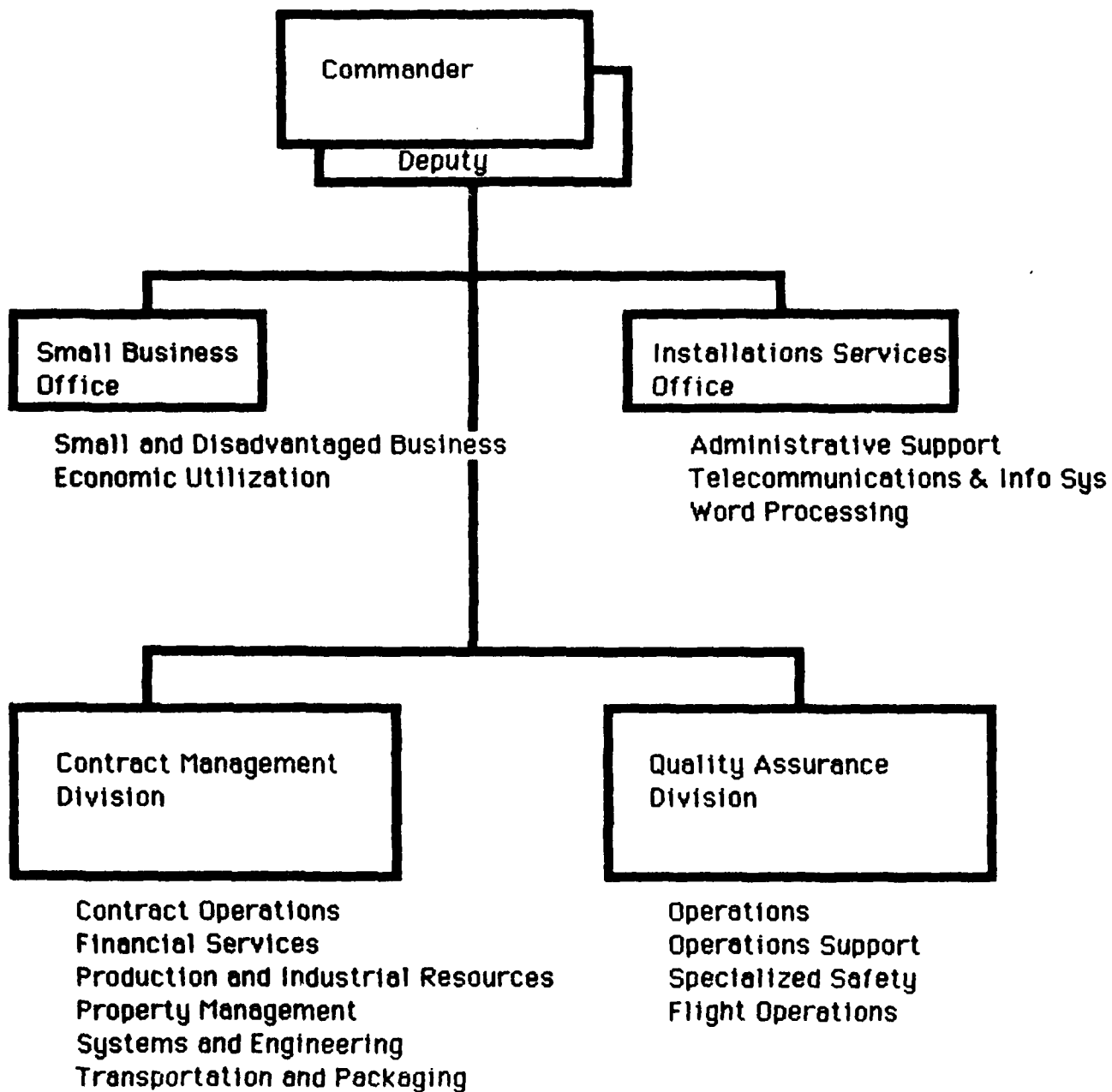
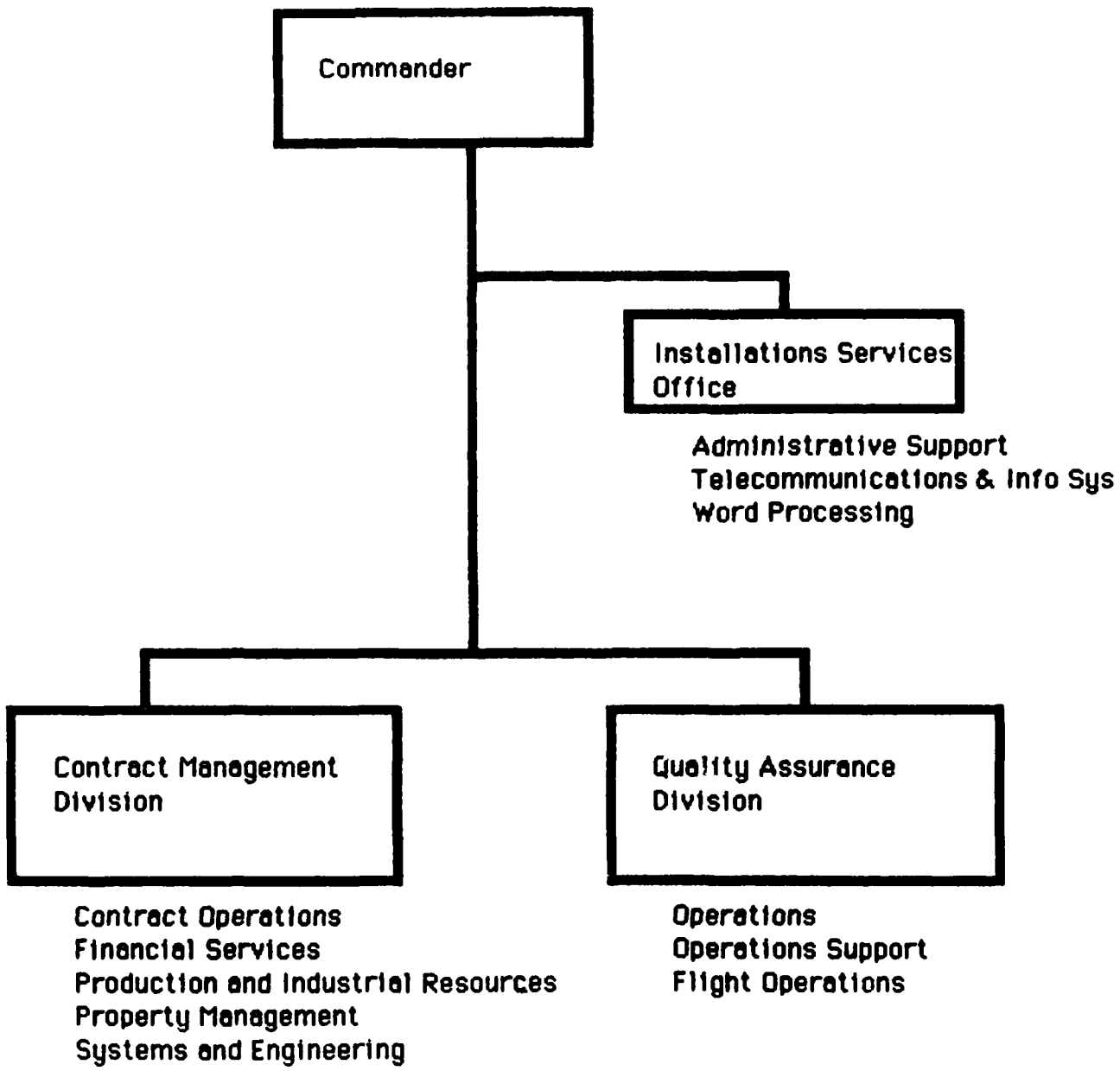


Figure 10. Army and Naval Plant Representative Offices (12:I-10-12)

TYPICAL DEFENSE CONTRACT ADMINISTRATION SERVICES MANAGEMENT AREA

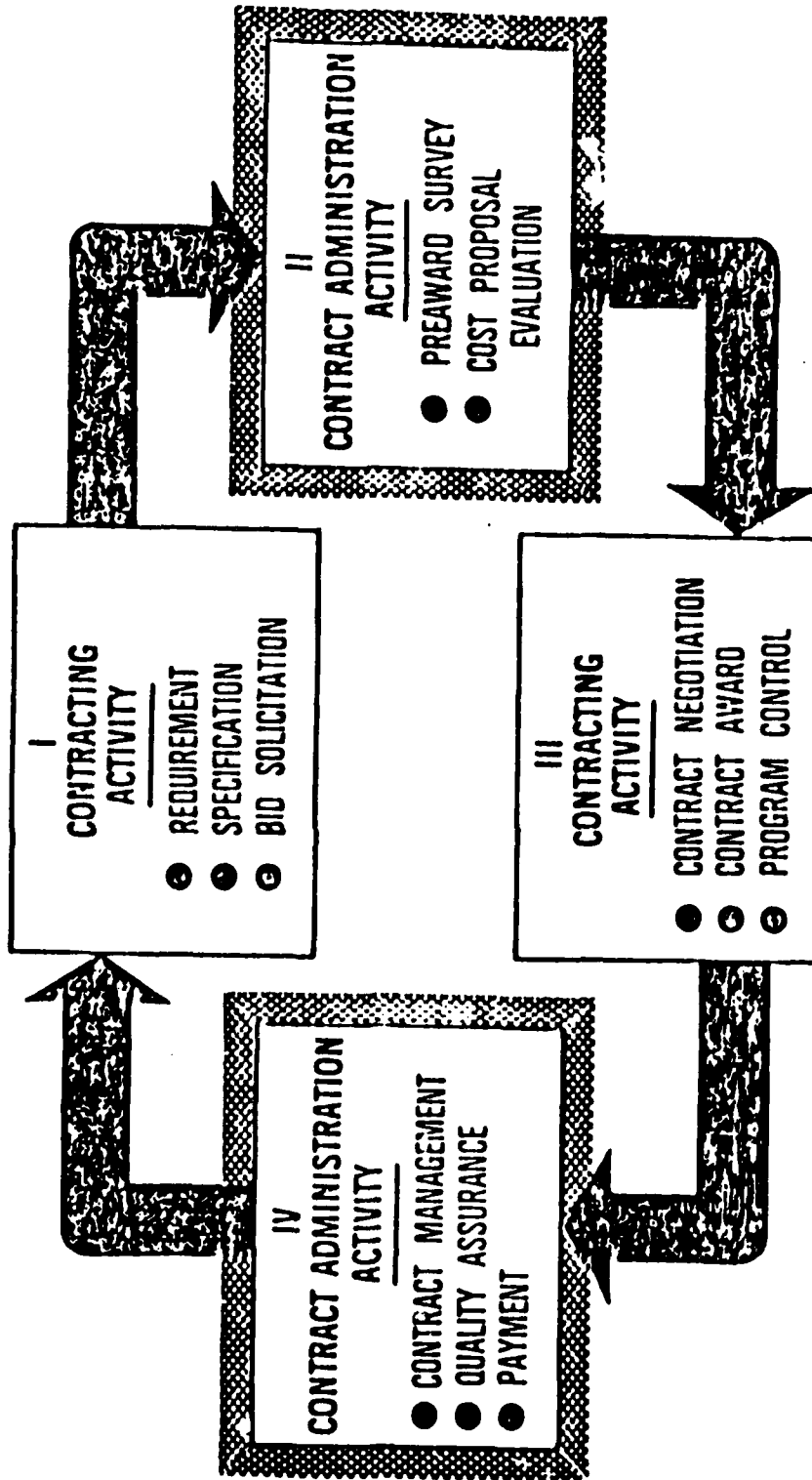


TYPICAL DEFENSE CONTRACT ADMINISTRATION SERVICES PLANT REP OFFICE

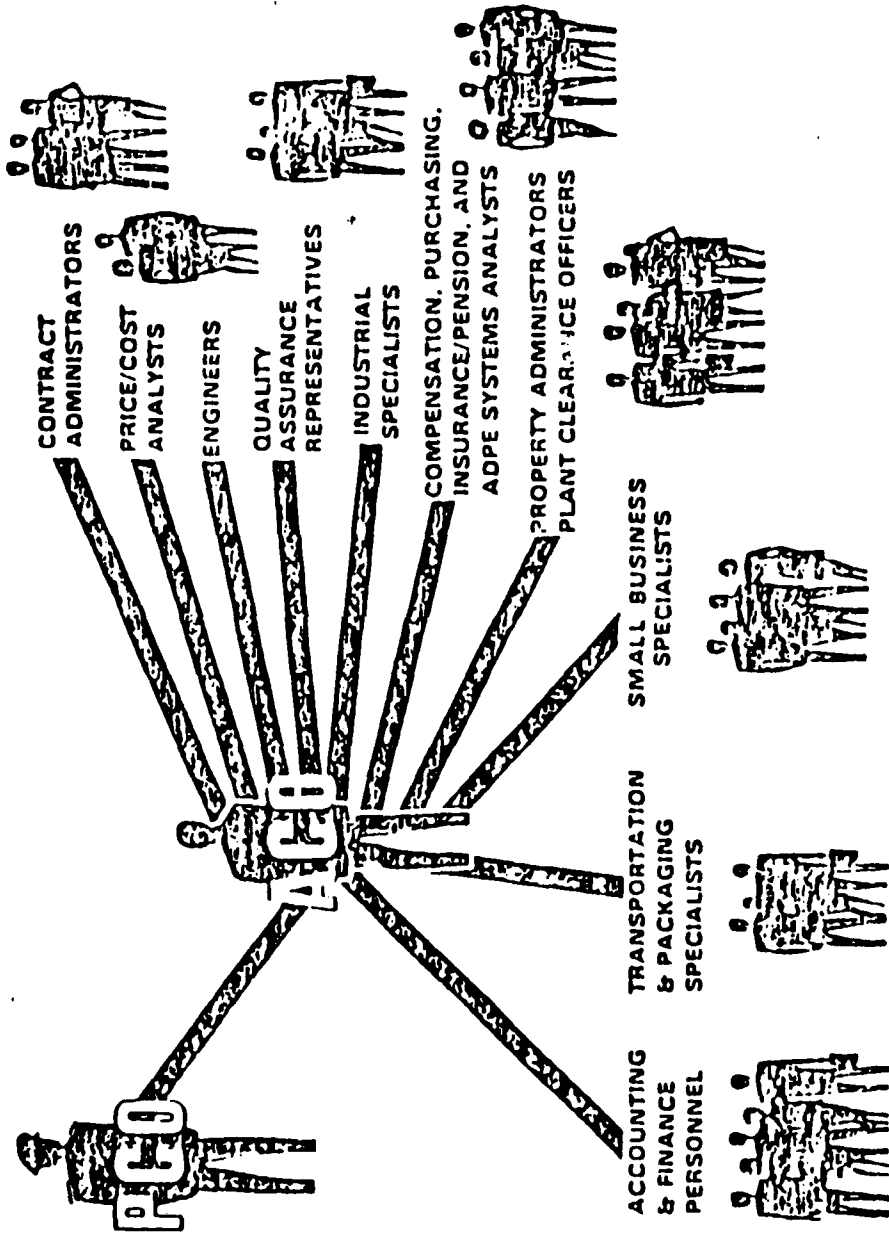


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# THE CONTRACTING CYCLE



# CONTRACT MANAGEMENT IS A TEAM EFFORT



## The Administrative Contracting Officer

Contract administration has progressed from simple inspection to a full-fledged discipline with many responsibilities. As a part of the government contracting process, it is the longest and most important phase. Federal Acquisition Regulation (FAR) 42.302(a) specifically identifies functions to be accomplished during the contract administration phase to the extent that those functions apply to a delegated contract.

The ACO's role is to assure delegated responsibilities are performed. Although the ACO is the focal point for all administrative and technical matters relating to a contract, a team of specialists assists the ACO in meeting these responsibilities. Quality assurance specialists, industrial engineers, production specialists and price analysts, among others may participate on this team. Team composition depends on the complexity and technical requirements of the contract, and duties assigned by the buying office. The ACO serves as the "team captain", coordinating specialists efforts in support of buying office delegations.

### Contracting Officer Qualifications

Concern for contracting officer qualifications is not new. In 1955, the "Hoover Commission" suggested "new attention should be given to improving the qualifications of contracting officers"; a 1970 Comptroller General's Report to the Congress recommended establishing experience and education standards for contracting positions; and in 1972, the Congressional Commission on Government Procurement (COGP) prescribed clarifying the methods for delegating contracting authority

...to assure that such authority is exercised by qualified individuals and is clearly understood by those within the agencies and by the agencies' suppliers of goods and services.

Despite the recommendations posed by these high-powered studies, contracting officer qualification requirements remained vague. The Defense Acquisition Regulation supplied the primary criteria prior to April 1984.

The DAR stated that expertise, training, education, business acumen, judgement, character, reputation and ethics shall be considered in selecting a CO. Additionally it provided the following evaluation criteria:

1. Experience in a Government procurement office, commercial procurement of related fields.
2. Formal education or special training in business administration, law, accounting, or related fields.
3. Completion of the Defense Procurement Management Course or other procurement courses.
4. Knowledge of the provisions of this Regulation and of other applicable regulations.

It must also be noted that the DAR allowed the designation of a CO by virtue of position. DOD organizations have assigned position authority to executive,

director and Head of Contracting Activity (HCA) type positions. A 1967 survey of 14 government executive agencies performed by the Office of Federal Procurement Policy (OFPP), recommended deletion of the "by virtue of position" assignment of CO authority. The OFPP report stated that "...no contracting officer delegations of authority should be given to others than those fully qualified by background, experience, and their present position"

Effective 1 April 1984 the FAR replaced the DAR. It attempts to consolidate acquisition regulations government-wide. The FAR lists verbatim the DAR CO selection considerations; however, it includes two additional example criteria:

1. Knowledge of acquisition policies and procedures.
2. Specialized knowledge in the particular assigned field of contracting.

Thirty years after the Hoover Commission report, contracting officers still strive for specific qualification criteria. Though the FAR provides two more selection items than the DAR, its criteria are offered as "examples": the DAR presented its criteria as mandatory considerations by using the term "shall." CO designation by virtue of position is excluded from the FAR. Also, the new regulation eliminates the term "PCO," relabeling the procuring contracting officer "contracting officer".

PCO, ACO and TCO distinctions seldom occur. "Contracting officers" are usually perceived as and addressed as a composite group. Renaming the PCO the generic "CO" may further reduce recognition of individual contracting specialities. The FAR's nondifferentiation of selection criteria for the contracting specialties also fosters the collective perception of COs.

### Push for Professionalism

While government commissions recommend improved qualification requirements and news media spotlight spare part "horror stories," contracting officers from government and industry pursue a professional designation for the contracting occupation. At the 1983 Air Force Systems Command (AFSC) contracting officer conference, Mr. Jim Williams, Deputy Assistant Secretary of the Air Force, Acquisition Management, identified five indicia of professionalism:

1. A defined body of specialized knowledge
2. Undergraduate and graduate intellectual training.
3. Relationship to a professional organization with set standards, tests of competency and certification procedures.
4. A Code of Ethics enforced by members of the profession.
5. A high degree of autonomy and responsibility [2].

In the test for professionalism, the government contracting occupation has the basic framework of a profession; the introduction of the FAR offers an

opportunity to refine the body of specialized knowledge; the proliferation of contracting in a number of degree programs at various colleges and universities provides training opportunities; and, the National Contract Management Association (NCMA) fulfills the professional organization requirement as well as offering a Code of Ethics. Because government contracting promotes the team concept, it somewhat restricts autonomy; however, the CO remains responsible for contractual actions.

Although the basic structure for professional designation is available, the boundaries are not firm. Members of the contracting community relentlessly pursue professionalism suggesting ways to improve contracting's status as a profession. Although the following literature review perpetuates the generic reference to COs, professionalism is a concern for all CO specialities.

### CO's Concern

In Public Purchasing and Materials Management, Harry R. Page, Professor of Business Administration at the George Washington University, cites the Commission on Government Procurement 1971 survey of 110,000 federal civilian public-purchasing and material-management employees. Of the 53,568 persons responding to the COGP survey, "the work force was characterized at that time by one commission member as 'over aged and under educated'". Forty-one percent of the respondents were between the ages of 46 and 55, with an average educational level of high school plus three months of college. Page contends that "the competence of the work force is the most important factor in achieving organizational goals". He further references the commission's report stating:

...more than half of the civilian agencies of the federal government were using as contracting officers personnel whose training, education, experience and expertise did not qualify them; personnel who did not have knowledge of applicable laws and regulations essential to the contracting function; and who were exercising the contracting officer authority that resided in the position occupied although no determination had been made of their qualifications to do so.

To avoid placement of unqualified persons in CO positions, Page identifies training and education in four skill areas which contracting officers should have:

1. Business knowledge and skills.
2. Communication skills.
3. General management skills.
4. Conceptual skills.

Two years after the publication of the book referenced above, Mr. Page testified before the Senate Subcommittee on Federal Expenditures, Research and Rules, Committee on Governmental Affairs on the 1982 proposed Uniform Federal Procurement System. Once again he emphasized the importance of business and management skills for the contracting officer for sound business



judgement. He assured the subcommittee that "competence in business and management can be taught and learned", and that "the educational opportunities exist, and they are being utilized to advantage-by the private sector". Page noted that procurement position announcements for private sector businesses require a bachelor's degree in a business related field while position announcements in federal government require no formal education. In fact, "under present standards, education cannot be a selection factor". With only 1/3 of the present procurement force college graduates, Page indicated this lack of education standard as the principle reason for the relatively low level of professionalism in federal procurement. To improve the professional level of the work force, Page recommended to the subcommittee that

...the Office of Personnel Management needs to say that formal education in business and procurement management is necessary, and that professional certification is desirable.

The professional certification mentioned above would attest that the individual has attained a prescribed level of knowledge through formal course work or examination, has completed a prescribed minimum term of work experience in the contracting field, and has made a commitment to a standard of behavior and performance.

Another advocate of education and professionalism for contracting personnel is Robert Ragan. Presently a procurement manager for Bechtel National Incorporated, Ragan has been in contracting for over fifteen years both in government and private industry. He writes, "Procurement to be a true profession must be considered as such not only by those who comprise its ranks but also by 'outsiders'". Ragan considers one factor leading to this outside recognition to be the manner in which procurement personnel conduct their activities, including the daily demonstration of their business expertise. Like Page, he recognizes that there are people in procurement without college degrees, and comments:

It is difficult to be placed at the same level of esteem as doctors, engineers and other professionals who must hold a college degree in their discipline, when procurement professionals have no such requirement.

Regan identifies a procurement professional as "a person with the specialized knowledge and often long and intensive academic training in procurement". He does not feel enough schools offer undergraduate graduate degrees in procurement; therefore, he advocates the promotion of procurement and contract management degree programs at local colleges and universities.

As Ragan alluded, defense contractors face the same need for professional contract managers as does the government. Efficient

and effective contract administration reduces cost and therefore contributes directly to the corporate profit position. Top executives expect more than money management from contract administrators in today's environment. They expect purchasing and management professionals. To this end, one group of executives in a Special Chief Executive Report concluded that industry emphasis should be directed at more professional development through training programs. This emphasis even included attendance of government courses when possible. Another group, including Robert Howard, vice president-materials management, for GTE Corp echoed that professional development through training sentiment.

The Professional. In "The Public Purchasing Profession," S.D. Zemansky and Stephan B. Gordon suggest "professional designations" are recognized as the hallmark of outstanding

performance indicating the highest quality of work the best people in the field can deliver. Because many groups claim professional status, they continue, the definition of profession has been watered down. "Consequently, few, if any of these groups would satisfy the rigorous criteria that set the true professional apart from the individual practitioner of occupational specialty". For public purchasing Zemansky and Gordon concluded that true professional status is structurally available, but still not fully a reality.

Although an individual may not be part of a "profession," he or she may still be a professional. "Of primary and therefore greater importance are the characteristics of individuals who want to apply their skills in a truly professional manner". Zemansky and Gordon identify a professional purchasing officer by the following traits:

1. He is knowledgeable and competent in the areas of public purchasing, public administration, business management, and product/service responsibility.
2. He is dedicated to the public service and the best interests of the whole.
3. He is guided by a desire for excellence.
4. He is governed by the highest ideals of honor, integrity, and objectivity.
5. He is completely honest.
6. He is recognized as a professional by his peers.
7. He accepts responsibility for failure and is modest when successful.
8. He is a team player.

9. He is active in at least one professional organization of public purchasers.

10. He is friendly, courteous and tactful at all times.

Government and industry contracting officers yearn for professionalism. The avenue to professional designation noted in the literature stresses various forms of CO qualification criteria and selection procedures:

1. Bachelor's degree.
2. Master's degree.
3. Training and education in various business skills.
4. Professional certification.
5. Decision making skills.
6. Written or oral examinations.

The COs' suggestions seem to emphasize minimum selection and appointment procedures which would convince "outsiders" of government CO professionalism.

Contracting officers' aspirations parallel government and media demands for qualifications improvement. COs are and should be professionals "dedicated to the public service and the best interest of the whole".



DEPARTMENT OF DEFENSE

**DEFENSE  
LOGISTICS  
AGENCY**

Cameron Station,  
Alexandria, Virginia 22304-6100

**LIST OF PRIMARY  
ACO  
FUNCTIONS  
AND  
RESPONSIBILITIES**

**CONTRACT ADMINISTRATION  
SERVICES**

**JUNE 1986**



**DEFENSE LOGISTICS AGENCY  
HEADQUARTERS  
CAMERON STATION  
ALEXANDRIA, VIRGINIA 22304-6100**

19 JUN 1986

**PREFACE**

This pamphlet has been prepared as an updated and revised unofficial listing of primary ACO functions and responsibilities. It is generally limited to areas in which the ACO must take action under appropriate circumstances. The listing is intended to serve as a quick reference/review tool for ACOs and other Contract Administration personnel. Users of the listing should consult the Defense Logistics Agency Manual (DLAM) 8105.1, the Federal Acquisition Regulation (FAR), the DoD FAR Supplement (DFARS), and other regulatory media for official, detailed coverage with respect to contract administration functions.

A handwritten signature in black ink, appearing to read "R D Hackett, Jr.", written in a cursive style.

ROBERT D. HACKETT, JR.  
Colonel, USAF  
Deputy Executive Director  
Contract Management

**DISTRIBUTION:**

62 (same as DLAM 8105.1 plus  
additional 300 ea DCASR)

This pamphlet is a complete revision of the May 1978 edition which is hereby superseded.

## GLOSSARY

ACO	Administrative Contracting Officer
ADP	Automatic Data Processing
ADPE	Automatic Data Processing Equipment
ASI	Amended Shipping Instructions
B&P	Bid and Proposal
BOA	Basic Ordering Agreement
BPA	Blanket Purchase Agreement
CA	Contract Administration
CAO	Contract Administration Office
CAR	Contract Administration Report
CMA	Contract Management Alert
CASB	Cost Accounting Standards Board
D&F	Determination and Findings
DCAA	Defense Contract Audit Agency
DCAS	Defense Contract Administration Services
DCASR	Defense Contract Administration Services Region
DISAO	Designated Independent Senior Acquisition Official
DISCO	Defense Industrial Security Clearance Office
DoD	Department of Defense
DTIC	Defense Technical Information Center
HQ DLA	Headquarters Defense Logistics Agency
ILRO	Industrial Labor Relations Officer
IPE	Industrial Plant Equipment
IR&D	Independent Research and Development
IS	Industrial Specialist
J&A	Justification and Approval
OFCCP	Office of Federal Contract Compliance Programs

PA	Property Administrator
PAOC	Postaward Orientation Conference
PCO	Procuring Contracting Officer
PLCO	Plant Clearance Officer
QAR	Quality Assurance Representative
SADBU	Small and Disadvantaged Business Utilization
TCO	Termination Contracting Officer

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#### ACCELERATION OF DELIVERY

Forward acceleration requests to Production for processing with the contractor when such requests are processed through the CAO. Review and evaluate the contractor's proposal and furnish recommendations to the PCO. Negotiate, or negotiate and execute supplemental agreements, when delegated.

FAR 42.302(b) (3)

DLAM 8105.1 12.1

#### ACCESS TO SCIENTIFIC TECHNICAL INFORMATION

Reply to inquiries for specific information received by the CAO. Certify DD Form 1540, Registration for Scientific and Technical Information Services, if specifically delegated responsibility by the PCO. Forward a copy of the delegation to DTIC, ATTN: DDRA.

FAR 35.010

DFARS 35.010

DLAM 8105.1 35.010

#### ACCOUNTING SYSTEMS REVIEW

Request DCAA through Financial Services element to review contractor accounting systems. Request contractor to make necessary accounting system changes. Make final determination as to adequacy of accounting system. ACOs shall not make formal written approval of contractor accounting systems. Advise PCOs of status of accounting systems.

FAR 16.104(h), 32.503-3

DFARS 15.805-1(a) (72)

DLAM 8105.1 16.104, 32.592, 90.01

#### AUTOMATIC DATA PROCESSING EQUIPMENT (ADPE)

Advise contractor in writing that he is subject to the provisions of DFARS 70.6 and FAR 31.205-2. Review ADPE acquisition requests requiring senior ADPE Policy Official approval for completeness and provide recommendations, as appropriate, to the PCO. Conduct initial and annual review/approval when the total cost of leasing ADPE in a single plant, division, or cost center exceeds \$500,000 annually and 50 percent or more of the total cost is allocated to Government contracts requiring the negotiation or determination of costs. Review/approve proposed lease of a new ADPE system or any proposed major change to an existing system. Establish suspense for receipt of contractor's documentation for initial and annual reviews. Upon receipt of documentation, request ADP technical assistance in accordance with DLAM 8105.1, paragraph 42.13-5d. Upon completion of initial and annual review of leased ADPE, consider executing an advance agreement with the contractor as evidence of the reasonableness of the requirement and related costs. When appropriate, require a check of the utilization of ADPE to determine capacity versus requirement. Assure that any excess ADPE, which was leased by the contractor under terms which provide the Government an option to purchase or provide other residual interests, is reported by the contractor to the Plant Clearance Officer (PLCO).

FAR 31.205-2

DFARS 70.6

DLAM 8105.1 42.13

ADVANCE AGREEMENTS (IR&D AND B&P)

Negotiate advance agreements on particular cost items when assigned responsibility to do so. Prepare negotiation memorandum setting forth principal elements of the ceilings negotiated. Forward a copy of the negotiation memorandum to HQ DLA, ATTN: DLA-AFO. Submit advance agreement to Board of Review prior to definitization.

FAR 31.109, 31.205-18, 42.302(a)(6)

DFARS 31.205-18

DLAM 8105.1 31.109, 90.16

ADVANCE PAYMENTS

Ensure that application for advance payments includes supporting elements outlined in FAR 32.408. Forward advance copy to PCO. Obtain analysis from DCAA and functional elements as necessary. Evaluate findings and forward with recommendations to PCO. Countersign check withdrawals from Special Bank Account. Maintain close surveillance of contractor performance and financial condition.

FAR 32.4, 42.302(a)(14), 52.232-12

DFARS 32.4

DLAM 8105.1 32.4

ALLOWABILITY OF COSTS, PUBLIC VOUCHERS

Review paid vouchers to ensure adequacy of contractor management, cost control, performance, and compliance with Limitation of Cost or Funds clauses. Review total costs upon completion of cost-reimbursement contracts and identify any excess funds that are available for deobligation. Review and approve final vouchers. Certify contractor progress for payment of fee. Determine allowability of costs suspended or disapproved on DCAA Form 1, Notice of Contract Costs Suspended and/or Disapproved, when contractor appeals in writing. Direct DCAA to issue Form 1 on costs that should be suspended or disapproved.

FAR 31, 42.302(a)(7), 42.803, 52.232-20 thru -22

DFARS 31

DLAM 8105.1 31.2

AMENDED SHIPPING INSTRUCTIONS (ASIs)

Issue amended shipping instructions when authorized by the purchasing office. When necessary, negotiate and execute supplemental agreements incorporating contractor proposals resulting from the amended shipping instructions. If not delegated authority, forward contractor proposals to PCO for contract modifications. Assure that shipments are not delayed pending completion and formalization of negotiations of revised shipping instructions. When the ACO considers it advantageous, a number of ASIs may be definitized in a single supplemental agreement.

FAR 13.503, 42.302(a)(61), 42.302(b)(5), 47.3

DFARS 13.503, 47.3

DLAM 8105.1 47.3

#### ANTICIPATED OR ACTUAL LATE DELIVERY OR PERFORMANCE

Take prompt action when delay in delivery or performance is anticipated. Notify PCO by letter, DD Form 375, Production Progress Report, or DLA Form 1654, (Test), Delay in Delivery or other media, with definitive recommendations developed through coordination with the cognizant Industrial Specialist. Issue Cure Notice or Show Cause Letter if directed by PCO. Forward contractor's reply or "failure to cure condition" information to PCO with appropriate recommendations. If delegated by the PCO, negotiate consideration for revised delivery schedule and execute supplemental agreement.

FAR 42.302(a) (31), 42.302(b) (3), 42.11, 49.402-3, 52.242-2  
DFARS 42.11  
DLAM 8105.1 42.11, 49.4

#### ASSIGNMENT OF CLAIMS

Receive and acknowledge receipt of notice and instrument of assignment by signing and dating all copies of the notice of assignment. Forward true copy of instrument and original of notice to contract file. Expeditiously forward two copies of the notice of assignment to the Office of Comptroller. Return one copy of notice to assignee. Advise PCO that assignment has been made. Annotate CAR.

FAR 32.8, 52.232-23  
DFARS 32.8  
DLAM 8105.1 32.8

#### AUDIT FOLLOWUP

Document agreement or disagreement with contract audit reports received. Conduct discussion as required with the auditor. Refer unresolved differences to the Designated Independent Senior Acquisition Official or Board (DISAO). Pursue timely resolutions and disposition of contract audit reports. Consider DISAO's recommendation when making independent decisions as to action deemed appropriate. Obtain supervisor's review when required.

DLAM 8105.1 90.01

#### BAILMENTS

Assure contractor compliance with Bailment Agreement. Review and process bailment applications and recommend action to PCO. Primary responsibility relates to assuring the contractor's receipt, maintenance, authorized utilization, and return of the bailed property.

FAR 45.310  
DLAM 8105.1 45.310

#### BANKRUPTCY

Coordinate all actions taken by DCAS. Notify PCOs, paying activities, counsel, security office, and others of anticipated or actual bankruptcy. Monitor disposition of Government property. Consult with and provide information to counsel who will represent DCAS on legal requirements. Act as official contact with Referee or Trustee in Bankruptcy.

FAR 32.606, 32.613  
DFARS 32.671, 42.302(a) (16)  
DLAM 8105.1 32.671

#### BASIC EMERGENCY PLAN (BEP)

Ensure that high priority functions continue to be performed manually in the event of ADPE failure.

DLAM 8105.1 90.17

#### BASIC ORDERING AGREEMENTS (BOAs)

Administer orders under BOAs as separate contracts. When authorized, issue, negotiate, and definitize unpriced orders. Establish control register (DLA Form 1516, Unpriced Order Control Register) for unpriced orders. Issue priced orders. Obtain D&F, J&A, and appropriate synopsis documents from PCO before issuing orders. Coordinate funds with Office of Comptroller. Synopsise orders after placement in accordance with FAR/DFARS 5.3.

FAR 5.3, 16.703, 42.302(b)(2)

DFARS 5.3, 16.703

DLAM 8105.1 5.303, 16.703, 90.16-6f(3)

#### BOARDS OF REVIEW

Compile data and present memorandum of proposed action to Board of Review. Determine, on case-by-case basis, whether review by DCASR counsel is warranted. Provide Board with recommended actions and reasons. Document file when final actions taken are not in conformity with Board's recommendations (Board's recommendations are advisory only).

DLAM 8105.1 90.16

#### CERTIFICATE OF CURRENT COST OR PRICING DATA

Obtain certified cost or pricing data as soon as practicable after final negotiations conducted by the ACO regardless of who has definitization authority. Assure defective pricing cases are processed through Financial Services/PCO/DCAA/DCASR Counsel, as appropriate.

FAR 15.804

DFARS 15.804

DLAM 8105.1 15.805

#### CHANGE ORDERS

Issue change orders when delegated authority by the PCO. Obtain technical review of change proposals submitted by contractor. Analyze contractor's claims for adjustment resulting from change orders. When authorized to definitize change orders, ensure that sufficient funds are available prior to final price negotiations. Establish register (DLA Form 1515, Change Order Control Register) to monitor undefinitized change orders. Obtain contractor's written acceptance of no cost change orders. If required, obtain clearance from the Office of Federal Contract Compliance Programs (OFCCP).

FAR 42.302(b)(1), 43, 43.2, 52.243-1 thru -6

DFARS 43, 43.2

DLAM 8105.1 43, 43.2

#### CHANGES (CONSTRUCTIVE)

Receive and promptly forward to the PCO the contractor's notice of Government conduct considered to constitute a change to the contract terms and conditions. Furnish supporting facts and information to the PCO if requested. When specifically authorized by the PCO to make an equitable adjustment, modify the contract accordingly.

FAR 43.104, 52.243-7  
DFARS 43.104

#### CONGRESSIONAL NOTIFICATION, CONTRACTUAL ACTIONS OF \$3,000,000 OR MORE

Provide required information to purchasing activity five working days prior to execution of a contractual action in excess of \$3,000,000. Assure receipt of clearances (indicating Congressional notification has been made) from PCO prior to awarding the particular action.

FAR 5.303  
DFARS 5.303  
DLAM 8105.1 5.303

#### CONSENT TO SUBCONTRACTS

Consent to the placement of subcontracts as provided for in the prime contract and FAR 52.244.2. Obtain, when necessary, recommendations from Financial Services, Production, DCAA, and other functional elements, in review of proposed subcontracts. Consider contractor compliance with various special requirements, e.g., advance notifications, Small Business/Small Disadvantaged Business and Labor Surplus Area subcontracting programs, Certificate of Current Cost or Pricing Data, and Contractor Employment Compliance Certificate of Clearance, if required. Ensure flowdown of applicable clauses. Screen Consolidated List of Debarred, Suspended, and Ineligible Contractors. Advise contractor in writing of consent or refusal. If consent is withheld, notify PCO if contract performance will be affected.

FAR 42.302(a) (51), 44.2, 52.244-2  
DLAM 8105.1 44.2

#### CONTRACT CLOSEOUT

Ensure comprehensive review of contract prior to physical completion and initiate closeout process. Prepare and distribute appropriate forms, as required, e.g., DD Form 1597, Contract Closeout Checklist, and DD Form 1593, Contract Administration Completion Record. Assure receipt and final acceptance of contractually required reports prior to contract closeout.

FAR 4.804  
DFARS 4.804-1  
DLAM 8105.1 4.804

#### CONTRACT DEBTS

Take prompt action to collect those contract debts which are not the responsibility of the Office of Comptroller or the purchasing activity to



collect. Be familiar with procedures in DLAM 7000.1, Chapter 12, and FAR and DFARS 32.6. Coordinate with the Office of Comptroller to determine current interest rate when issuing a demand letter. Report uncollectable debts to the Office of Comptroller.

FAR 32.6

DFARS 32.6

DLAM\_8105.1 32.6

#### CONTRACT FILES

Ensure that contractual documents and correspondence are furnished to the Contract Operations File element (COF) for inclusion in official contract files. Review each contract or modification distributed by COF and forward to official contract file.

FAR 4.8

DFARS 4.8, Supplement No. 2 (ASPR)

DLAM 8105.1 4.8

#### CONTRACT FUNDS STATUS REPORT (CFSR)

Establish controls to ensure receipt of the CFSR within 25 days following report cutoff date. Forward an advance copy to PCO without comment. Review current CFSR and compare it to prior submissions. Submit reports selected for detailed review to the Financial Services element for analysis. Complete applicable portions of DLA Form 1069, Funds Analysis Control.

DLAM 8105.1 32.7, 90.06

#### CONTRACT MANAGEMENT ALERT PROGRAM

Maintain close surveillance of contracts to which Contract Management Alerts are required. Assure that problems or potential problems are immediately identified to the DCASR Production Division.

DLAM 8300.1

DLAR 8300.4

#### CONTRACT MODIFICATION

Issue modifications, and negotiate and execute supplemental agreements when authorized by the PCO. Maintain control register when modifications as defined in FAR 43.101 are to be definitized by the ACO. Submit modifications to Board of Review when required. Follow Congressional notification procedures for all modifications of \$3,000,000 or more. Obtain OFOCP clearance if required. Ensure correct distribution of copies of contract modifications.

FAR 42.302, 43

DFARS 42.302, 43

DLAM 8105.1 43, 43.101, 43.2

#### CONTRACTOR APPLICATIONS FOR RELIEF UNDER PUBLIC LAW 85-804

Forward claims for relief to the PCO. Furnish supporting facts and information to the office investigating the claim when requested.

FAR 50

DFARS 50

CONTRACTOR CERTIFICATION OF REQUESTS FOR ADJUSTMENT OR RELIEF EXCEEDING \$100,000

Assure that any contract claim, request for equitable adjustment to contract terms, request for relief under P.L. 85-804 or similar request is accompanied at time of submission by a properly executed certificate as defined in DFARS 52.233-7000. If certificate is not submitted, advise contractor claim will not be processed further until it is received.

FAR 33.205  
DFARS 33.70, 52.233-7000  
DLAM 8105.1 33.70

CONTRACTOR COST DATA REPORTING (CCDR)

Establish controls to ensure timely receipt of reports and conformance of submissions to the requirements of the contract. Forward a copy of all CCDR submissions to DCAA within three days after receipt from the contractor. Forward copies of all audit reports covering CCDR submissions, with appropriate comments, to the recipient specified in the contract or the PCO within 10 days after receipt of the audit report. Obtain assistance from other functional elements as necessary. (See DODI 7000.11).

FAR 42.302(a) (58)  
DLAM 8105.1 90.07

CONTRACTOR EMPLOYEE COMPENSATION SYSTEM REVIEW (CECSR)

Notify contractor of proposed date and purpose of CECSR. Determine acceptability of compensation costs utilizing recommendations of the Compensation System Analyst. Advise contractor of the results of the CECSR and necessity of taking corrective action, when appropriate. Advise contractor that significant changes to the compensation structure made after the initial review and acceptance should be reviewed and accepted by the ACO prior to incorporation. Prepare justification for waiving a biennial CECSR on a year-to-year basis and provide to the Chief, Financial Services Division.

FAR 31.205-6, 42.302(a) (1)  
DLAM 8105.1 31.205

CONTRACTOR ESTIMATING METHODS REVIEW (CEMR)

Assure that contractors use effective estimating policies, procedures, and methods in developing and submitting proposals for which the ACO has final negotiating responsibility. Arrange, through the Financial Services element and in coordination with the DCAA CEMR Auditor, for participation in the team review by DCASR representatives. The CEMR Auditor, as team leader, is responsible for survey planning, direction of work, preparation and distribution of survey reports. Suggest areas of special interest to be included in the CEMR. Coordinate on draft report.

FAR 15.811, 42.302(a) (4)  
DFARS 15.811  
DLAM 8105.1 15.811

### CONTRACTOR IMPROVEMENT PROGRAM (CIP)

Assure as team leader of individual functional experts that a concerted effort is made to correct Government or contractor shortcomings which may result in unacceptable contractor performance. Assist the PCO in actions designed to bring the contractor up to an acceptable level of performance. Initiate debarment reports on those contractors who refuse to take necessary corrective action to resolve poor performance. As the team leader, conduct an initial meeting of the team to define the problem, determine a time-phased plan of action, and establish a means of measuring and reporting progress to higher management. Notify contractors that they have been placed in the program, and buying activities of contractors placed in the program and recommended for preaward survey.

DLAM 8105.1 90.14

### CONTRACTOR INSURANCE/PENSION REVIEW (CIPR)

Identify contractors eligible for CIPRs. Determine contractor compliance with contractual insurance requirements. Request CIPR from the Insurance/Pension Specialist (I/PS) at the appropriate DCASR, or the Chief, Financial Services element for those DCASRs that do not have an I/PS. Notify contractor that a CIPR is to be conducted and request pertinent information. Provide copies of audit reports which contain pertinent insurance/pension information to the I/PS or Chief, Financial Services element.

FAR 28.3, 42.302(a)(2)

DFARS 28.3

DLAM 8105.1 28.3

### CONTRACTOR PURCHASING SYSTEM REVIEW (CPSR)

Notify contractor of proposed review. Participate in initial meeting and exit conference. Participate in the CPSR Board Meeting as a nonvoting member. Transmit CPSR recommendations and report to contractor. Grant, continue, withhold or withdraw approval of the contractor's procurement system. Develop, in conjunction with Purchasing System Analyst (PSA), a plan of surveillance for contractors in the CPSR program. After initial system approval, make annual evaluation of need to perform subsequent reviews.

FAR 44.3, 42.302(a)(50)

DFARS 44.3, Supplement No. 1 (DAR)

DLAM 8105.1 44.3

### COORDINATION OF CONTRACT ADMINISTRATION

Serve as primary coordinator of CA team of functional experts. Utilize technical input provided by the team members in making professional judgements/decisions. Assure that the contractor understands that the ACO is the only CAO team member who can speak on behalf of the Government with respect to contract terms and conditions. Fully document rationale for any decisions made which may be at variance with recommendations from supporting elements.

DLAM 8105.1 90.14

CORPORATE ACO (CACO)

Perform selected contract administration functions on a corporate-wide basis. Duties and responsibilities of CACOs are set forth in DLAM 8105.1, Part 42.6. Where a CACO program has been established, ACOs cognizant of a contractor's subsidiary location may be designated in writing as Divisional ACOs (DACOs). CACO/DACO agreement will be executed to identify and specify functional responsibilities. Maintain constant coordination with DACOs.

FAR 42.6  
DFARS 42.6  
DLAM 8105.1 42.6

CORRECTIVE ACTION FOR CONTRACTOR'S QUALITY/INSPECTION PROBLEMS

Coordinate with QAR regarding course of action to resolve serious quality problems. Coordinate with Industrial Specialist (IS) if delivery schedule may be affected. Arrange conference with contractor and appropriate functional elements. Confirm agreements in writing to the contractor. If contractor fails to respond, forward facts with recommendation to PCO. Maintain followup with PCO to assure timely resolution of problem.

FAR 46, 42.302(a) (38)  
DFARS 46  
DLAM 8105.1 46.104

COST ACCOUNTING STANDARDS (CAS)

Determine adequacy of contractor's Disclosure Statements. Determine compliance of the Disclosure Statement with FAR and CASB rules, regulations and standards and with disclosed or established practices. Review and approve contractor accounting change proposals and any Disclosure Statement revisions related thereto. Determine contractor compliance with Cost Accounting Standards and Disclosure Statements, if applicable, and negotiate impact of changes or noncompliances as related to CAS-covered prime and subcontracts. Execute supplemental agreements related to prime contracts. When the total negotiation results in a gross adjustment of \$100,000 or more, submit to Region Board of Review.

FAR 30, 43.302(a) (11), 52.230-3 thru -5  
DFARS 30, DAR Appendix O  
DLAM 8105.1 30, 90.16-6

COST PERFORMANCE REPORT (CPR)

Assist, as required, in onsite review of contractor's proposed accounting and management control systems. Ensure timely receipt of CPR. Arrange for evaluation and provide comments on CPRs unless PCO specifically indicates that a review is not desired.

DLAM 8105.1 90.8  
DLAM 8400.2  
DLAH 8315.1 and 8315.2

COST/SCHEDULE CONTROL SYSTEMS CRITERIA (C/SCSC)

Schedule and conduct postaward conference. Maintain liaison with DCAA and DCAS Demonstration Team members to monitor contractor's progress toward implementation. Participate in preparing surveillance agreement with procuring activity. Assure implementation of a detailed surveillance program. Evaluate changes in the contractor's management system. Assure that recurring evaluations are performed. Advise DCAA of reports requiring audit verification. Distribute all C/SCSC reports. Issue supporting delegations where C/SCSC is extended to subcontracts. Prepare, execute and distribute Memorandum of Understanding when it is anticipated that contractor will have multiple contracts subject to C/SCSC. (See DODI 7000.2, Performance Measurement for Selected Acquisition).

DFARS 34.005, 42.302(a)(41), 52.234-7000, and -7001  
DLAM 8105.1 42.302

COST/SCHEDULE STATUS REPORT (C/SSR)

Provide assistance, as required, in onsite review of contractor's proposed accounting and management control systems. Ensure receipt of C/SSR within 25 days following reporting cutoff date. Arrange for evaluation and provide comments on C/SSRs unless PCO specifically indicates that a review is not desired.

DLAM 8105.1 90.08  
DLAM 8400.2  
DLAH 8315.3

DEBARRED, INELIGIBLE OR SUSPENDED CONTRACTORS

Screen the Consolidated List of Debarred, Suspended, and Ineligible Contractors prior to consenting to placement of subcontracts or novation or change of name agreements. Decline to consent to the subcontract if the subcontractor is on the list and advise the prime, in writing, accordingly. Decline to execute a novation or change of name agreement prior to notifying and obtaining advice from DCASR Counsel. Screen the Consolidated List when reviewing proposed changes to the contractor's make-or-buy schedule. If a proposed supplier is on the List, determine whether or not the proposed change would be in the Government's best interest and approve or deny the change accordingly, or submit recommendations to the PCO, depending on authority delegated. Upon receipt of notice of ineligibility, ensure that all PCOs with contracts with an ineligible contractor are promptly notified of the contractor's ineligibility for future contracts and requested to provide specific instructions regarding administration of existing contracts. Assure DCASR Counsel is made aware of any cause or condition which may affect a contractor's or subcontractor's present responsibility within the meaning of FAR 9.1.

FAR 9.1, 9.4  
DFARS 9.4  
DLAM 8105.1 9.4, 15.7, 42.12, 44.2

DEOBLIGATION OF EXCESS FUNDS

Notify PCO when it is determined that excess funds are available. When authorized, negotiate or negotiate and execute supplemental agreement deobligating excess funds.

FAR 42.302(b) (4)  
DLAM 8105.1 32.7, 43.103

DEVIATIONS FROM FAR, DFARS, DOD DIRECTIVE OR DLAM 8105.1

Request deviations when they are in the best interest of the Government. All requests for deviation from FAR, DFARS, or DoD Directive will be submitted, with full justification, through command channels to HQ DLA, ATTN: DLA-AC. Submit one-time deviation from DLAM 8105.1 to the DCASR, Director of Contract Management for approval. Requests for deviations from DLAM 8105.1 which affect more than one contract or transaction will be submitted in duplicate to HQ DLA, ATTN: DLA-AC.

FAR 1.4, 42.302(a) (47)  
DFARS 1.4  
DLAM 8105.1 1.4

DIMINISHING MANUFACTURING SOURCES AND MATERIAL SHORTAGES (DMSMS) PROGRAM

Advise all affected PCOs of any information provided by the IS or QAR with respect to the DMSMS program. Forward reports prepared by the IS to the PCO.

DLAM 8105.1 90.19

DISPUTES AND APPEALS

Prepare written final decision pursuant to the Disputes clause and the Contract Disputes Act of 1978 (CDA) on matters in which the CAO has the authority to take definitive action. Deliver to contractor by certified mail, return receipt requested or any other method that provides evidence of receipt. Assure claims over \$50,000 include the contractor certification required by the CDA. Immediately upon receiving notice of an appeal, forward it to DCASR Counsel. Coordinate all actions with DCASR Counsel.

FAR 33, 42.302(a) (10), 52.233-1  
DFARS 33  
DLAM 8105.1 33

DUTY AND CUSTOMS

Assure contractor compliance with Duty-Free Entry clauses, particularly the requirement for advance notification of foreign purchases. Promptly forward such notifications to DCASR New York. Assure prime contractors include substance of appropriate Duty-Free Entry clause(s) in subcontracts. Promptly respond to any inquiries generated by DCASR New York's automated system. When requested, verify status of imported supplies already received. Upon receipt of import documents from DCASR New York, review them to assure imported supplies are in accordance with the contract.

FAR 25.6, 42.302(a) (19), 52.225-10  
DFARS 25.6, 42.302(a) (74), 52.225-7008, and -7014  
DLAM 8105.1 25.6

#### ECONOMIC PRICE ADJUSTMENT (EPA) CLAUSES

Review and verify, in coordination with the Office of Comptroller and the Financial Services element, selected contractor certifications to assure compliance with the appropriate EPA clause. Evaluate EPA proposals submitted by the contractor and verify applicable price adjustments. Verify, at contract completion, the contractor's certification that all price decreases have been applied. When authorized, negotiate and definitize contract price adjustments resulting from exercise of an EPA clause.

FAR 16.203, 42.302(b)(7), 52.216-2 thru -4  
DFARS 16.2, 52.216-7000, and -7001  
DLAM 8105.1 16.203

#### ENGINEERING CHANGE PROPOSALS (ECPs)

Forward Class I ECPs to PCO together with the required technical evaluation, analyses and recommendations. Forward Class II ECPs, along with the QAR recommendation to the PCO for approval unless approval authority has been delegated to the CAO. The QAR will approve/disapprove Class II ECPs if authority is delegated.

DFARS 43.205, 52.243-7000, and -7001  
DLAM 8105.1 43.2-6

#### ENVIRONMENTAL PROTECTION

Conduct PAOC if necessary. Report violations of the Clean Air and Federal Water Pollution Control Act to the PCO. Assure contractor includes substance of the provisions of FAR clause 52.223-2 in nonexempt subcontracts.

FAR 23.1, 52.223-1, and -2  
DLAM 8105.1 23.1

#### EQUAL EMPLOYMENT OPPORTUNITY (EEO) PROGRAM

Determine, in coordination with the OFCCP, whether contractor is in compliance with the EEO program prior to issuing order in excess of \$1,000,000. Obtain Certificate of Clearance from the OFCCP regional office prior to consenting to placement of a subcontract of \$1,000,000 or more.

FAR 22.8, 52.222-26  
DFARS 22.8  
DLAM 8105.1 16.703, 22.101, 43.2, 44.3

#### FACILITIES CONTRACTS

Evaluate contractor requests for Government facilities or changes in facilities in coordination with Production and forward, with recommendations, to PCO. Assure proper acquisition or retention of IPE. Execute rental agreement if required. Forward rental payment checks to the Office of Comptroller immediately upon receipt. Certify accuracy of rental payment. Periodically review facilities contracts (see paragraph 45.4-14, DLAM 8105.1 for checklist).

FAR 42-302(a)(30), 45.302, 52.245-9  
DFARS 45.302  
DLAM 8105.1 45.4

### FACILITIES LEASES

Review and evaluate contractor lease requests in coordination with the Financial Services, Production, and Industrial Property Management elements. Submit requests, together with recommendations, to PCO. Assure compliance with the provisions of facilities leases.

DLAM 8105.1 45.3

DLAM 8300.1 5-200, 5-400

### FINANCIAL INFORMATION AND ANALYSIS

Obtain advice from the Financial Services element on extent and types of financial assistance required by contractors. Make appropriate recommendations to the PCO on financial assistance requirement of contractors.

FAR 32.108, 32.503-2

DFARS 32.173, 32.174

DLAM 8105.1 32.173, 32.4

### FIRST ARTICLE APPROVAL

Advise consignee of the contractual requirement for first article approval. Distribute approval, conditional approval, disapproval letters received from the PCO. Assure CAR is revised to reflect payment limitation in accordance with First Article Approval clause.

FAR 9.3, 52.209-3 and -4

DFARS 9.3

DLAM 8105.1 9.3, 32.592

### FORWARD PRICING RATES AND PRICING FORMULAS

Establish (execute) agreements with contractors for use of negotiated forward pricing rates and pricing formulas. Invite interested procurement activities to attend negotiations. Obtain recommendations from Board of Review before executing the agreement.

FAR 15.809, 42.302(a)(5)

DFARS 15.809

DLAM 8105.1 15.809

### FUNDS CONTROL

Establish controls and maintain records to provide visibility of the status of bulk fund commitments when delegated ordering authority under BOAs, maintenance, overhaul and repair contracts and contracts with provisioning requirements. Establish and maintain, as applicable, control registers such as DLA Forms 1514, Provisioned Items Order Register, 1515, Change Order Control Register, and 1516, Unpriced Order Control Register. Be alert for possible insufficient or excess funds. Notify PCO, as appropriate, and, if delegated, take action to deobligate excess funds.

DLAM 8105.1 16.703, 17.74, 90.03



GOVERNMENT PROPERTY

Assure, in coordination with the Property Administrator (PA), that contractor use of Government property is in accordance with DoD policy and applicable regulations. Execute rental agreement when required. Assure that screening for availability of Government ADPE and IPE is accomplished through appropriate approving channels prior to purchase by the contractor. Be cognizant of Utilization Surveys performed. Process DD Form 1651, Industrial Equipment Modernization Program - Post Analysis Report. Upon advice of PA, prepare and distribute notification of withdrawal of approval of property control system.

FAR 42.302(a)26, 45

DFARS 45.4, Supplement No. 3 (ASPR)

DLAM 8105.1 45.4, 45.5, 45.605

GOVERNMENT TITLE

Maintain surveillance of contractor's financial situation on contracts with progress payments to ensure that the Government's title to progress payment inventory is sufficiently protected. Obtain subordination agreements if necessary.

FAR 32.503-14, -15, -16

DLAM 8105.1 32.595

GUARANTEED MAXIMUM SHIPPING WEIGHTS AND DIMENSIONS

Resolve disagreements between the contractor and the Office of Comptroller with respect to contract price deductions pursuant to the Guaranteed Maximum Shipping Weights and Dimensions clause.

FAR 47.305-16, 52.247-60

DLAM 8105.1 47

GUARANTY AND SUBORDINATION AGREEMENTS (PREAWARD)

Acknowledge and distribute executed Guaranty and Subordination Agreements upon notice of contract award. Notify PCO if such Guaranty or Subordination Agreement is terminated. Remind PCO of existing agreements that support contracts being terminated for default.

DLAM 8105.1 9.1

INCENTIVE CONTRACTS

Develop working knowledge of the concepts of incentive contract administration. Establish method to assure receipt of information and advice from team members and other sources on a regular basis. Provide recommendations to PCO when adverse situations develop regarding incentive features. Establish controls to ensure timely receipt of data required by incentive provisions. Take action, as required, regarding price adjustments and funding surveillance.

FAR 16.4, 42.302(a)(15), (16), (17)

DFARS 16.4

DLAM 8105.1 16.4, 32.7, 90.06

#### INDEFINITE DELIVERY TYPE CONTRACTS

Ensure that functional elements and contractor have common understanding of scope of work and contract provisions. Coordinate with the Office of Comptroller on funds control. Establish order control register when authorized to issue unpriced orders. Obtain pricing support, negotiate, and definitize orders when authorized.

FAR 16.5

DFARS 16.5

DLAM 8105.1 16.703

#### JEWEL BEARINGS (REQUIRED SOURCE)

Consider postaward orientation on contracts which contain the Required Source for Jewel Bearings and Related Items clause. Establish controls to ensure verification of contractor compliance and appropriate flowdown of the clause to subcontracts. Review contractor/subcontractor requests for waiver and advise PCO of action taken.

FAR 8.2, 52.208-1, and -2

DLAM 8105.1 8.2, 42.5

#### LABOR RELATIONS

Notify the Industrial Labor Relations Officer (ILRO) upon receipt of any contract or subcontract which contains labor standards provisions. Rely on the ILRO to take action, as necessary, to assure contractor compliance with contract labor standards. Assure contract file is documented with evidence of actions completed by the ILRO.

FAR 22.101, 42.302(a) (34)

DFARS 22.101

DLAM 8105.1 22.101

#### LETTER CONTRACTS

Establish controls to monitor and assure compliance with definitization schedule. Report delays or anticipated delays to PCO. Monitor contractor expenditures. Advise PCO immediately upon receipt of contractor's proposal.

FAR 16.603

DFARS 16.603

DLAM 8105.1 16.603

#### LIMITATION OF COST OR FUNDS

Ensure receipt of required contractor notices of funding status. Forward advance copy to PCO. Request Financial Services element to evaluate notice. Prepare DLA Form 1069, Funds Analysis Control. Promptly notify PCO of excess funds eligible for deobligation.

FAR 32.7, 42.302(a) (17)

DFARS 32.7

DLAM 8105.1 32.7

#### LIQUIDATED DAMAGES

Ensure close surveillance of and proper priority for contracts with the Liquidated Damages provision. Ensure that all correspondence/documents pertinent to the provision are forwarded to the official file by functional elements via the ACO. Evaluate invoices covering delinquent shipments prior to payment. Determine PCO's position on approval of payment or assessment of damages when delinquencies occur. Pending PCO's decision, authorize payment (less amount in question) and submit copy of authorization to PCO with recommendations. Follow up with PCO and others as necessary to complete action.

FAR 12.2, 52.212-4

DLAM 8105.1 12.2

#### LOSS, DAMAGE OR DESTRUCTION OF GOVERNMENT PROPERTY

Assure that credit accrues to the Government as a result of credit memorandum or other adjusting documents issued by the PA. Review cases where contractor is to be held liable and furnish the contractor and PA with copies of the determination. Furnish the disbursing officer copies of written requests for (demand) payment issued to contractors.

FAR 45.5

DFARS 45.5, Supplement No. 3 (ASPR)

DLAM 8105.1 45.5

#### MAINTAINING LIAISON WITH PCO/PROGRAM MANAGER

Assist in preaward phase of procurement action, as requested. Inform PCO when newly assigned contracts contain outdated clauses or are not prepared in compliance with FAR/DFARS. Keep PCO advised of contract status and potential major problem areas. Obtain approval from HQ DLA before agreeing to any special Memorandum of Understanding with project managers or buying offices.

DLAM 8105.1 90.13

#### MAINTENANCE, OVERHAUL AND REPAIR CONTRACTS

Perform thorough review of contract requirements. Maintain close coordination with other functional elements. When authorized to issue, price, negotiate or definitize orders, establish controls to provide visibility of status of these orders. Establish system for work request review. Conduct regular program status meetings when required. Prepare and distribute minutes of the meetings to all attendees.

FAR 42.302(a) (21)

DLAM 8105.1 90.03

#### MAKE-OR-BUY (MOB) PROGRAMS

Assure contractor compliance with MOB schedules. Assure contractor establishment of programs that provide for submission of proposed changes. When authorized by PCO, consent to or deny requested changes. When authorized, negotiate and execute contract modifications resulting from changes to the MOB programs (including price revisions). Ensure subcontracts are consistent with prime's MOB program prior to consent.

FAR 15.7

DFARS 15.7

DLAM 8105.1 15.7

#### MATERIAL DEFICIENCY REPORTS (MDRs)/QUALITY DEFICIENCY REPORTS (QDRs)

Assist the QAR in the resolution of deficiency reports. Coordinate with other functional elements, including Counsel, to obtain and evaluate information and recommend or take appropriate action with respect to uncorrected deficiencies and/or warranty remedies (See DLAR 8260.2).

FAR 46

DFARS 46

DLAM 8105.1 46

#### MONITOR CONTRACTORS' COSTS

Establish and maintain Cost Monitoring Programs (CMPs) with contractors meeting certain qualifications. Advise the contractor of the Government's intention to initiate a CMP. Serve as leader of the DLA cost monitoring team and perform the functions identified in DLAM 8105.1, paragraph 42.70-5.

FAR 42.302(a)(8), 42.801

DFARS 42.70

DLAM 8105.1 42.70

#### MULTIYEAR PROCUREMENT (CANCELLATIONS)

Refer cancelled multiyear contract to Termination element for negotiation and settlement of claims.

FAR 17.1, 42.302(a)(24)

DFARS 17.103-70

DLAM 8105.1 17.1

#### NASA NEW TECHNOLOGY CLAUSE

Assure contractor is aware of requirements of clause. Arrange for review of contractor's implementation plan by the Engineering element. Advise PCO or designated Technology Utilization Officer if contractor is not complying with his New Technology plan.

DLAM 8105.1 90.04

#### NONCONFORMING SUPPLIES AND SERVICES

Submit Type I nonconformance requests to PCO along with comments and recommendations. Negotiate contract price adjustments and issue contract modifications required by acceptance of Type II nonconformances by the QAR.

FAR 46

DFARS 46

DLAM 8105.1 46

NOTICE OF INTENT TO DISALLOW OR NOT RECOGNIZE COSTS

Issue a Notice of Intent to Disallow or Not Recognize Costs when deemed appropriate. Coordinate with the Regional Cost Monitoring Specialist and the auditor prior to issuing notice. Within 60 days receipt of contractor's written response to the notice, either withdraw or modify the notification in writing or issue a final decision pursuant to the Disputes clause in the contract. When required, submit appropriate documentation for Board of Review action.

FAR 42.302(a)(8), 42.801  
DFARS 42.801  
DLAM 8105.1 42.801, 90.16

NOVATION AND CHANGE OF NAME AGREEMENTS

Develop, process, and execute agreements on a priority basis. Obtain DCASR Counsel review of all agreements prior to execution. Obtain approval from appropriate Departments/Agencies prior to executing a novation agreement. Distribute executed agreements in accordance with FAR and DFARS. Prepare and distribute required administrative change (SF 30, Amendment of Solicitation/Modification of Contract).

FAR 42.12, 42.302(a)(25)  
DFARS 42.12  
DLAM 8105.1 42.12

OVERTIME

Perform periodic reviews of contractor's use of approved overtime. Prepare report of each review for contract file. Forward contractor requests for additional overtime or premium approval to PCO together with a factual analysis and appropriate recommendation.

FAR 22.103, 52.222-2  
DFARS 22.103  
DLAM 8105.1 22.103

PACKING, CRATING, AND HANDLING (PC&H) SERVICES

Issue contract modification incorporating funds for PC&H services on excess Government property if required. When determined to be in the Government's best interest, contract for such services with a vendor other than the contractor in possession of the property. Submit proposed contracts of \$30,000 or more to the Board of Review. Distribute contracts in accordance with FAR 4.2 and DFARS 4.202. Prepare and distribute DD Form 350, Individual Procurement Action Report, if the contract is in excess of \$25,000. For contracts less than \$25,000 forward a copy of the contract marked "For Monthly Procurement Summary Report" to the DCASR Directorate of Command Support.

FAR 42.302(a)(29), 45.608-7  
DFARS 4.202  
DLAM 8105.1 45.608, 90.16

## PATENTS

Assure contractor compliance with the invention disclosure and reporting provisions of the Patent Rights clauses. Assist PCO/Patent Counsel as requested. Assure receipt of patent clearance prior to authorizing final payment. Forward royalty information to the PCO/Patent Counsel.

FAR 27.2, 27.3  
DFARS 27.3  
DLAM 8105.1 27

## POSTAWARD ORIENTATION OF CONTRACTORS

Determine extent and method of postaward orientation required. Complete DLA Form 1533, Postaward Orientation Determination. Conduct required postaward orientation, i.e., formal or limited conference or postaward letter/telephone call.

FAR 42.302(a)(3), 42.5  
DFARS 42.5  
DLAM 8105.1 42.5

## PREAWARD SURVEYS

Provide any known information, which could impact on the evaluation of the offeror, to the preaward survey monitor. Arrange for DCAA accounting systems reviews when required. Assure close surveillance of contractors who are awarded contracts subsequent to a negative preaward survey.

FAR 9.1  
DFARS 9.105, 9.106  
DLAM 8105.1 9.1, 16.104-4

## PRECISION COMPONENTS FOR MECHANICAL TIME DEVICES

Establish controls and perform periodic checks of contractor records to ensure contractor/subcontractor compliance with procedures governing the purchase/supply of precision components. Serve as a focal point for the CAO for all actions relating to the clause.

DFARS 8.74, 52.208-7001  
DLAM 8105.1 8.2

## PRICE/COST ANALYSIS

Request pricing assistance from the Financial Services element as required by DLAM 8105.1, Part 15.805. Perform price analysis on proposals when pricing assistance is not required. Advise PCO of anticipated date of the completed report. Review the pricing report for content and accuracy and transmit to the PCO.

FAR 15.8  
DFARS 15.8  
DLAM 8105.1 15.805

### PROGRESS PAYMENTS

Verify that the contractor's accounting system is adequate. Review and approve progress payment requests. Ensure that progress payment requests conform to the terms and requirements of the contract which impact on progress payments (e.g., progress payment rates, liquidation rates, presence of Foreign Military Sales provisions, first article requirements, -etc.). Reduce or suspend progress payments if necessary. Obtain subordination agreements if necessary to protect Government's interest in progress payment inventory. Forward Reports of Adverse Developments to the Production element, PCO, DCASR, HQ DLA, and the Contract Finance Office of the Department or Agency concerned.

FAR 32.5 42.302(a) (12)

DFARS 32.5

DLAM 8105.1 32.590 thru 32.594

### PROVISIONED ITEMS

Assure contractor's progress during the provisioning cycle is monitored. Issue Provisioned Items Orders and obligate funds as delegated. Negotiate and definitize unpriced Provisioned Items Orders. Maintain control register. Process changes to Provisioned Items as directed.

DFARS 15.8, 17.74

DLAM 8105.1 17.74

### RADIOACTIVE MATERIALS

Assure, if so delegated, that appropriate licenses are obtained or safeguards are taken upon receipt of contractor's notice of radioactive materials. Take actions to ensure that applicable deliveries are clearly marked and labeled as required, especially where inspection is at destination. Forward contractor's notice to the using activity to alert it to the hazards involved.

DFARS 23.303, 52.223-7000

### REASSIGNMENT OF CONTRACT ADMINISTRATION/DISBURSING RESPONSIBILITIES TO ANOTHER CAO

Issue a unilateral contract modification to reassign contracts which are either incorrectly assigned or transferred. Issue modification for change in place of manufacture if authorized by PCO. Assure contract files are forwarded to new CAO along with brief summary of actions of which new CAO should be immediately aware.

FAR 42.206

DFARS 42.205

DLAM 8105.1 42.206

### RIGHTS IN TECHNICAL OR OTHER DATA AND COPYRIGHTS

Determine appropriate action upon receipt of information from the QAR/IS or the Systems and Engineering element that compliance with contractual requirements pertinent to technical data is unsatisfactory.

Withhold payment if warranted. Conduct periodic review of contractor's written procedures for the use of restrictive markings on technical data. Submit written inquiry to the contractor if technical data is received with unauthorized or improper restrictive markings. If contractor is not complying with the procedures governing restrictive markings, take corrective action as specified in DFARS 52.227-7018.

FAR 27.4, 42.302(a) (48)  
DFARS 27.4, 52.227-7013, thru 7037  
DLAM 8105.1 27.4

#### SAFETY PRECAUTIONS

Assure contractor compliance with contractual provisions pertaining to ammunition, explosions and other dangerous/hazardous material. Rely upon technical expertise of the Specialized Safety Office on all safety matters. Review and process safety reports. Advise Specialized Safety Office of actions taken.

FAR 23.3, 52.223-3  
DFARS 23.3, 28.71, 52.223-7000, 52.228-7007  
DLAM 8105.1 23.3

#### SECURITY REQUIREMENTS

Maintain close coordination with Industrial Security Staff Specialists when administering classified contracts. Approve and sign DD Form 254, Contract Security Classification Specification for Classified Subcontracts. Perform security-related functions as outlined in DoD 5220.22-R, Industrial Security Regulation.

FAR 4.4, 52.204-1 and -2, 53.204-1  
DFARS 42.302(a) (73)  
DLAM 8105.1 4.4

#### SERVICE CONTRACT ACT OF 1965

Assure compliance with the reporting requirements under the Service Contract Act clauses when issuing orders under BOAs or BPAs which contain such clauses.

DAR XII, Part 10

#### SHOULD COST REVIEWS

Assist the Should Cost team in the review planning stage by providing comments relative to contractors' known strengths and weaknesses. Advise the team during the course of the review. Coordinate the efforts of DCAS elements involved in the review. Coordinate DCAS efforts in monitoring a contract resulting from the review. Advise the procuring activity of significant developments in contractor performance relative to contractually-imposed review objectives. Participate on review teams if assigned.

FAR 15.810  
DFARS 15.810  
DLAM 8105.1 15.810



### SMALL BUSINESS, LABOR SURPLUS, SMALL DISADVANTAGED BUSINESS REQUIREMENTS

Conduct postaward orientation for all new small business/small disadvantaged business contractors who have been awarded their first Government contract. Rely on the Small and Disadvantaged Business Utilization (SADBU) Specialist to maintain surveillance and conduct periodic reviews of contractors who must comply with subcontracting program clauses pertaining to small business, labor surplus area, or small disadvantaged business concerns. Furnish PCOs with copies of reports furnished by the SADBU Specialist which cite deficiencies in a contractor's subcontracting program. Maintain frequent liaison with Section 8(a) Small Business Administration subcontractors.

FAR 19.7, 19.8, 42.302(a) (52) thru (55)

DFARS 19.2, 19.5, 19.7

DLAM 8105.1 19

### SPECIAL TEST EQUIPMENT

Review contractor's notice of intent to acquire or fabricate items of special test equipment. Ascertain whether Government-owned property can be furnished in lieu thereof. Resolve any funding problems with the PCO. Notify contractor of approval/disapproval of the proposed acquisition or fabrication, or that the equipment will be furnished by the Government.

FAR 42.302(a) (27), 45.3, 52.245-18

DFARS 45.403

DLAM 8105.1 45.4

### SPECIAL TOOLING

Determine contractor's ability to discharge his obligations under the Special Tooling clause. If the contractor's procedures, records, or controls are inadequate, advise the contractor of the deficiencies and obtain corrective action. Acquire initial tooling list if specified in contract or requested by PCO and forward to PCO. Obtain final tooling list and forward to PCO. Assure proper disposition of special tooling prior to contract closeout.

FAR 45.3, 45.6

DFARS 45.306

DLAM 8105.1 45.306

### SUPPLEMENTAL AGREEMENTS

Negotiate and execute supplemental agreements when authorized by the PCO, contract or FAR/DFARS 42.302 for actions such as definitized change orders, negotiated overhead rates, revised delivery schedules, provisioning orders, orders under BOAs, etc. Set forth in negotiation memorandum, all terms of the supplemental agreement. Coordinate with DCASR Counsel when nonstandard contractual provisions are included in the supplemental agreement. Obtain the recommendation of the DCASR Board of Review prior to execution of the supplemental agreement. Include the change or impact on unit price/cost, quantity, appropriation data, and delivery schedule in the modification. Assure obligation or deobligation of funds information is identified to the funding activity.

FAR 42.302, 43

DFARS 43

DLAM 8105.1 43.103

#### SUPPORTING CONTRACT ADMINISTRATION

Consider value, complexity, type of contract, and importance of work allocated to other locations when determining need for supporting administration. Transmit consolidated delegation letter to the supporting CAO with sufficient copies of contractual documents and other pertinent data. Notify the prime contractor of functions being delegated. Ensure that performance information is received from supporting CAO. Advise prime ACO of deficiencies or unsatisfactory conditions noted while performing supporting administration. Maintain communication between requesting/ supporting ACO. Process overseas delegations in accordance with DLAM 8105.1, 42.204-6.

FAR 42.204

DFARS 42.204

DLAM 8105.1 42.204

#### TAXES

Consult with DCASR Counsel in resolving tax problems. Refer matters requiring negotiation with tax authorities to the PCO. Evaluate proposed price adjustments to fixed-price contracts resulting from tax changes and forward recommendations to the PCO. Determine allowability of taxes in cost-reimbursement type contracts. In the event of lost or destroyed shipments, assure appropriate adjustments to reflect reduction in articles subject to excise tax exemption. Coordinate receipt and return of alcohol tax certificates through DCASR New York.

FAR 29, 42.302(a)(18)

DFARS 29

DLAM 8105.1 29

#### TERMINATION FOR CONVENIENCE

Notify the DCASR TCO by telephone immediately upon receipt of a termination for convenience notice. Provide copies of the notice to the Office of Comptroller, the regional Contract Employment Compliance activity and the TCO. Assure appropriate closeout actions upon complete termination of a contract.

FAR 49

DFARS 49

DLAM 8105.1 4.804-9

#### TERMINATION FOR DEFAULT

Take action under contracts terminated for default only in response to, and in support of, the PCO. Advise all functional elements concerned of the termination and forward to the PCO any information with respect to actions required to protect the Government's interest. Notify CAOs involved in supporting administration. Assure all required actions are complete prior to closeout.

FAR 49.4

DFARS 49.402

DLAM 8105.1 4.804-9, 49.4

#### TRAVEL BY CONTRACTOR PERSONNEL OUTSIDE CONUS

Approve requests for overseas travel. Obtain PCO approval when not provided in contract. Obtain DISCO personnel security clearance verification when visit involves disclosure of classified information. Obtain approval for visit from the U.S. overseas activity to be visited. Assure that the travel is necessary to contract performance. Forward the original DLA Form 437, Request for Authorization for Overseas Travel - Contractor Personnel to Transportation Operations element for completion of travel arrangements.

DLAM 8105.1 90.02

#### UNSATISFACTORY PROPERTY CONTROL SYSTEMS

Notify the contractor in writing of changes required to correct property control system deficiencies and establish a schedule for completion of corrective actions. Advise that failure to correct deficiencies as specified could result in the withholding or withdrawal of system approval and subsequent increase in contractor liability for loss or damage. Provide written notice of final determination as appropriate.

FAR 45.5

DLAM 8105.1 45.4, 45.5

#### VALUE ENGINEERING CHANGE PROPOSALS (VECPs)

Request technical review of VECP from Systems and Engineering element and forward with comments to the PCO. If required, follow up with PCO after coordination with the Systems and Engineering element. Forward copy of PCO's approval or disapproval of VECP to Systems and Engineering element. When requested by the PCO, obtain a review and evaluation from the Financial Services element. Analyze review and evaluation and furnish comments and recommendations to the PCO.

FAR 42.302(a)(49), 48

DLAM 8105.1 48

#### VARIATION IN QUANTITY CLAUSE

Request additional shipping instructions from the procuring activity if required as a result of a permitted variation. Coordinate with the PCO regarding acceptability of a variation which is more or less than that permitted by the contract. Ensure appropriate notices to the contractor as well as contractual modifications/adjustments to reflect the desires of the PCO.

FAR 12.4, 52.212-9 thru -11

DFARS 12.4

DLAM 8105.1 12.4

VOLUNTARY REFUNDS

Forward voluntary refund checks received from contractors immediately to the Disbursing Officer making payments for the contract and request acknowledgement of receipt. If possible, provide the information required by DFARS 42.710(b). Forward recommendations to solicit voluntary refunds to HQ DLA, Executive Director, Contract Management, for his decision.

DFARS 42.71, 42.7102(b)  
DLAM 8105.1 42.71

WALSH-HEALEY PUBLIC CONTRACTS ACT

Ensure that contractors subject to the Act are furnished the prescribed poster (W.H. Publication 1313, Notice to Employees Working on Government Contracts). Forward reports of alleged violations involving safety of the type foreseen by the Act to the cognizant Occupational Safety and Health Administration (OSHA) Area Director.

FAR 22.6  
DFARS 22.6  
DLAM 8105.1 22.6

**PART 42**

**CONTRACT ADMINISTRATION**

**42.000 Scope of part.**

This part prescribes general policies and procedures for performing contract administration functions and related audit services.

**SUBPART 42.1—INTERAGENCY CONTRACT ADMINISTRATION AND AUDIT SERVICES**

**42.100 Scope of subpart.**

This subpart prescribes policies and procedures for obtaining and providing interagency contract administration and audit services in order to (a) provide specialized assistance through field offices located at or near contractors' establishments, (b) avoid or eliminate overlapping and duplication of Government effort, and (c) provide more consistent treatment of contractors.

**42.101 Policy.**

(a) Agencies requiring field contract administration or audit services are encouraged to use cross-servicing arrangements with existing contract administration and contract audit components (see 42.102(a) for the directories of cognizant offices). The customer agency and the servicing agency shall enter into a formal cross-servicing arrangement when the volume of work or other circumstances warrants a formal understanding.

(b) Multiple reviews, inspections, and examinations of a contractor or subcontractor by several agencies involving the same practices, operations, or functions shall be eliminated to the maximum practicable extent through the use of cross-servicing arrangements.

(c) OMB Circular No. A-73, Audit of Federal Operations and Programs, states executive branch policy on audit cross-servicing arrangements. As further provided in OFPP Policy Letter 78-4, Field Contract Support Cross-Servicing Program, (1) agencies shall use cross-servicing arrangements for the audit of costs incurred under contracts of two or more agencies being performed at the same business entity, and (2) the responsible auditor or contracting officer shall coordinate with concerned agencies the establishment of indirect cost rates at such entities and shall convey the finally established rates to those agencies for application to their contracts to the extent allocable and allowable (see Subpart 42.7).

(d) Subject to the fiscal regulations of the agencies concerned, agencies (1) may be reimbursed in accordance with the Economy Act of 1932 (31 U.S.C. 1535)

for services rendered under formal or informal cross-servicing arrangements, (2) normally should refrain from seeking reimbursement for cross-servicing accomplished incidental to their own needs or Government-wide responsibilities, and (3) may use the hourly rate established under the cross-servicing arrangement between the Department of Defense and the National Aeronautics and Space Administration to facilitate reimbursement arrangements.

(e) Agencies are not expected to enter into cross-servicing arrangements that would unduly burden agency resources or otherwise obstruct an agency in fulfilling its responsibilities.

**42.102 Procedures.**

(a) In locating available field contract administration or audit services, contracting offices shall consult the Department of Defense Directory of Contract Administration Services Components or the Directory of Federal Contract Audit Offices. Questions regarding contract administration offices may be referred to the Defense Logistics Agency, Attn: DLA-AO, Cameron Station, Alexandria, Virginia, 22314. Questions regarding audit offices may be referred to the Defense Contract Audit Agency, Attn: OTD, Cameron Station, Alexandria, Virginia, 22314. Agencies having a field contract administration or audit cross-servicing capability shall arrange for identification of this capability (including changes as they occur) in the appropriate directory by contacting one of these offices.

(b) Services may be obtained by direct request to the cognizant contract administration or audit component indicated in the applicable directory or as specified in a formal cross-servicing arrangement (see 42.101(a)).

(c) Except for requests submitted under formal cross-servicing arrangements, requests for services from Government agencies may be declined on a case-by-case basis if resources are inadequate to accomplish delegated tasks, provided the decision is made by an official above the level of the contract administration office, or as otherwise provided in agency regulations.

(d) Contract administration and audit services will be performed using the procedures of the servicing agency unless formal agreements between agencies provide otherwise.

(e) Both the requesting and servicing activities are responsible for prudent use of the services provided under either formal or informal interagency cross-servicing arrangements. When it is appropriate, servicing activities shall counsel requesting agencies or contract-

ing offices concerning the desirability and practicality of relaxing or waiving controls and surveillance that may not be necessary to ensure satisfactory contract performance.

#### SUBPART 42.2—ASSIGNMENT OF CONTRACT ADMINISTRATION

##### 42.200 Scope of subpart.

This subpart prescribes policies and procedures for (a) assigning, retaining, or reassigning contract administration responsibility, (b) withholding normal functions or delegating additional functions when assigning contracts for administration, and (c) requesting and performing supporting contract administration. Subpart 42.3 lists both the normal contract administration functions and those requiring specific authorization by the contracting office.

##### 42.201 Definition.

"Supporting contract administration" means performance of specific contract administration functions by another contract administration office (CAO) as required by (a) the CAO to which a contract is assigned for administration or (b) the contracting office retaining a contract for administration.

##### 42.202 Assignment of contract administration.

(a) *Authority.* Except as provided in paragraph (b) below, assignment of a contract to a CAO for administration automatically carries with it the authority to perform all of the normal functions listed in 42.302(a) to the extent that those functions apply to the contract. The CAO has the authority to perform the functions requiring specific authorizations, listed in 42.302(b), only to the extent specified by the contracting office. No other function shall be performed by the CAO unless delegated as provided under 42.202(c).

(b) *Withholding normal functions.* In assigning a contract for administration by a CAO, the contracting office may withhold individual functions among those listed in 42.302(a) if—

(1) Their retention by the contracting office is required by (i) the contracting agency's level acquisition regulations or (ii) a formal interagency cross-servicing arrangement (see 42.101(a) and 42.102(b)); or

(2) It is clear, after consultation with the CAO when appropriate, that they can best be performed by the contracting office and the decision to withhold them is approved above the contracting officer's level.

(c) *Delegating additional functions.* For individual contracts or groups of contracts, the contracting office may delegate to the CAO functions not listed in 42.302; provided, that—

(1) Prior coordination with the CAO ensures the availability of required resources;

(2) In the case of authority to issue orders under provisioning procedures in existing contracts and

under basic ordering agreements for items and services identified in the schedule, the head of the contracting activity or designee approves the delegation; and

(3) The delegation does not require the CAO to undertake new or follow-on acquisitions.

(d) *Transmittal and documentation.* When assigning a contract for administration by a CAO, the contracting officer shall—

(1) Enter on the contract the name and address of the CAO designated to administer it;

(2) Provide any special instructions, including any specific authorization to perform functions listed in 42.302(b), in an accompanying letter to the CAO;

(3) Include, along with the contract furnished to the CAO, copies of all contracting agency regulations or directives that are (i) incorporated into the contract by reference or (ii) otherwise necessary to administer the contract, unless copies have been previously provided; and

(4) Advise the contractor (and other activities as appropriate) of any functions withheld or additional functions delegated in the special instructions under subparagraph (2) above.

(e) *Contract administration office responsibilities.* For each contract assigned for administration, the CAO shall—

(1) Perform the functions listed in 42.302(a) to the extent that they apply to the contract, except for any functions specifically withheld under paragraph (b) above;

(2) Perform the functions listed in 42.302(b) to the extent that they apply and are specifically authorized by the contracting office;

(3) Serve as a focal point for inquiries and keep the contracting office and other interested activities advised concerning all pertinent matters related to administration of the contract;

(4) Request supporting contract administration under 42.204 when it is required; and

(5) Reassign contract administration under 42.206(a) if reassignment is required.

##### 42.203 Retention of contract administration.

(a) Contracting offices shall retain for administration any contract (1) not requiring the performance of contract administration functions (see 42.302) at or near contractor facilities, or (2) for which retention by the contracting office is prescribed by agency acquisition regulations. However, 30.401 requires that retained contracts to which Cost Accounting Standards (CAS) apply be assigned for CAS administration only. Instructions for marking and distributing these contracts are provided in 4.201(c).

(b) Contracting offices or CAOs may request supporting contract administration under 42.204 for contracts for which they have contract administration responsibility. However, if a substantial proportion of the

normal contract administration functions listed in 42.302(a) are to be requested, an official above the contracting officer's level shall review the validity of retaining administration while requesting extensive supporting contract administration.

#### 42.204 Supporting contract administration.

(a) A CAO assigned a contract for administration under 42.202 or a contracting office retaining administration under 42.203 may request supporting contract administration from the CAO cognizant of the contractor location where performance of specific contract administration functions is required. The request shall (1) be in writing, (2) clearly state the specific functions to be performed, and (3) be accompanied by a copy of pertinent contractual and other necessary documents.

(b) The prime contractor is responsible for managing its subcontracts. The CAO's concern with subcontracts is normally limited to evaluating the prime contractor's management of them (see Part 44). Therefore, supporting contract administration shall not be used for subcontracts unless (1) the Government would otherwise incur undue cost, (2) successful completion of the prime contract is threatened, or (3) it is authorized under paragraph (c) below or elsewhere in this regulation.

(c) For major system acquisitions (see Part 34), the contracting officer may designate certain high-risk or critical subsystems or components for special surveillance (see 44.205) in addition to requesting supporting contract administration. This surveillance shall be conducted in a manner fully consistent with the policy of calling upon the cognizant CAO to perform contract administration functions at a contractor's facility (see Subpart 42.1).

#### 42.205 Designation of the paying office.

If the information is available, the contracting officer shall enter on the contract the name and address of the office designated under agency procedures to make payments on the contract. Unless agency acquisition regulations otherwise provide, the assignment of contract administration to a CAO does not affect the designation of the paying office.

#### 42.206 Reassignment of contract administration.

(a) The administrative contracting officer at the CAO of initial assignment shall reassign a contract for administration when the need for reassignment results from (1) an incorrect initial assignment, (2) organizational transfer of the cognizant CAO, (3) establishment or disestablishment of a CAO, or (4) a change in a CAO's geographical responsibility.

(b) The contracting officer at the contracting office shall reassign a contract for administration when reasons other than those in paragraph (a) above make reassignment appropriate.

(c) To reassign a contract, the responsible contracting officer shall use a unilateral contract modification. The CAO of initial assignment shall transfer the con-

tract file and necessary supporting documents to the successor CAO.

(d) When warranted by a change in circumstances and approved at a higher level, a contracting officer may recall a contract or function previously assigned for administration.

### SUBPART 42.3—CONTRACT ADMINISTRATION OFFICE FUNCTIONS

#### 42.301 General.

When a contract is assigned for administration under Subpart 42.2, the contract administration office (CAO) shall perform contract administration functions in accordance with this regulation, the contract terms, and, unless otherwise agreed upon in formal cross-servicing arrangements (see 42.101(a)), the applicable regulations of the servicing agency.

#### 42.302 Contract administration functions.

(a) The following are the normal contract administration functions to be performed by the cognizant CAO, to the extent they apply, as prescribed in 42.202:

- (1) Review the contractor's compensation structure.
- (2) Review the contractor's insurance plans.
- (3) Conduct post-award orientation conferences.
- (4) Review and evaluate contractors' proposals under Subpart 15.8 and, when negotiation will be accomplished by the contracting officer, furnish comments and recommendations to that officer.
- (5) Negotiate forward pricing rate agreements (see 15.809).
- (6) Negotiate advance agreements applicable to treatment of costs under contracts currently assigned for administration (see 31.109).
- (7) Determine the allowability of costs suspended or disapproved as required (see Subpart 42.8), direct the suspension or disapproval of costs when there is reason to believe they should be suspended or disapproved, and approve final vouchers.
- (8) Issue Notices of Intent to Disallow or not Recognize Costs (see Subpart 42.8).
- (9) Establish final indirect cost rates and billing rates for those contractors meeting the criteria for contracting officer determination in Subpart 42.7.
- (10) Prepare findings of fact and issue decisions under the Disputes clause on matters in which the administrative contracting officer (ACO) has the authority to take definitive action.
- (11) In connection with Cost Accounting Standards (see Part 30)—
  - (i) Determine the adequacy of the contractor's disclosure statements;
  - (ii) Determine whether disclosure statements are in compliance with Cost Accounting Standards and Part 31;

- (iii) Determine the contractor's compliance with Cost Accounting Standards and disclosure statements, if applicable; and
- (iv) Negotiate price adjustments and execute supplemental agreements under the Cost Accounting Standards clauses at 52.230-3, 52.230-4, and 52.230-5.
- (12) Review and approve or disapprove the contractor's requests for payments under the progress payments clause.
- (13) Make payments on assigned contracts when prescribed in agency acquisition regulations (see 42.205).
- (14) Manage special bank accounts.
- (15) Ensure timely notification by the contractor of any anticipated overrun or underrun of the estimated cost under cost-reimbursement contracts.
- (16) Monitor the contractor's financial condition and advise the contracting officer when it jeopardizes contract performance.
- (17) Analyze quarterly limitation on payments statements and recover overpayments from the contractor.
- (18) Issue tax exemption certificates.
- (19) Ensure processing and execution of duty-free entry certificates.
- (20) For classified contracts, administer those portions of the applicable industrial security program designated as ACO responsibilities (see Subpart 4.4).
- (21) Issue work requests under maintenance, overhaul, and modification contracts.
- (22) Negotiate prices and execute supplemental agreements for spare parts and other items selected through provisioning procedures when prescribed by agency acquisition regulations.
- (23) Negotiate and execute contractual documents for settlement of partial and complete contract terminations for convenience, except as otherwise prescribed by Part 49.
- (24) Negotiate and execute contractual documents settling cancellation charges under multi-year contracts.
- (25) Process and execute novation and change of name agreements under Subpart 42.12.
- (26) Perform property administration (see Part 45).
- (27) Approve contractor acquisition or fabrication of special test equipment under the clause at 52.245-18, Special Test Equipment.
- (28) Perform necessary screening, redistribution, and disposal of contractor inventory.
- (29) Issue contract modifications requiring the contractor to provide packing, crating, and handling services on excess Government property. When the ACO determines it to be in the Government's interests, the services may be secured from a contractor other than the contractor in possession of the property.
- (30) In facilities contracts—
  - (i) Evaluate the contractor's requests for facilities and for changes to existing facilities and provide appropriate recommendations to the contracting officer;
  - (ii) Ensure required screening of facility items before acquisition by the contractor;
  - (iii) Approve use of facilities on a noninterference basis in accordance with the clause at 52.245-9, Use and Charges;
  - (iv) Ensure payment by the contractor of any rental due; and
  - (v) Ensure reporting of items no longer needed for Government production.
- (31) Perform production support, surveillance, and status reporting, including timely reporting of potential and actual slippages in contract delivery schedules.
- (32) Perform pre-award surveys (see Subpart 9.1).
- (33) Advise and assist contractors regarding their priorities and allocations responsibilities and assist contracting offices in processing requests for special assistance and for priority ratings for privately owned capital equipment.
- (34) Monitor contractor industrial labor relations matters under the contract; apprise the contracting officer and, if designated by the agency, the cognizant labor relations advisor, of actual or potential labor disputes; and coordinate the removal of urgently required material from the strikebound contractor's plant upon instruction from, and authorization of, the contracting officer.
- (35) Perform traffic management services, including issuance and control of Government bills of lading and other transportation documents.
- (36) Review the adequacy of the contractor's traffic operations.
- (37) Review and evaluate preservation, packaging, and packing.
- (38) Ensure contractor compliance with contractual quality assurance requirements (see Part 46).
- (39) Ensure contractor compliance with applicable safety requirements, including contractual requirements for the handling of hazardous and dangerous materials and processes.
- (40) Perform engineering surveillance to assess compliance with contractual terms for schedule, cost, and technical performance in the areas of design, development, and production.
- (41) Evaluate for adequacy and perform surveillance of contractor engineering efforts and management systems that relate to design, development, production, engineering changes, subcontractors, tests, management of engineering resources, reliability and maintainability, data control systems, configuration management, and independent research and development.



(42) Review and evaluate for technical adequacy the contractor's logistics support, maintenance, and modification programs.

(43) Report to the contracting office any inadequacies noted in specifications.

(44) Perform engineering analyses of contractor cost proposals.

(45) Review and analyze contractor-proposed engineering and design studies and submit comments and recommendations to the contracting office, as required.

(46) Review engineering change proposals for proper classification, and when required, for need, technical adequacy of design, producibility, and impact on quality, reliability, schedule, and cost; submit comments to the contracting office.

(47) Assist in evaluating and make recommendations for acceptance or rejection of waivers and deviations.

(48) Evaluate and monitor the contractor's procedures for complying with procedures regarding restrictive markings on data.

(49) Monitor the contractor's value engineering program.

(50) Review, approve or disapprove, and maintain surveillance of the contractor's purchasing system (see Part 44).

(51) Consent to the placement of subcontracts.

(52) Review, evaluate, and approve plant or division-wide small and small disadvantaged business master subcontracting plans.

(53) Obtain the contractor's currently approved company- or division-wide plans for small business and small disadvantaged business subcontracting for its commercial products, or, if there is no currently approved plan, assist the contracting officer in evaluating the plans for those products.

(54) Assist the contracting officer, upon request, in evaluating an offeror's proposed small business and small disadvantaged business subcontracting plans, including documentation of compliance with similar plans under prior contracts.

(55) By periodic surveillance, ensure the contractor's compliance with small business and small disadvantaged business subcontracting plans and any labor surplus area contractual requirements; maintain documentation of the contractor's performance under and compliance with these plans and requirements; and provide advice and assistance to the firms involved, as appropriate.

(56) Maintain surveillance of flight operations.

(57) Assign and perform supporting contract administration.

(58) Ensure timely submission of required reports.

(59) With the exception of changes in accounting and appropriation data which must be issued by the contracting office, issue administrative changes (see 43.101).

(60) Cause release of shipments from contractor's plants according to the shipping instructions. When applicable, the order of assigned priority shall be followed; shipments within the same priority shall be determined by date of the instruction.

(61) Obtain contractor proposals for any contract price adjustments resulting from amended shipping instructions. ACO's shall review all amended shipping instructions on a periodic, consolidated basis to assure that adjustments are timely made. Except when the ACO has settlement authority, the ACO shall forward the proposal to the contracting officer for contract modification. The ACO shall not delay shipments pending completion and formalization of negotiations of revised shipping instructions.

(b) The CAO shall perform the following functions only when and to the extent specifically authorized by the contracting office:

(1) Negotiate or negotiate and execute supplemental agreements incorporating contractor proposals resulting from change orders issued under the Changes clause. Before completing negotiations, coordinate any delivery schedule change with the contracting office.

(2) Negotiate prices and execute priced exhibits for unpriced orders issued by the contracting officer under basic ordering agreements.

(3) Negotiate or negotiate and execute supplemental agreements changing contract delivery schedules.

(4) Negotiate or negotiate and execute supplemental agreements providing for the deobligation of unexpended dollar balances considered excess to known contract requirements.

(5) Issue amended shipping instructions and, when necessary, negotiate and execute supplemental agreements incorporating contractor proposals resulting from these instructions.

(6) Negotiate changes to interim billing prices.

(7) Negotiate and definitize adjustments to contract prices resulting from exercise of an economic price adjustment clause (see Subpart 16.2).

(8) Issue change orders and negotiate and execute resulting supplemental agreements under contracts for ship construction, conversion, and repair.

(c) Any additional contract administration functions not listed in 42.302(a) and (b), or not otherwise delegated, remain the responsibility of the contracting office.

#### SUBPART 42.4—CORRESPONDENCE AND VISITS

##### 42.401 Contract correspondence.

(a) The contracting officer (or other contracting agency personnel) normally shall (1) forward correspondence relating to assigned contract administration functions through the cognizant contract administration office (CAO) to the contractor and (2) provide a copy for the CAO's file. When urgency requires sending

such correspondence directly to the contractor, a copy shall be sent concurrently to the CAO.

(b) The CAO shall send the contracting office a copy of pertinent correspondence conducted between the CAO and the contractor.

#### 42.402 Visits to contractors' facilities.

(a) Government personnel planning to visit a contractor's facility in connection with one or more Government contracts shall provide the cognizant CAO with the following information, sufficiently in advance to permit the CAO to make necessary arrangements:

(1) Visitors' names, official positions, and security clearances.

(2) Date and duration of visit.

(3) Name and address of contractor and personnel to be contacted.

(4) Contract number, program involved, and purpose of visit.

(5) If desired, visitors to a contractor's plant may request that a representative of the CAO accompany them. In any event, the CAO has final authority to decide whether a representative shall accompany a visitor.

(b) Visitors shall fully inform the CAO of any agreements reached with the contractor or other results of the visit that may affect the CAO.

#### 42.403 Evaluation of contract administration offices.

Onsite inspections or evaluations of the performance of the assigned functions of a contract administration office shall be accomplished only by or under the direction of the agency of which that office is a part.

### SUBPART 42.5—POSTAWARD ORIENTATION

#### 42.500 Scope of subpart.

This subpart prescribes policies and procedures for the postaward orientation of contractors and subcontractors through (a) a conference or (b) a letter or other form of written communication.

#### 42.501 General.

(a) A postaward orientation aids both Government and contractor personnel to (1) achieve a clear and mutual understanding of all contract requirements and (2) identify and resolve potential problems. However, it is not a substitute for the contractor's fully understanding the work requirements at the time offers are submitted, nor is it to be used to alter the final agreement arrived at in any negotiations leading to contract award.

(b) Postaward orientation is encouraged to assist small business and small disadvantaged business concerns (see Part 19).

(c) While cognizant Government or contractor personnel may request the contracting officer to arrange for orientation, it is up to the contracting officer to decide whether a postaward orientation in any form is necessary.

(d) Maximum benefits will be realized when orientation is conducted promptly after award.

#### 42.502 Selecting contracts for postaward orientation.

When deciding whether postaward orientation is necessary and, if so, what form it shall take, the contracting officer shall consider, as a minimum, the—

(a) Nature and extent of the preaward survey and any other prior discussions with the contractor;

(b) Type, value, and complexity of the contract;

(c) Complexity and acquisition history of the product or service;

(d) Requirements for spare parts and related equipment;

(e) Urgency of the delivery schedule and relationship of the product or service to critical programs;

(f) Length of the planned production cycle;

(g) Extent of subcontracting;

(h) Contractor's performance history and experience with the product or service;

(i) Contractor's status, if any, as a small business or small disadvantaged business concern;

(j) Contractor's performance history with small business and small disadvantaged business subcontracting programs;

(k) Safety precautions required for hazardous materials or operations; and

(l) Complex financing arrangements, such as progress payments, advance payments, or guaranteed loans.

#### 42.503 Postaward conferences.

##### 42.503-1 Postaward conference arrangements.

(a) The contracting officer who decides that a conference is needed is responsible for—

(1) Establishing the time and place of the conference;

(2) Preparing the agenda, when necessary;

(3) Notifying appropriate Government representatives (e.g., contracting/contract administration office) and the contractor;

(4) Designating or acting as the chairperson;

(5) Conducting a preliminary meeting of Government personnel; and

(6) Preparing a summary report of the conference.

(b) When the contracting office initiates a conference, the arrangements may be made by that office or, at its request, by the contract administration office.

##### 42.503-2 Postaward conference procedure.

The chairperson of the conference shall conduct the meeting. Unless a contract change is contemplated, the chairperson shall emphasize that it is not the purpose of the meeting to change the contract. The contracting officer may make commitments or give directions within the scope of the contracting officer's authority and shall put in writing and sign any commitment or direction, whether or not it changes the contract. Any change to the contract that results from the postaward conference shall be made only by a contract modifica-

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tion (see 43.101) referencing the applicable terms of the contract. Participants without authority to bind the Government shall not take action that in any way alters the contract. The chairperson shall include in the summary report (see 42.503-3 below) all information and guidance provided to the contractor.

### **42.503-3 Postaward conference report.**

The chairperson shall prepare and sign a report of the postaward conference. The report shall cover all items discussed, including areas requiring resolution, controversial matters, the names of the participants assigned responsibility for further actions, and the due dates for the actions. The chairperson shall furnish copies of the report to the contracting office, the contract administration office, the contractor, and others who require the information.

### **42.504 Postaward letters.**

In some circumstances, a letter or other written form of communication to the contractor may be adequate postaward orientation (in lieu of a conference). The letter should identify the Government representative responsible for administering the contract and cite any unusual or significant contract requirements. The rules on changes to the contract in 42.503-2 also apply here.

### **42.505 Postaward subcontractor conferences.**

(a) The prime contractor is generally responsible for conducting postaward conferences with subcontractors. However, the prime contractor may invite Government representatives to a conference with subcontractors, or the Government may request that the prime contractor initiate a conference with subcontractors. The prime contractor should ensure that representatives from involved contract administration offices are invited.

(b) Government representatives (1) must recognize the lack of privity of contract between the Government and subcontractors, (2) shall not take action that is inconsistent with or alters subcontracts, and (3) shall ensure that any changes in direction or commitment affecting the prime contract or contractor resulting from a subcontractor conference are made by written direction of the contracting officer to the prime contractor in the same manner as described in 42.503-2.

**PART 42--CONTRACT ADMINISTRATION**  
**SUBPART 42.2--ASSIGNMENT OF CONTRACT ADMINISTRATION**

**42.203 Retention of Contract Administration.**

(a) When any field contract administration service is required, the contract will be assigned for administration regardless of dollar value.

(2) The purchasing office may retain responsibility for administration of contracts listed below:

- (i) contracts of or in support of the National Security Agency;
- (ii) contracts for coal or bulk petroleum;
- (iii) research and development contracts;
- (iv) grants;
- (v) contracts for flight training;
- (vi) contracts for headstones and gravemarkers;
- (vii) contracts for industry technical representatives;
- (viii) contracts for consultant support services;
- (ix) geodetic mapping, air charting, and information center contracts;
- (x) base, post, camp, and station purchases;
- (xi) contracts for operation or maintenance of, or installation of equipment at radar or communications network sites, e.g., SAGE, BMEWS, JCSAN, WHITE ALICE, etc.;
- (xii) communications service contracts;
- (xiii) contracts for installation, operation and maintenance of spacetrack sensors and relays;
- (xiv) Dependents Medicare Program contracts;
- (xv) stevedoring contracts;
- (xvi) contracts for construction and maintenance of military and civil public works, including harbors, docks, port facilities, military housing, development of recreational facilities, water resources, flood control, and public utilities;
- (xvii) architect-engineer (A-E) contracts;
- (xviii) contracts for airlift and sealift--Military Airlift Command and Military Sealift Command may perform contract administration services at contractor locations involved solely in performance of airlift or sealift contracts;
- (xix) contracts for subsistence supplies;
- (xx) ballistic missile site contracts--supporting administration of these contracts may be performed at missile activation sites during the installation, test, and checkout of the missiles and associated equipment; and
- (xxi) contracts for operation and maintenance of, or installation of equipment at, military test ranges, facilities, and installations.

(b) To avoid duplication of field contract administration capability, except for the performance of (xviii) and (xx) above, contract administration personnel from the purchasing office shall not be located at contractors' facilities. If field assistance from a DoD

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contract administration services component is needed in the administration of these contracts, such assistance will be requested by assignment of supporting contract administration to the contract administration offices listed in DoD Directory 4105.59-H as cognizant of the contractor's facility (facilities) at which the supporting contract administration function(s) is required. Specific instructions as to the assistance needed will be furnished. If field assistance is needed in the performance of the major portion of applicable contract administration functions, the contract will be reassigned to the cognizant contract administration office.

#### **42.204 Supporting Contract Administration.**

(a) Generally, the office for performing supporting functions shall be selected from the list in DoD Directory 4105.59-H. However, in special circumstances (for example, when contractor's work site is a military base), a component of a military command not listed in DoD Directory 4105.59-H may be selected to perform supporting contract administration when prior coordination between the offices concerned has indicated that such an arrangement is feasible and that adequate resources are available, but see 42.270. Where supporting contract administration is required on a contractor purchase order or subcontract which includes FMS requirements, the requesting CAO shall clearly indicate "FMS Requirement" on the face of the document and provide the FMS case identifier code, associated item quantity, and related DoD prime contract number and contract line/subline item number. When more than one FMS case is involved, the information shall be provided for each.

#### **42.205 Designation of the Paying Office.**

(a) Defense Contract Administration Services Disbursing Office. Contracts assigned to an office of Defense Contract Administration Services for administration shall also specify disbursement by the cognizant Defense Contract Administration Services Regional Office if funded with DoD funds (i.e., Department codes 17 (Navy), 21 (Army), 57 (Air Force), 97 (OSD, including Defense Agencies), and 43 (Civil Defense). For any other department or agency funds, the payment office serving that department or agency must be cited for the portion of the contract covered by non-DoD funds, even though the contract is otherwise wholly administered by the DCASR.

(b) Other Disbursing Office(s). Any contract not assigned to a Defense Contract Administration Services Office for administration shall designate a disbursing office in accordance with Departmental or Agency regulations. Such contract, if issued for requirements of more than one Department or Agency, may provide for payment by more than one disbursing office.

(c) Disbursement for Air Force Missile Propellant Contracts. The Department of the Air Force shall retain the disbursement function on all contracts for Air Force missile propellants.

**42.270 Contracts Requiring Performance of Contract Administration Services (CAS) on Military Installations.**

(a) Contract administration functions on a military installation are normally performed by the installation commander who is responsible for its continued operation as a military base. Where work on the military installation is unrelated to the base mission and requires skills and resources which exceed the installation commander's capability, DCAS shall, upon request by the relevant service, provide the required contract administration functions. When a contractor's normal place of industrial operation is located on a military base because of the availability of real estate or the existence of an industrial facility on that base, DCAS shall have cognizance of that facility, unless cognizance has otherwise been assigned to a Military Department in accordance with DoDI 4105.59.

(b) The Military Departments shall coordinate their Departmental contract administration efforts so as to avoid mixed contract administration arrangements which result when more than one CAS activity performs CAS at the same military installation.

(c) DCAS shall provide preaward survey assistance for post, camp, and station work performed on military installations. The purchasing office and the DCAS preaward survey monitor shall jointly determine the scope of the survey and individual responsibilities.

(d) All requests from the Military Departments for Defense Logistics Agency/Defense Contract Administration Services support under (a) above should be coordinated to ensure availability of the capability and resources for performing requested functions.

**PART 42--CONTRACT ADMINISTRATION**  
**SUBPART 42.3--CONTRACT ADMINISTRATION OFFICE FUNCTIONS**

**42.302 Contract Administration Functions.**

(a)(11)(ii) & (iii) For those contractors with which the Tri-Service Contracting Officer negotiates advance agreements pursuant to FAR 42.10, he shall have full authority for determinations related to CAS 420.

(70) Perform industrial readiness and mobilization production planning field surveys and schedule negotiations.

(71) Perform post award surveillance of contractor progress toward demonstration of Cost/Schedule Control Systems to meet the Cost/Schedule Control Systems Criteria, provide assistance in the review and acceptance of contractors' Cost/Schedule Control Systems, and perform post acceptance surveillance to ensure continuing operation of contractors' accepted systems. (See 34.005-70.)

(72) Monitor the contractor's costs as prescribed under Subpart 42.70.

(73) In connection with classified contracts, administer those portions of the Industrial Security Program designated as ACO responsibilities in the ISR and ISM. (See Appendix C, Industrial Security Regulation, DoD 5220.22-R, for partial listing of primary responsibilities (also see FAR 4.401).)

(74) In connection with the provisions of paragraph (b) of the clause at FAR 52.225-10, Duty-Free Entry, and paragraph (c) of the clause at 52.225-7008, Duty-Free Entry--Qualifying Country End Products and Supplies, negotiate and issue appropriate contract modifications reducing contract prices.

**PART 42--CONTRACT ADMINISTRATION  
SUBPART 42.5--POSTAWARD ORIENTATION**

**42.501 General.**

The need for a postaward orientation conference normally will be established as a result of substantive review and analysis of the contract by the Contract Administration Office. However, the contracting officer or technical representative of the purchasing office may initiate the request for a conference. A conference of Government personnel normally shall be held prior to notifying and conferring with the contractor to assure that the Government position on all matters is established.

**42.503-1 Postaward Conference Arrangements.**

(a)(2) The agenda of the postaward conference may include such matters as are indicated on DD Form 1484.

**42.503-2 Postaward Conference Procedure.**

The chairperson shall use the DD Form 1484 in conducting the conference to assure that all significant matters are covered.

**42.503-3 Postaward Conference Report.**

The chairperson may use the DD Form 1484 as the summary report where appropriate.



EXTRACTS FROM

THE DCAS IMAGE

"An ACO - PCO Perspective"

## **DCAS Image and Relationship with Buying Activities An Evaluation of the Current Environment**

Assessing the quality of the DCAS support to buying activities required that an evaluation be made of the overall DCAS system, as well as an evaluation of the perceived effectiveness of performance under that system.

In general, procurement and administration personnel consider the quality of DCAS support to be continually improving, and that the ACO/PCO relationship is better than it has been in past years. Personnel at major buying activities believe DCAS, in most instances, capably provides an essential, worthwhile service. This opinion should not be construed to mean that improvements aren't needed. Both ACOs and PCOs feel that a realignment of emphasis in certain DLA procedures for doing business would improve operations and increase productivity. To enhance the DCAS image, DLA must give top priority to being responsive to the needs of the buying activities.

In setting its internal policies and goals, DLA has often failed to consider its customers' true requirements. DLA has created a system predicated on "management by exception," with the bulk of contract activity performed on an "as required" basis. This system effectively prevents proactive contract management on low dollar value, fixed-price contracts and purchase orders, and gives credence to buying activities' complaints that ACOs are dollar oriented, not mission oriented, and that the more mundane the contract type, the less attention it receives from DCAS. Buying activities, not aware of how the system limits DCAS's service until after a problem arises, are frustrated when they don't receive the support they expect and require. This type of experience contributes to the PCO's perception that DCAS is at times non-responsive to their needs. The image of DCAS is especially poor within the Agency itself, at the DLA Supply Centers, where the majority of awards made are low dollar, fixed-price contracts and orders. Clearly, DLA needs to revise the system and allot the necessary resources to ensure better coverage is provided. Also, the Agency has to articulate its system to the buying activities to preclude unrealistic expectations.

Buying activities are particularly concerned about DCAS attention, or lack of attention, to mission requirements. PCOs consistently complain that delivery status reporting is inadequate, being "too little and too late" to serve any useful purpose. They feel they obtain better production information from the QAR than from the IS. Another primary area of concern pertains to the quality of pricing support. PCOs feel that pricing reports are not sufficiently detailed, that they don't specifically address the contractor's proposal, and don't reconcile differences between the audit and technical reports. Pricing reviews of proposals under \$500,000 are considered too superficial. PCOs also question the depth of pre--award surveys. In general, buying activities believe DCAS response is too slow in the pre-contract stage, and that PCO response to ACOs is too slow in the postaward stage. Also, the activities, including the DLA Supply Centers, acknowledge that they know little about the various DCAS functions.

The image of DCAS is affected by the Buying Activities' perception that ACOs are more responsive to institutional demands than to the PCOs needs.

## Condition Found During Study

1. DLA relies on the Service school (AFIT, ALMC, NAVMAT) courses to train its employees. These courses provide the broad concepts and theory of the acquisition process and emphasize the procurement role rather than that of administration.
2. Existing courses do not recognize the distinct difference between procurement and administration functions. There is no course available that addresses the multi-functional needs of DCAS employees.
3. Course material and personnel training have not kept pace with the changes to the acquisition process.
4. Procurement personnel and administration personnel are largely unfamiliar with each other's organizational structure and function.
5. Training courses are not scheduled sufficiently in advance to allow effective use of resources. Late notification of availability too frequently results in lost slots or cancelled courses.
6. Buying activities are not conversant with DLA programs and procedures that focus on problem contractors, such as the Contractor Improvement Program (CIP) and Quality Assurance Corrective Action (Method A,B,C,D,E).
7. DCAS is a multi-functional organization composed of a variety of technical specialists at the managerial, staff, and operational levels. Each technical specialist is directed by and reports to his/her supervisory chain of command in all work matters. These specialists are generally not co-located and do not share common workloads.
8. The ACO, purported to be the AMT leader, is responsible for effective mission management. However, the ACO is hampered in fulfilling that responsibility and is unable to make commitments to PCOs because the ACO cannot direct the various functional specialists.
9. PCOs feel ACOs devote more attention to satisfying institutional demands and internal quotas than to supporting their contracts. The DLA goals emphasize tasks that are easily measurable rather than mission critical.
10. The preponderance of internal reporting is the primary concern of management, staff, and operations personnel. Redundant and voluminous reporting requirements decrease productivity and impact the quality of support provided to the PCOs. Continuous requests for seemingly superfluous reports from top management and outside activities require unrealistically fast response times that interrupt operations, and degrade the quality of the information provided.
11. New regulations and Agency directives and policy are often distributed to field personnel unaccompanied by implementing procedures, or reflecting implementation guidance that conflicts with the practices of the Services and DCAA. An excellent example of this conflict is the varied reaction to the Joint Services Agreement for uniform escalation rates. Contracting Officers

within the buying activities cannot exceed the objectives without top management review. DCAA auditors have been directed to continue using the disaggregate Date Resources Index to develop recommended rates. DLA Contracting Officers are to use the DRI's Private/Nonfarm index. The DCAS ACOs negotiate forward pricing rate agreements (FPRAs) for use by all Government Contracting Officers. The ACO's settlement must be consistent with DCAA's recommendations, or additional justification and review are required; yet the ACO and DCAA are tasked to use different indices. Further, if the resultant FPRA exceeds the Service's uniform rates, the PCO can't utilize the FPRA, although he is required by regulation to do so. Lack of guidance, and contradictory guidance, prevents DCAS from supporting PCOs in an informed, consistent manner.

12. DLA's grade structure is not compatible with the other Services or with industry. This restricts the Agency's capability to recruit and retain qualified professionals, and contributes to excessive turnover rates that cripple productivity. It also affects the buying activities' perception of DCAS employees, reducing their willingness to recognize DCAS as an equal partner in the acquisition process.

13. Political issues can result in top management directives that place ACOs in the difficult position of attempting to enforce edicts that are, in effect, constructive changes to the contract which are subject to contractor claims. An example is the recent directive regarding certification of overhead costs in billings. It mandated that ACOs withhold payments from contractors until the certification was received, yet the ACO had no contractual authority to do so.

14. Face-to-face contact between ACOs and PCOs is relatively rare since few interagency visits are made at the operations level. Neither individual is familiar with the work environment and organizational process of the other.

15. ACOs and PCOs rely heavily on telephone and written communications. Delays and misrouting occur when the authorized representative on a specific contract is not identified.

16. ACOs review contracts to determine whether a Post Award Orientation Conference (PAOC) should be scheduled with the contractor to clarify contract requirements and assure mutual understanding. The decision is based on the complexity of the contract and the performance record of the contractor. Workload constraints cause inadequate initial contract review. As a result, PAOCs are not convened as frequently as they should be. When PAOCs are held, PCOs are invited, but rarely attend.

17. PCOs rely on DCAS and DCAA for pricing and audit support on major negotiations. While PCOs occasionally perform fact-finding at the contractors plant, negotiations are conducted at the buying activity, without the presence of the DCAS specialists. Contractors frequently amend their proposals or introduce new data at the negotiating table.

18. Contracting Officers (ACOs and PCOs) consider the information provided in pricing, audit, and technical reports to be insufficient to develop sound negotiation objectives.

19. PCOs, technical personnel, and other buying activity representatives visit contractor facilities without providing the required notice to the cognizant DCAS representatives. These representatives rarely meet with DCAS personnel.

20. PCOs feel ACOs are dollar oriented, not mission oriented, and that the more mundane the contract type, the less attention it receives from the ACO. This opinion is particularly prevalent within the DLA Supply Centers.

21. A primary concern of all buying activities is the inadequacy of DCAS delivery reporting. Notification is not provided in a timely manner, and lacks sufficient detail. Surveillance Critically Designators and priority codes are supplied differently by the Services.

NOTES

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## Chapter B

### CONTRACT & CONTRACTOR FINANCING

Management of payments to contractors is a major duty of the contract administration team. It is imperative that the contractor receive payments due but they must be reviewed frequently enough to prevent overpayment. This chapter contains clauses which may appear in a contract, examples to clarify portions of FAR Part 32, and a case which may be used by your instructor.

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<u>Title</u>	<u>Page</u>	<u>Assignment</u>
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2. Worksheet for Progress Payment Liquidation	B-3	Review
3. DAR Council Implementation Letter	B-4 thru B-21	Read
4. FAR Part 32 - Contract Financing	B-22 thru B-50	Review
5. FAR 52.209-4 First Article Approval	B-50a thru B-50b	Review
6. FAR 52.232-12 Advance Payments	B-51 thru B-55	Read
7. FAR 52.232-13 Notice of Progress Payments	B-56	Review
52.232-14 Notice of Availability of Progress Payments Exclusively for Small Business Concerns		
8. FAR 52.232-15 Progress Payments Not Included	B-57	Read
9. FAR 52.232-16 Progress Payments	B-57 thru B-60	Read
10. DFARS PART 32	B-61 thru B-87	Review
11. DFARS 52.232-70003 Progress Payments For Foreign Military Sales	B-88	Review
12. DFARS 52.232-7004 Flexible Progress Payments	B-89 thru B-93	Read

SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Contractor and Contract Financing

TIME: 6 Hrs

OBJECTIVE: Comprehend the policies and methods of contract financing.

SAMPLES OF BEHAVIOR:

- a. State DOD policy regarding government financing of contractors.
- b. List various sources of government financial assistance.
- c. Demonstrate the use of liquidation and alternate liquidation rates in the administration of progress payments.
- d. Compute the fair value/loss ratio.

INSTRUCTIONAL METHODS: Lecture/Discussion  
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS: ACA Textbook

REQUIRED STUDENT PREPARATION: As defined in Chapter "B" of the ACA textbook.



**CONTRACTOR'S REQUEST FOR PROGRESS PAYMENT**

Form Approved  
OMB No 3090-0105

**IMPORTANT: This form is to be completed in accordance with instructions on reverse.**

**SECTION I - IDENTIFICATION INFORMATION**

1. TO: NAME AND ADDRESS OF CONTRACTING OFFICE (Include ZIP Code)		2. FROM: NAME AND ADDRESS OF CONTRACTOR (Include ZIP Code)		
PAYING OFFICE		3. SMALL BUSINESS <input type="checkbox"/> YES <input type="checkbox"/> NO	4. CONTRACT NO.	5. CONTRACT PRICE \$
6. RATES	7. DATE OF INITIAL AWARD	8A. PROGRESS PAYMENT REQUEST NO.		8B. DATE OF THIS REQUEST
A. PROG. PYMTS. %	B. LIQUIDATION %	A. YEAR	B. MONTH	

**SECTION II - STATEMENT OF COSTS UNDER THIS CONTRACT THROUGH \_\_\_\_\_ (Date)**

9. PAID COSTS ELIGIBLE UNDER PROGRESS PAYMENT CLAUSE	\$
10. INCURRED COSTS ELIGIBLE UNDER PROGRESS PAYMENT CLAUSE	
11. TOTAL COSTS ELIGIBLE FOR PROGRESS PAYMENTS (Item 9 plus 10)	
12. a. TOTAL COSTS INCURRED TO DATE	\$
b. ESTIMATED ADDITIONAL COST TO COMPLETE	
13. ITEM 11 MULTIPLIED BY ITEM 6a	
14. a. PROGRESS PAYMENTS PAID TO SUBCONTRACTORS	
b. LIQUIDATED PROGRESS PAYMENTS TO SUBCONTRACTORS	
c. UNLIQUIDATED PROGRESS PAYMENTS TO SUBCONTRACTORS (Item 14a less 14b)	
d. SUBCONTRACT PROGRESS BILLINGS APPROVED FOR CURRENT PAYMENT	
e. ELIGIBLE SUBCONTRACTOR PROGRESS PAYMENTS (Item 14c plus 14d)	
15. TOTAL DOLLAR AMOUNT (Item 13 plus 14e)	
16. ITEM 5 MULTIPLIED BY ITEM 6b	
17. LESSER OF ITEM 15 OR ITEM 16	
18. TOTAL AMOUNT OF PREVIOUS PROGRESS PAYMENTS REQUESTED	
19. MAXIMUM BALANCE ELIGIBLE FOR PROGRESS PAYMENTS (Item 17 less 18)	

**SECTION III - COMPUTATION OF LIMITS FOR OUTSTANDING PROGRESS PAYMENTS**  
\*SEE SPECIAL INSTRUCTIONS ON BACK FOR USE UNDER THE FEDERAL ACQUISITION REGULATION.

20. COMPUTATION OF PROGRESS PAYMENT CLAUSE (a)(3)(i) or a(4)(i) LIMITATION *	\$
a. COSTS INCLUDED IN ITEM 11, APPLICABLE TO ITEMS DELIVERED, INVOICED, AND ACCEPTED TO THE DATE IN HEADING OF SECTION II.	
b. COSTS ELIGIBLE FOR PROGRESS PAYMENTS, APPLICABLE TO UNDELIVERED ITEMS AND TO DELIVERED ITEMS NOT INVOICED AND ACCEPTED (Item 11 less 20a)	
c. ITEM 20b MULTIPLIED BY ITEM 6a	\$
d. ELIGIBLE SUBCONTRACTOR PROGRESS PAYMENTS (Item 14e)	
e. LIMITATION a(3)(i) or a(4)(i) (Item 20c plus 20d) *	
21. COMPUTATION OF PROGRESS PAYMENT CLAUSE (a)(3)(ii) or a(4)(ii) LIMITATION *	
a. CONTRACT PRICE OF ITEMS DELIVERED, ACCEPTED AND INVOICED TO DATE IN HEADING OF SECTION II	
b. CONTRACT PRICE OF ITEMS NOT DELIVERED, ACCEPTED AND INVOICED (Item 5 less 21a)	
c. ITEM 21b MULTIPLIED BY ITEM 6b	
d. UNLIQUIDATED ADVANCE PAYMENTS PLUS ACCRUED INTEREST	
e. LIMITATION (a)(3)(ii) or a(4)(ii) (Item 21c less 21d) *	
22. MAXIMUM UNLIQUIDATED PROGRESS PAYMENTS (Lesser of Item 20e or 21e)	
23. TOTAL AMOUNT APPLIED AND TO BE APPLIED TO REDUCE PROGRESS PAYMENT	
24. UNLIQUIDATED PROGRESS PAYMENTS (Item 18 less 23)	
25. MAXIMUM PERMISSIBLE PROGRESS PAYMENTS (Item 22 less 24)	
26. AMOUNT OF CURRENT INVOICE FOR PROGRESS PAYMENT (Lesser of Item 25 or 19)	
27. AMOUNT APPROVED BY CONTRACTING OFFICER	

**CERTIFICATION**

I certify that the above statement (with attachments) has been prepared from the books and records of the above-named contractor in accordance with the contract and the instructions hereon, and to the best of my knowledge and belief, that it is correct, that all the costs of contract performance (except as herewith reported in writing) have been paid to the extent shown herein, or where not shown as paid have been paid or will be paid currently, by the contractor, when due, in the ordinary course of business, that the work reflected above has been performed, that the quantities and amounts involved are consistent with the requirements of the contract. That there are no encumbrances (except as reported in writing herewith, or on previous progress payment request No. \_\_\_\_\_) against the property acquired or produced for, and allocated or properly chargeable to the contract which would affect or impair the Government's title, that there has been no materially adverse change in the financial condition of the contractor since the submission of the most recent written information dated \_\_\_\_\_ by the contractor to the Government in connection with the contract, that to the extent of any contract provision limiting progress payments pending first article approval, such provision has been complied with, and that after the making of the requested progress payment the unliquidated progress payments will not exceed the maximum unliquidated progress payments permitted by the contract.

NAME AND TITLE OF CONTRACTOR REPRESENTATIVE SIGNING THIS FORM	SIGNATURE
NAME AND TITLE OF CONTRACTING OFFICER	SIGNATURE

## INSTRUCTIONS

**GENERAL** - All entries on this form must be typewritten - all dollar amounts must be shown in whole dollars, rounded up to the next whole dollar. All line item numbers not included in the instructions below are self-explanatory.

**SECTION I - IDENTIFICATION INFORMATION.** Complete Items 1 through 8c in accordance with the following instructions:

**Item 1. TO** - Enter the name and address of the cognizant Contract Administration Office. **PAYING OFFICE** - Enter the designation of the paying office, as indicated in the contract.

**Item 2. FROM - CONTRACTOR'S NAME AND ADDRESS/ZIP CODE** - Enter the name and mailing address of the contractor. If applicable, the division of the company performing the contract should be entered immediately following the contractor's name.

**Item 3.** Enter an "X" in the appropriate block to indicate whether or not the contractor is a small business concern.

**Item 5.** Enter the total contract price, as amended. If the contract provides for escalation or price redetermination, enter the initial price until changed and not the ceiling price; if the contract is of the incentive type, enter the target or billing price, as amended until final pricing. For letter contracts, enter the maximum expenditure authorized by the contract, as amended.

**Item 6A. PROGRESS PAYMENT RATES** - Enter the 2-digit progress payment percentage rate shown in paragraph (a)(1) of the progress payment clause.

**Item 6B. LIQUIDATION RATE** - Enter the progress payment liquidation rate shown in paragraph (b) of the progress payment clause, using three digits - Example: show 80% as 800 - show 72.3% as 723.

**Item 7. DATE OF INITIAL AWARD** - Enter the last two digits of the calendar year. Use two digits to indicate the month. Example: show January 1982 as 82/01.

**Item 8A. PROGRESS PAYMENT REQUEST NO.** - Enter the number assigned to this request. All requests under a single contract must be numbered consecutively, beginning with 1. Each subsequent request under the same contract must continue in sequence, using the same series of numbers without omission.

**Item 8B.** Enter the date of the request.

**SECTION II - GENERAL INSTRUCTIONS. DATE.** In the space provided in the heading enter the date through which costs have been accumulated from inception for inclusion in this request. This date is applicable to item entries in Sections II and III.

**Cost Basis.** For all contracts with Small Business concerns, the base for progress payments is total costs incurred. For contracts with concerns other than Small Business, the progress payment base will be the total recorded paid costs, together with the incurred costs per the Computation of Amounts paragraph of the progress payment clause in FPR 1-30.510-1(a) or FAR 52.232-16, as appropriate. Total costs include all expenses paid and incurred, including applicable manufacturing and production expense, general and administrative expense for performance of contract, which are reasonable, allocable to the contract, consistent with sound and generally accepted accounting principles and practices, and which are not otherwise excluded by the contract.

**Manufacturing and Production Expense, General and Administrative Expense.** In connection with the first progress payment request on a contract, attach an explanation of the method, bases and period used in determining the amount of each of these two types of expenses. If the method, bases or periods used for computing these expenses differ in subsequent requests for progress payments under this contract, attach an explanation of such changes to the progress payment request involved.

**Incurred Costs Involving Subcontractors for Contracts with Small Business Concerns.** If the incurred costs eligible for progress payments under the contract include costs shown in invoices of subcontractors, suppliers and others, that portion of the costs computed on such invoices can only include costs for: (1) completed work to which the prime contractor has acquired title; (2) materials delivered to which the prime contractor has acquired title; (3) services rendered, and (4) costs billed under cost reimbursement or time and material subcontracts for work to which the prime contractor has acquired title.

### SECTION II - SPECIFIC INSTRUCTIONS

**Item 9. PAID COSTS ELIGIBLE UNDER PROGRESS PAYMENT CLAUSE** - Line 9 will not be used for Small Business Contracts.

For large business contracts, costs to be shown in Item 9 shall include only those recorded costs which have resulted at time of request in payment made by cash, check, or other form of actual payment for items or services purchased directly for the contract. This includes items delivered, accepted and paid for, resulting in liquidation of subcontractor progress payments.

Costs to be shown in Item 9 are not to include advance payments, downpayments, or deposits, all of which are not eligible for reimbursement; or progress payments made to subcontractors, suppliers or others, which are to be included in Item 14. See "Cost Basis" above.

**Item 10. INCURRED COSTS ELIGIBLE UNDER PROGRESS PAYMENT CLAUSE** - For all Small Business Contracts, Item 10 will show total costs incurred for the contract.

Costs to be shown in Item 10 are not to include advance payments, downpayments, deposits, or progress payments made to subcontractors, suppliers or others.

For large business contracts, costs to be shown in Item 10 shall include all costs incurred (see "Cost Basis" above) for: materials which have been issued from the stores inventory and placed into production process for use on the contract; for direct labor; for other direct in-house costs; and for properly allocated and allowable indirect costs as set forth under "Cost Basis" above.

**Item 12a.** Enter the total contract costs incurred to date; if the actual amount is not known, enter the best possible estimate. If an estimate is used, enter (E) after the amount.

**Item 12b.** Enter the estimated cost to complete the contract. The estimate may be the last estimate made, adjusted for costs incurred since the last estimate; however, estimates shall be made not less frequently than every six months.

**Items 14a through 14c.** Include only progress payments on subcontracts which conform to progress payment provisions of the prime contract.

**Item 14a.** Enter only progress payments actually paid.

**Item 14b.** Enter total progress payments recouped from subcontractors.

**Item 14d.** For Small Business prime contracts, include the amount of unpaid subcontract progress payment billings which have been approved by the contractor for the current payment in the ordinary course of business. For other contracts, enter "0" amount.

**SECTION III - SPECIFIC INSTRUCTIONS.** This Section must be completed only if the contractor has received advance payments against this contract, or if items have been delivered, invoiced and accepted as of the date indicated in the heading of Section II above. EXCEPTION: Item 27 must be filled in by the Contracting Officer.

**Item 20a.** Of the costs reported in Item 11, compute and enter only costs which are properly allocable to items delivered, invoiced and accepted to the applicable date. In order of preference, these costs are to be computed on the basis of one of the following: (a) The actual unit cost of items delivered, giving proper consideration to the deferment of the starting load costs or, (b) projected unit costs (based on experienced costs plus the estimated cost to complete the contract), where the contractor maintains cost data which will clearly establish the reliability of such estimates.

**Item 20d.** Enter amount from 14c.

**Item 21a.** Enter the total billing price, as adjusted, of items delivered, accepted and invoiced to the applicable date.

**Item 23.** Enter total progress payments liquidated and those to be liquidated from billings submitted but not yet paid.

**Item 25.** Self-explanatory. (NOTE: If the entry in this item is a negative amount, there has been an overpayment which requires adjustment.)

**Item 26.** Self-explanatory, but if a lesser amount is requested, enter the lesser amount.

**SPECIAL INSTRUCTIONS FOR USE UNDER FEDERAL ACQUISITION REGULATION (FAR).**

**Items 20 and 20a.** Delete the references to a(3)(i) of the progress payment clause.

**Items 21 and 21a.** Delete the references to a(3)(ii) of the progress payment clause.

WORK SHEET

PROGRESS PAYMENT LIQUIDATION

Given \$50,000 price each, 1st deliveries are month 8, small business

MONTH	COST INCURRED		PROGRESS PAYMENTS		QTY	DELIVERIES		LIQUIDATED		CUM UNLIQ	CHECK ISSUED TO CONTRACTOR
	CUM		PAID	CUM		BILLED	CUM	TOTAL	CUM		
7	100,000	400,000			(0)						
8	200,000	600,000			(3)						
9	100,000	700,000			(1)						
10	300,000	1,000,000			(3)						

WHAT IS THE CUM UNLIQUIDATED AMOUNT IN MONTH 7? \_\_\_\_\_

WHAT IS THE CUM LIQUIDATED AMOUNT IN MONTH 8? \_\_\_\_\_

WHAT IS THE CUM UNLIQUIDATED AMOUNT IN MONTH 9? \_\_\_\_\_

DAR Council Implementation Letter

Recent changes involving Progress Payments have not yet been formally incorporated into the FAR or DFARS.

On 26 Nov 86, the Defense Acquisition Regulatory (DAR) Council issued the attached Departmental Implementation Letter instructing the military departments to implement these changes through Defense Agencies.



ACQUISITION AND  
LOGISTICS  
P/DARS

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE

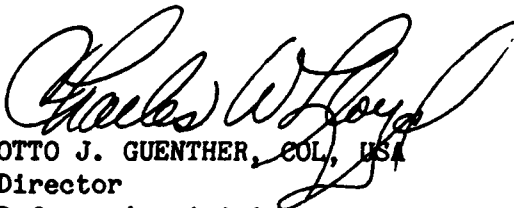
WASHINGTON, D.C. 20301-8000

26 NOV 1986

In reply refer to:  
DAR Case 86-110

SUBJECT: Progress Payment Rates

The attached Departmental Implementation Letter was issued by the Military Departments and by this office to the Defense Agencies under our cognizance.

*for*   
OTTO J. GUENTHER, COL, USA  
Director  
Defense Acquisition  
Regulatory Council

Attachment



ACQUISITION AND  
LOGISTICS  
P/DARS

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301-8000

26 NOV 1986

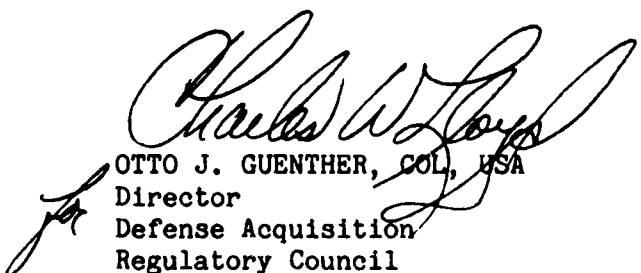
In reply refer to:  
DAR Case 86-110

MEMORANDUM FOR THE DIRECTOR, NATIONAL SECURITY AGENCY  
THE DIRECTOR, DEFENSE COMMUNICATIONS AGENCY  
THE DIRECTOR, DEFENSE INTELLIGENCE AGENCY  
THE DIRECTOR, DEFENSE NUCLEAR AGENCY  
THE DIRECTOR, DEFENSE MAPPING AGENCY

SUBJECT: Progress Payment Rates

The attached revisions to the DoD FAR Supplement are authorized for immediate distribution and use by the Military Departments and Defense Agencies. This coverage implements Section 9105 of the FY 1987 DoD Appropriations Act and is effective on all solicitations issued on or after October 18, 1986. For contract actions such as unpriced options, follow-on purchases for additional quantities, letter contracts, etc., the applicability guidance will be the same as in other progress payment rate changes. Such guidance was issued by the Military Departments and Defense Agencies when the progress payment rate was lowered from 90% to 80% in April 1985.

This coverage will be printed as an interim rule in the Federal Register on or about November 25, 1986. This coverage incorporates all prior departmental letters issued on Subparts 32.1, 32.5, and 52.232 of the DoD FAR Supplement, which are superseded as a result of this action. A Defense Acquisition Circular which replaces all affected pages of the DoD FAR Supplement will be published after expiration of the public comment period.

  
OTTO J. GUENTHER, COL, USA  
Director  
Defense Acquisition  
Regulatory Council

Attachment

25 November 1986

**CHANGES TO DFARS PART 32--CONTRACT FINANCING**

1. DFARS 32.070 is added to read as follows:

**32.070 Definition.** "Contract action," as used in this part, means an action resulting in a contract, as defined in FAR Subpart 2.1, including contract modifications for additional supplies or services, but not including contract modifications that are within the scope and under the terms of the contract, such as contract modifications issued pursuant to the Changes clause, or funding and other administrative changes.

2. DFARS 32.102 is added to read as follows:

**32.102 Description of Contract Financing Methods.**

(e)(2) Progress payments based on percentage or stage of completion will be confined to contracts for construction, shipbuilding and ship conversion, alteration or repair. Agency procedures must ensure that payments are commensurate with work accomplished, which meets the quality standards established under the contract. Furthermore, progress payments may not exceed 80 percent of the eligible costs of work accomplished on undefinitized contract actions.

3. DFARS 32.111 is revised to read as follows:

**32.111 Contract Clauses.**

(a), (b), (c) and (d) See DAC 76-42, Item I, for authorized modifications with respect to payment due dates.

(70) The contracting officer shall insert the clause at 52.232-7000, Invoices, in solicitations and contracts for supplies and services when a fixed price contract is contemplated.

(71) The contracting officer shall insert the clause at 52.232-7005, Payments Under Fixed-Price Construction Contracts, in lieu of FAR clause 52.232-5, in solicitations and contracts for construction when a fixed-price contract is contemplated.

(72) The contracting officer shall insert the clause at 52.232-7006, Payments Under Fixed-Price Architect-Engineer Contracts, in lieu of FAR clause 52.232-10, appropriately modified with respect to payment due dates, in fixed-price architect-engineer contracts.

4. DFARS 32.501-1(a) is revised to read as follows:

**32.501-1 Use of Customary Progress Payments.**

(a) The customary progress payment rate applicable to DoD contracts awarded to large businesses is 75 percent and 80 percent for small businesses. The customary progress payment rate applicable to

Foreign Military Sales requirements is the same as that applicable to DoD requirements. The customary progress payment rate for flexible progress payments is the rate determined by use of either the CASHII, CASHIII or CASHIV computer program as applicable in accordance with the requirements of 32,502-1(71).

5. DFARS 32.502-1 is revised to read as follows:

**32.502-1 Use of Customary Progress Payments.**

**(70) Customary FMS Progress Payments.**

(1) FMS progress payments shall be applicable to Department of Defense acquisitions on behalf of foreign governments or international organizations pursuant to Section 22 of the Arms Export Control Act (FMS requirements).

(2) FMS progress payments are not applicable to:

(i) Acquisitions for replenishment of U.S. Government inventories or stocks, and

(ii) Acquisitions made under DoD cooperative logistic support arrangements.

**(71) Customary Flexible Progress Payments.**

(1) Paying progress payments assists in financing a contractor's performance and reduces the contractor's investment in its work in process inventory. The actual investment held by a contractor in work in process inventory is influenced by a number of factors in addition to progress payments, such as delivery schedules, cash management practices, and Government payment practices. Progress payment amounts that are determined by using uniform, standard progress payment rates are insensitive to these other factors influencing investment and, as a consequence, result in investments by contractors in work in process inventory that vary among contractors and across contracts; on the other hand, flexible progress payment rates (expressed as a percentage that will be applied to costs to determine the amount payable as a progress payment in the same manner as uniform, standard progress payment rates) are designed to tailor more closely the progress payment rate to the cash needs for financing performance of a particular contractor for a given contract.

(2) For flexible progress payments, cash needs are measured and projected in relation to investment underlying the work in process inventory over the life of the contract. Total investment is measured by a weighted average of total costs paid by the contractor to complete performance of the contract, and the contractor's investment is the weighted average of the amount not paid by the Government. The Department of Defense (DoD), as a matter of policy, has concluded that a contractor should retain at least a 25% investment in work in process inventory over the life of the contract. Accordingly, the DoD will make progress payments at a rate (expressed as a whole number) that is the highest rate which yields a corresponding investment by the contractor in work in process inventory of not less than 25%. The



progress payment rate is to be determined by the DoD Cash Flow Computer Model. In no event will the progress payment rate be greater than 100%, or less than the uniform, standard progress payment rate that would have been applied to the contract absent flexible progress payments.

(3) Contracting officers shall use a flexible progress payment rate in lieu of the uniform standard rates if:

(i) The contractor requests the use of flexible progress payments rates,

(ii) The contractor agrees to the requirements of this section, and

(iii) The criteria in paragraph (5) below are met.

(4) The flexible progress payment rate shall be determined through application of the DoD Cash Flow Computer Model, available to contracting officers on the COPPER IMPACT computer time sharing network under the computer file name "CASH IV". The model takes into account key cash flow factors, such as contract cost profile, delivery schedules, subcontractor progress payments, liquidation rates, and payment/reimbursement cycles. Operating instructions and cash flow data requirements are retrievable within the model in a conversational mode. Contractors may obtain copies of the DoD Cash Flow Computer Model User's Guide from the Defense Technical Information Center, Building 5, Cameron Station, Alexandria, VA 22314. Contracting officers shall not grant contractor access to Government leased COPPER IMPACT time sharing computer network.

(5) Contractors who submit certified cost or pricing data, as defined in FAR 15.804-2, for negotiated fixed-price contracts in excess of \$1 million may request flexible progress payments. Formally advertised contracts are not eligible for flexible progress payments. Flexible progress payments are not available for contracts awarded and performed entirely outside of the United States, its possessions and territories.

(6) Contractors will furnish to the contracting officer cash flow data in the form and context specified by the DoD Cash Flow Computer Model. These data include: actual and projected incurred cost broken down by element of cost and by month for the duration of the contract, float times for each element of cost, progress payment receipts and delivery payment receipts and associated contract prices and profit percentage. Contracting officers will verify the cash flow data in accordance with normal procedures used to verify contractor cost and pricing data. Administrative contracting officers are encouraged to establish advance agreements at contractor locations for float and payment lag which are common to several contracts. Such agreements should be established when administratively practical.

(7) A redetermination of the flexible progress payment rate shall be made upon the request of the Government or contractor if measurement of the contractor's cumulative investment in work in process inventory using actual and projected cash flow data indicates

an investment level above 27% or below 23%. The cash flow computer model is designed to generate a progress payment rate that yields a target investment of 25%, based on a weighted average. Accordingly, there should normally be no need to request actual and projected contract cash flow data unless delivery schedules are revised, Government progress payment lag times are substantially changed from those used in the establishment of the progress payment rate, or substantial new work (e.g., option) is added to the contract.

(8) As noted in FAR 32.504, the standards for progress payments to subcontractors ought to be the same as those applicable to prime contractors. Accordingly, subcontractors who request a flexible progress payment rate, meet the criteria in paragraph (5) above and agree to the requirements of this section are to receive a flexible progress payment rate. The subcontract flexible progress payment rate will be determined by the prime contractor without regard to the progress payment rate in the prime contract. The DoD Cash Flow Computer Model and associated procedures will be used by the prime contractor and a reasonable review of the cash flow data provided by

(9) When flexible progress payments are contemplated for use on a definitive contract superseding a letter contract or an unpriced BPA order, the applicable standard progress payment clause at 52.232-7007 shall be used until definitization.

6. DFARS 32.502-4 is revised to read as follows:

**32.502-4 Contract Clauses.**

(70) The contracting officer shall insert the clause at 52.232-7003, Progress Payments for Foreign Military Sales Acquisitions, in any contract that provides for progress payments and contains FMS requirements.

(71) The contracting officer shall insert the clause at 52.232-7004, Flexible Progress Payments, when a flexible progress payment rate is used in the contract.

(72) The contracting officer shall insert the clause at 52.232-7007, Progress Payments, in lieu of FAR clause 52.232-16 and its Alternates I and II, in solicitations and fixed-price contracts under which the Government will provide progress payments based on costs.

(73) If the contract is with a small business concern, the contracting officer shall use the clause at 52.232-7007, Progress Payments, with its Alternate I.

(74) If the contract is a letter contract, the contracting officer shall use the clause with its Alternate II.

25 November 1986

**CHANGES TO DFARS PART 52--SOLICITATION PROVISIONS AND CONTRACT CLAUSES**

1. DFARS 52.232-7004 is revised to read as follows:

**52.232-7004 Flexible Progress Payments.** As prescribed at 32.502-4(71), insert the following clause:

**FLEXIBLE PROGRESS PAYMENTS (OCT 1986)**

This contract is subject to flexible progress payment procedures. The progress payment rate of this contract is \_\_%, and this percentage applies in lieu of the uniform, standard progress payment rate and liquidation rate of the "Progress Payments" clause. The progress payment rate of this contract was determined by the DoD Cash Flow Computer Model, (dated \_\_\_\_\_), using twenty-five (25%) as the targeted rate for the Contractor's investment (as a weighted average of costs) in its work in process inventory over the life of the contract. If actual and projected cash flow data generated during performance of this contract reveal that the progress payment rate will result in an investment in work in process inventory by the Contractor in excess of twenty-seven (27%) or less than twenty-three percent (23%), the progress payment rate shall be redetermined by using the DoD Cash Flow Computer Model. Unless it contained an error, the version of the DoD Cash Flow Computer Model that was used initially in this contract will be used for any redetermination permitted by this clause. In no event will the progress payment rate be less than the uniform, standard progress payment rate that would have applied to this contract absent flexible progress payment procedures, and in no event will the progress payment rate be greater than one hundred percent (100%).

(End of clause)

2. DFARS 52.232-7005, 52.232-7006, and 52.232-7007 are added to read as follows:

**52.232-7005 Payments Under Fixed-Price Construction Contracts.** As prescribed in 32.111(71), insert the following clause:

**PAYMENTS UNDER FIXED-PRICE CONSTRUCTION CONTRACTS (APR 1986) (DEV.)**

(a) The Government shall pay the Contractor the contract price as provided in this contract.

(b) The Government shall make progress payments monthly as the work proceeds, or at more frequent intervals as determined by the Contracting Officer, on estimates of work accomplished which meets standards of quality established under the contract, as approved by the Contracting Officer. If requested by the Contracting Officer, the Contractor shall furnish a breakdown of the total contract price showing the amount included therein for each principal category of work, in such detail as requested, to provide a basis for determining progress payments. In the preparation of estimates, the Contracting Officer may authorize material

delivered on the site and preparatory work done to be taken into consideration. Material delivered to the Contractor at locations other than the site may also be taken into consideration if--

- (1) Consideration is specifically authorized by this contract; and
- (2) The Contractor furnishes satisfactory evidence that it has acquired title to such material and that the material will be used to perform this contract.

(c) In making these progress payments, the Contracting Officer may retain a maximum of ten percent (10%) of the approved estimated amount until final completion and acceptance of the contract work. If the Contracting Officer finds that satisfactory progress was achieved during any period for which a progress payment is to be made, the Contracting Officer may authorize payment to be made in full without retention of a percentage. However, by the time the work is substantially complete, the Contracting Officer shall have retained an amount that the Contracting Officer considers adequate protection of the Government and may then release to the Contractor all or a portion of any excess amount. Also, on completion and acceptance of each separate building, public work, or other division of the contract, for which the price is stated separately in the contract, payment may be made for the completed work without retention of a percentage.

(d) All material and work covered by progress payments made shall, at the time of payment, become the sole property of the Government, but this shall not be construed as--

- (1) Relieving the Contractor from the sole responsibility for all material and work upon which payments have been made or the restoration of any damaged work; or
- (2) Waiving the right of the Government to require the fulfillment of all of the terms of the contract.

(e) In making these progress payments, the Government shall, upon request, reimburse the Contractor for the amount of premiums paid for performance and payment bonds (including coinsurance and reinsurance agreements, when applicable) after the Contractor has furnished evidence of full payment to the surety. The retainage provisions in paragraph (c) above shall not apply to that portion of progress payments attributable to bond premiums.

(f) The Government shall pay the amount due the Contractor under this contract after--

- (1) Completion and acceptance of all work;
- (2) Presentation of a properly executed voucher; and
- (3) Presentation of release of all claims against the Government arising by virtue of this contract, other than claims, in stated amounts, that the Contractor has specifically excepted from the operation of the release. A release may also be required of the assignee if the Contractor's claim to amounts payable under this contract has been assigned under the Assignment of Claims Act of 1940 (31 U.S.C. 203 and 41 U.S.C. 15).

(g) Notwithstanding any other provision of this contract, progress payments shall not exceed eighty percent (80%) on work accomplished on undefinitized contract actions. A "contract action" is any action resulting in a contract, as defined in FAR Subpart 2.1, including contract modifications for additional supplies or services, but not including contract modifications that are within the scope and under the terms of the contract, such as contract modifications issued pursuant to the Changes clause, or funding and other administrative changes.

(End of clause)

**52.232-7006 Payments Under Fixed-Price Architect-Engineer Contracts.** As prescribed in 32.111(72), insert the following clause:

**PAYMENTS UNDER FIXED-PRICE ARCHITECT-ENGINEER CONTRACTS (APR 1986) (DEV.)**

(a) Estimates shall be made monthly of the amount and value of the work accomplished and services performed by the Contractor under this contract which meet standards of quality established under this contract. The estimates shall be prepared by the Contractor and accompanied by any supporting data required by the Contracting Officer.

(b) Upon approval of the estimate by the Contracting Officer, payment upon properly executed vouchers shall be made to the Contractor, as soon as practicable, of ninety percent (90%) of the approved amount, less all previous payments; provided, that payment may be made in full during any months in which the Contracting Officer determines that performance has been satisfactory. Also, whenever the Contracting Officer determines that the work is substantially complete and that the amount retained is in excess of the amount adequate for the protection of the Government, the Contracting Officer may release the excess amount to the Contractor.

(c) Upon satisfactory completion by the Contractor and acceptance by the Contracting Officer of the work done by the Contractor under the "Statement of Architect-Engineer Services", the Contractor will be paid the unpaid balance of any money due for work under the statement, including retained percentages relating to this portion of the work. If the Government exercises the option under the Option for Supervision and Inspection Services clause, progress payments as provided in (a) and (b) above will be made for this portion of the contract work. Upon satisfactory completion and final acceptance of the construction work, the Contractor shall be paid any unpaid balance of money due under this contract.

(d) Before final payment under the contract, or before settlement upon termination of the contract, and as a condition precedent thereto, the Contractor shall execute and deliver to the Contracting Officer a release of all claims against the Government arising under or by virtue of this contract, other than any claims that are specifically excepted by the Contractor from the operation of the release in amounts stated in the release.

(e) Notwithstanding any other provision in this contract, and specifically paragraph (b) of this clause, progress payments shall not exceed eighty percent (80%) on work accomplished on undefinitized contract actions. A "contract action" is any action resulting in a contract, as defined in FAR Subpart 2.1, including contract modifications for additional supplies or services, but not including contract modifications that are within the scope and under the terms of the contract, such as contract modifications issued pursuant to the Changes clause, or funding and other administrative changes.

(End of clause)

#### 52.232-7007 Progress Payments.

(a) As prescribed in 32.502-4(72), insert the following clause in solicitations and fixed-price contracts under which the Government will provide progress payments based on costs. A different customary rate for other than small business concerns may be substituted in accordance with 32.502-4(73) for the progress payment and liquidation rate indicated.

(b) If an unusual progress payment rate is approved for the prime contractor (see FAR 32.501-2), the rate approved shall be substituted for the customary rate in the paragraph (a)(1).

(c) If the liquidation rate is changed from the customary progress payment rate (see FAR 32.503-8 and FAR 32.503-9), the new rate shall be substituted for the rate in paragraphs (a)(4), (a)(5), and (b).

(d) If advance and progress payments are authorized in the same contract, the words "less any unliquidated advance payments" may be deleted from paragraph (a)(4) of this clause.

(e) If an unusual progress payment rate is approved for a subcontract (see FAR 32.504(b) and FAR 32.501-2), subparagraph (j)(4) shall be modified to specify the new rate, the name of the subcontractor, and that the new rate shall be used for that subcontractor in lieu of the customary rate.

#### PROGRESS PAYMENTS (OCT 1986)

Progress payments shall be made to the Contractor when requested as work progresses, but not more frequently than monthly in amounts approved by the Contracting Officer, under the following conditions:

##### (a) Computation of Amounts.

(1) Unless the Contractor requests a smaller amount, each progress payment shall be computed as (i) seventy-five percent (75%) of the Contractor's cumulative total costs under this contract, as shown by records maintained by the Contractor for the purpose of obtaining payment under Government contracts, plus (ii) progress payments to subcontractors (see paragraph (j) below), all less the sum of all previous progress payments made by the Government under this contract. Cost of money that would be allowable under 31.205-10 of the Federal Acquisition Regulation shall be deemed an incurred cost for progress payment purposes

(2) The following conditions apply to the timing of including costs in progress payment requests:

(1) The costs of supplies and services purchased by the Contractor directly for this contract may be included only after payment by cash, check, or other form of actual payment.

(ii) Costs for the following may be included when incurred, even if before payment, when the Contractor is not delinquent in payment of the costs of contract performance in the ordinary course of business:

(A) Materials issued from the Contractor's stores inventory and placed in the production process for use on this contract.

(B) Direct labor, direct travel, and other direct in-house costs.

(C) Properly allocable and allowable indirect costs.

(iii) Accrued costs of Contractor contributions under employee pension, profit sharing, and stock ownership plans shall be excluded until actually paid unless--

(A) The Contractor's practice is to contribute to the plans quarterly or more frequently; and

(B) The contribution does not remain unpaid thirty (30) days after the end of the applicable quarter or shorter payment period (any contributions remaining unpaid shall be excluded from the Contractor's total costs for progress payments until paid).

(iv) If the contract is subject to the special transition method authorized in Cost Accounting Standard (CAS) 410, Allocation of Business Unit General and Administrative Expense to Final Cost Objective, General and Administrative expenses (G&A) shall not be included in progress payment requests until the suspense account prescribed in CAS 410 is less than--

(A) Five million dollars (\$5 million); or

(B) The value of the work-in-process inventories under contracts entered into after the suspense account was established (only a pro rata share of the G&A allocable to the excess of the inventory over the suspense account value is includable in progress payment requests under this contract).

(3) The Contractor shall not include the following in total costs for progress payment purposes in subparagraph (a)(1)(1) above:

(i) Costs that are not reasonable, allocable to this contract, and consistent with sound and generally accepted accounting principles and practices.

(ii) Costs incurred by subcontractors or suppliers.

(iii) Costs ordinarily capitalized and subject to depreciation or amortization except for the properly depreciated or amortized portion of such costs.

(iv) Payments made or amounts payable to subcontractors or suppliers, except for--

(A) Completed work, including partial deliveries, to which the Contractor has acquired title; and

(B) Work under cost-reimbursement or time-and-material subcontracts to which the Contractor has acquired title.

(4) The amount of unliquidated progress payments may exceed neither (i) the progress payments made against incomplete work (including

allowable unliquidated progress payments to subcontractors) nor (ii) the value, for progress payment purposes, of the incomplete work. Incomplete work shall be considered to be the supplies and services required by this contract, for which delivery and invoicing by the Contractor and acceptance by the Government are incomplete.

(5) The total amount of progress payments shall not exceed seventy-five percent (75%) of the total contract price.

(6) If a progress payment or the unliquidated progress payments exceed the amounts permitted by subparagraphs (a)(4) or (a)(5) above, the Contractor shall repay the amount of such excess to the Government on demand.

(b) Liquidation. Except as provided in the Termination for Convenience of the Government clause, all progress payments shall be liquidated by deducting from any payment under this contract, other than advance or progress payments, the unliquidated progress payments, or seventy-five percent (75%) of the amount invoiced, whichever is less. The Contractor shall repay to the Government any amounts required by a retroactive price reduction, after computing liquidations and payments on past invoices at the reduced prices and adjusting the unliquidated progress payments accordingly. The Government reserves the right to unilaterally change from the ordinary liquidation rate to an alternate rate when deemed appropriate for proper contract financing.

(c) Reduction or Suspension. The Contracting Officer may reduce or suspend progress payments, increase the rate of liquidation, or take a combination of these actions, after finding on substantial evidence any of the following conditions:

(1) The Contractor failed to comply with any material requirement of this contract (which includes paragraphs (f) and (g) below).

(2) Performance of this contract is endangered by the Contractor's (i) failure to make progress or (ii) unsatisfactory financial condition.

(3) Inventory allocated to this contract substantially exceeds reasonable requirements.

(4) The Contractor is delinquent in payment of the costs of performing this contract in the ordinary course of business.

(5) The unliquidated progress payments exceed the fair value of the work accomplished on the undelivered portion of this contract.

(6) The Contractor is realizing less profit than that reflected in the establishment of any alternate liquidation rate in paragraph (b) above, and that rate is less than the progress payment rate stated in subparagraph (a)(1) above.

(d) Title.

(1) Title to the property described in this paragraph (d) shall vest in the Government. Investiture shall be immediately upon the date of this contract, for property acquired or produced before that date. Otherwise, investiture shall occur when the property is or should have been allocable or properly chargeable to this contract.



(2) "Property," as used in this clause, includes all of the below-described items acquired or produced by the Contractor that are or should be allocable or properly chargeable to this contract under sound and generally accepted accounting principles and practices.

(1) Parts, materials, inventories, and work in process;

(ii) Special tooling and special test equipment to which the Government is to acquire title under any other clause of this contract;

(iii) Nondurable (i.e., noncapital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment, and other similar manufacturing aids, title to which would not be obtained as special tooling under subparagraph (ii) above; and

(iv) Drawings and technical data, to the extent the Contractor of subcontractors are required to deliver them to the Government by other clauses of this contract.

(3) Although title to property is in the Government under this clause, other applicable clauses of this contract, e.g., the termination or special tooling clauses, shall determine the handling and disposition of the property.

(4) The Contractor may sell any scrap resulting from production under this contract without requesting the Contracting Officer's approval, but the proceeds shall be credited against the costs of performance.

(5) To acquire for its own use or dispose of property to which title is vested in the Government under this clause, the Contractor must obtain the Contracting Officer's advance approval of the action and the terms. The Contractor shall (i) exclude the allocable costs of the property from the costs of contract performance, and (ii) repay to the Government any amount of liquidated progress payments allocable to the property. Repayment may be by cash or credit memorandum.

(6) When the Contractor completes all of the obligations under this contract, including liquidation of all progress payments, title shall vest in the Contractor for all property (or the proceeds thereof) not--

(i) Delivered to, and accepted by, the Government under this contract; or

(ii) Incorporated in supplies delivered to, and accepted by, the Government under this contract and to which title is vested in the Government under this clause.

(7) The terms of this contract concerning liability for Government-furnished property shall not apply to property to which the Government acquired title solely under this clause.

(e) Risk of Loss. Before delivery to and acceptance by the Government, the Contractor shall bear the risk of loss for property, the title to which vests in the Government under this clause, except to the extent the Government expressly assumes the risk. The Contractor shall repay the Government an amount equal to the unliquidated progress payments that are based on costs allocable to property that is damaged, lost, stolen, or destroyed.

(f) Control of Costs and Property. The Contractor shall maintain an accounting system and controls adequate for the property administration of this clause.

(g) Reports and Access to Records. The Contractor shall promptly furnish reports, certificates, financial statements, and other pertinent information reasonably requested by the Contracting Officer for the administration of this clause. Also, the Contractor shall give the Government reasonable opportunity to examine and verify the Contractor's books, records, and accounts.

(h) Special Terms Regarding Default. If this contract is terminated under the Default clause, (i) the Contractor shall, on demand, repay to the Government the amount of unliquidated progress payments and (ii) title shall vest in the Contractor, on full liquidation of progress payments, for all property for which the Government elects not to require delivery under the Default clause. The Government shall be liable for no payment except as provided by the Default clause.

(i) Reservations of Rights.

(1) No payment or vesting of title under this clause shall (i) excuse the Contractor from performance of obligations under this contract or (ii) constitute a waiver of any of the rights to remedies of the parties under the contract.

(2) The Government's rights and remedies under this clause (i) shall not be exclusive but rather shall be in addition to any other rights and remedies provided by law or this contract and (ii) shall not be affected by delayed, partial, or omitted exercise of any right, remedy, power, or privilege, nor shall such exercise or any single exercise preclude or impair any further exercise under this clause or the exercise of any other right, power, or privilege of the Government.

(j) Progress Payments to Subcontractors. The amounts mentioned in (a)(1)(ii) above shall be all progress payments to subcontractors or divisions, if the following conditions are met:

(1) The amounts included are limited to (i) the unliquidated remainder of progress payments made plus (ii) for small business concerns any unpaid subcontractor requests for progress payments that the Contractor has approved for current payment in the ordinary course of business.

(2) The subcontract or interdivisional order is expected to involve a minimum of approximately six (6) months between the beginning of work and the first delivery, or, if the subcontractor is a small business concern, four (4) months.

(3) The terms of the subcontract or interdivisional order concerning progress payments--

(i) Are substantially similar to the terms of the clause at 52.232-7007, Progress Payments, for any subcontractor that is a large business concern, or that clause with its Alternate I for any subcontractor that is a small business concern;

(ii) Are at least as favorable to the Government as the terms of this clause;

(iii) Are not more favorable to the subcontractor or division than the terms of this clause are to the Contractor;

(iv) Are in conformance with the requirements of paragraph 32.504(e) of the Federal Acquisition Regulation; and

(v) Subordinate all subcontractor rights concerning property to which the Government has title under the subcontract to the Government's right to require delivery of the property to the Government if (A) the Contractor defaults or (B) the subcontractor becomes bankrupt or insolvent.

(4) The progress payment rate in the subcontract is the customary rate used by the Contracting Agency, depending on whether the subcontractor is or is not a small business concern.

(5) The parties agree concerning any proceeds received by the Government for property to which title has vested in the Government under the subcontract terms, that the proceeds shall be applied to reducing any unliquidated progress payments by the Government to the Contractor under this contract.

(6) If no unliquidated progress payments to the Contractor remain, but there are unliquidated progress payments that the Contractor has made to any subcontractor, the Contractor shall be subrogated to all the rights the Government obtained through the terms required by this clause to be any subcontract, as if all such rights had been assigned and transferred to the Contractor.

(7) The Contractor shall pay the subcontractor's progress payment request under subparagraph (j)(1)(ii) above, within a reasonable time after receiving the Government progress payment covering those amounts.

(8) To facilitate small business participation in subcontracting under this contract, the Contractor agrees to provide progress payments to small business concerns, in conformity with the standards for customary progress payments stated in Subpart 32.5 of the Federal Acquisition Regulation. The Contractor further agrees that the need for such progress payments shall not be considered as a handicap or adverse factor in the award of subcontracts.

(k) Limitations on Undefined Contract Actions.

Notwithstanding any other progress payment provision in this contract, progress payments may not exceed eighty percent (80%) of costs incurred on work accomplished under undefined contract actions. A "contract action" is any action resulting in a contract, as defined in FAR Subpart 2.1, including contract modifications for additional supplies or services, but not including contract modifications that are within the scope and under the terms of the contract, such as contract modifications issued pursuant to the Changes clause, or funding other administrative changes. This limitation shall apply to the costs incurred, as computed in accordance with paragraph (a), and shall remain in effect until the contract action is definitized. Costs incurred which are subject to this limitation shall be segregated on contractor progress payment requests

and invoices from those costs eligible for higher progress payment rates. For purpose of progress payment liquidation, as described in paragraph (b), progress payments for undefinitized contract actions shall be liquidated at eighty percent (80%) of the amount invoiced for work performed under the undefinitized contract action as long as the contract action remains undefinitized. The amount of unliquidated progress payments for undefinitized contract actions shall not exceed eighty percent (80%) of the maximum liability of the Government under the undefinitized contract action or such lower limit specified elsewhere in the contract. Separate limits may be specified for separate actions.

(End of clause)

**Alternate I (OCT 1986).** If the contract is with a small business concern, change each mention of the progress payment and liquidation rates excepting paragraph (k) to the customary rate of eighty percent (80%) for small business concerns, delete subparagraphs (a)(1) and (a)(2) from the basic clause, and substitute the following subparagraphs (a)(1) and (a)(2):

(a) Computation of Amounts.

(1) Unless the Contractor requests a smaller amount, each progress payment shall be computed as (i) eighty percent (80%) of the Contractor's total costs incurred under this contract whether or not actually paid, plus (ii) progress payments to subcontractors (see paragraph (j) below), all less the sum of all previous progress payments made by the Government under this contract. Cost of money that would be allowable under 31.205-10 of the Federal Acquisition Regulation shall be deemed an incurred cost for progress payment purposes.

(2) Accrued costs of Contractor contributions under employee pension plans shall be excluded until actually paid unless--

(i) The Contractor's practice is to make contributions to the retirement fund quarterly or more frequently; and

(ii) The contribution does not remain unpaid thirty (30) days after the end of the applicable quarter or shorter payment period (any contribution remaining unpaid shall be excluded from the Contractor's total costs for progress payments until paid).

**Alternate II (OCT 1986).** If the contract is a letter contract, add paragraphs (l) and (m) shown below. The amount specified in paragraph (m) shall not exceed eighty percent (80%) applied to the maximum liability of the Government under the letter contract. Separate limits may be specified for separate parts of the work.

(1) Progress payments made under this letter contract shall, unless previously liquidated under paragraph (b), be liquidated under the following procedures:

(1) If this letter contract is superseded by a definitive contract, unliquidated progress payments made under this letter contract shall be liquidated by deducting the amount from the first progress or other payments made under the definitive contract.

(2) If this letter contract is not superseded by a definitive contract calling for the furnishing of all or part of the articles or services covered under the letter contract, unliquidated progress payments made under the letter contract shall be liquidated by deduction from the amount payable under the Termination clause.

(3) If this letter contract is partly terminated and partly superseded by a contract, the Government shall allocate the unliquidated progress payments to the terminated and untermiated portions as the Government deems equitable, and shall liquidate each portion under the relevant procedure in subparagraphs (1) and (2) above.

(4) If the method of liquidating progress payments provided above does not result in full liquidation, the Contractor shall immediately pay the unliquidated balance to the Government on demand.

(m) The amount of unliquidated progress payments shall not exceed \_\_\_\_\_ (specify dollar amount).

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**PART 32**

**CONTRACT FINANCING**

**32.000 Scope of part.**

This part prescribes policies and procedures for contract financing and other payment matters. This includes—

- (a) Payment methods, including partial payments and progress payments based on percentage or stage of completion;
- (b) Loan guarantees, advance payments, and progress payments based on costs;
- (c) Administration of debts to the Government arising out of contracts;
- (d) Contract funding, including the use of contract clauses limiting costs or funds;
- (e) Assignment of claims to aid in private financing; and
- (f) Selected payment clauses.

**32.001 Definition.**

“Contract action,” as used in this part, means an action resulting in a contract, as defined in FAR Subpart 2.1, including contract modifications for additional supplies or services, but not including contract modifications that are within the scope and under the terms of the contract, such as contract modifications issued pursuant to the Changes clause, or funding and other administrative changes.

**SUBPART 32.1—GENERAL**

**32.100 Scope of subpart.**

This subpart provides policies and procedures applicable to the general subject of contract financing and payment.

**32.101 Authority.**

The basic authority for the contract financing described in this part is contained in section 305 of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 255), section 2307 of the Armed Services Procurement Act (10 U.S.C. 2307), and Title III of the Defense Production Act of 1950 (50 U.S.C. App. 2091).

**32.102 Description of contract financing methods.**

(a) Advance payments are advances of money by the Government to a prime contractor before, in anticipation of, and for the purpose of complete performance under one or more contracts. They are expected to be liquidated from payments due to the contractor incident to performance of the contracts. Since they are not measured by performance, they differ from partial, progress, or other payments based on the performance or partial performance of a contract. Advance payments may be made to prime contractors for the purpose of making subadvances to subcontractors.

(b) Progress payments based on costs are made on the

basis of costs incurred by the contractor as work progresses under the contract. This form of contract financing does not include—

- (1) Payments based on the percentage or stage of completion accomplished;
  - (2) Payments for partial deliveries accepted by the Government; or
  - (3) Partial payments for a contract termination proposal.
- (c) Loan guarantees are made by Federal Reserve banks, on behalf of designated guaranteeing agencies, to enable contractors to obtain financing from private sources under contracts for the acquisition of supplies or services for the national defense.
- (d) Partial payments for accepted supplies and services that are only a part of the contract requirements are authorized under section 305 of the Federal Property and Administrative Services Act (41 U.S.C. 255). Although partial payments are generally treated as a method of payment and not as a method of contract financing, using partial payments can assist contractors to participate in Government contracts without, or with minimal, contract financing. When appropriate, agencies shall use this payment method.

(e) (1) Progress payments based on a percentage or stage of completion are authorized by the statutes cited in 32.101.

(2) This type of progress payment may be used as a payment method under agency procedures. Agency procedures must ensure that payments are commensurate with work accomplished, which meets the quality standards established under the contract. Furthermore, progress payments may not exceed 80 percent of the eligible costs of work accomplished on undefinitized contract actions.

**32.103 Progress Payments Construction Contracts.**

When satisfactory progress has not been achieved by a contractor during any period for which a progress payment is to be made, a percentage of the progress payment may be retained. Retainage should not be used as a substitute for good contract management, and the contracting officers should not withhold funds without cause. Determinations to retain and the specific amount to be withheld shall be made by the contracting officers on a case-by-case basis. Such decisions will be based on the contracting officer's assessment of past performance and the likelihood that such performance will continue. The amount of retainage withheld shall not exceed 10 percent of the approved estimated amount in accordance with the terms of the contract and may be adjusted as the contract approaches completion to recognize better than expected performance, the ability to rely on alternative safeguards, and other factors. Upon completion of all contract requirements, retained amounts shall be paid promptly.



performance of essential contracts. Government financing shall be provided only to the extent actually needed for prompt and efficient performance, considering the availability of private financing. Contract financing shall be administered so as to aid, not impede, the acquisition. At the same time, the contracting officer shall avoid any undue risk of monetary loss to the Government through the financing. The contractor's use of the contract financing provided and the contractor's financial status shall be monitored.

(b) If the contractor is a small business concern, the contracting officer shall give special attention to meeting the contractor's contract financing need. However, a contractor's receipt of a certificate of competency from the Small Business Administration has no bearing on the contractor's need for or entitlement to contract financing.

#### 32.105 Uses of contract financing.

(a) Contract financing methods covered in this part are intended to be self-liquidating through contract performance. Consequently, agencies shall only use the methods for financing of contractor working capital, not for the expansion of contractor-owned facilities or the acquisition of fixed assets. However, under loan guarantees, exceptions may be made for—

(1) Facilities expansion of a minor or incidental nature, if a relatively small part of the guaranteed loan is used for the expansion and the contractor's repayment would not be delayed or impaired; or

(2) Other instances of facilities expansion for which contract financing is appropriate under agency procedures.

(b) The limitations in this section do not apply to contracts under which facilities are being acquired for Government ownership.

#### 32.106 Order of preference.

The contracting officer shall consider the following order of preference when a contractor requests contract financing, unless an exception would be in the Government's interest in a specific case:

(a) Private financing without Government guarantee. It is not intended, however, that the contractor be required to obtain private financing (1) at unreasonable terms, or (2) from other agencies.

(b) Progress payments based on costs at customary rates (see 32.501-1).

(c) Loan guarantees.

(d) Progress payments based on costs with unusual terms (see 32.501).

(e) Advance payments (see exceptions in 32.402(b)).

#### 32.107 Need for contract financing not a deterrent.

(a) If the contractor or offeror meets the standards prescribed for responsible prospective contractors at 9.104, the contracting officer shall not treat the contractor's need for contract financing as a handicap for a contract award; e.g., as a responsibility factor or evaluation criterion.

(b) The contractor should not be disqualified from contract financing solely because the contractor failed to indicate a need for contract financing before the contract was awarded.

#### 32.108 Financial consultation.

Each contracting office should have available and use the services of contract financing personnel competent to evaluate credit and financial problems. In resolving any questions concerning (a) the financial capability of an offeror or contractor to perform a contract or (b) what form of contract financing is appropriate in a given case, the contracting officer should consult the appropriate contract financing office.

#### 32.109 Termination financing.

To encourage contractors to invest their own funds in performance despite the susceptibility of the contract to termination for the convenience of the Government, the contract financing procedures under this part may be applied to the financing of terminations either in connection with or independently of financing for contract performance (see 49.112-1).

#### 32.110 Contract performance in foreign countries.

(a) In applying the coverage of Part 32 to a contract performed partly or completely in a foreign country, the contracting officer shall give due consideration to the sovereignty, laws, and procedures of the country concerned and shall obtain legal advice as necessary. The legal advice may indicate a need for additional protective arrangements within the foreign jurisdiction or for deviations from the contract clauses prescribed in this part.

(b) The contracting officer shall act as necessary to comply with applicable foreign laws, while providing the most effective protection of the Government's interest.

#### 32.111 Contract clauses.

(a) The contracting officer shall insert the following clauses, appropriately modified with respect to payment due dates, in accordance with agency regulations—

(1) The clause at 52.232-1, Payments, in solicitations and contracts when a fixed-price supply contract, a fixed-price service contract, or a contract for nonregulated communication services is contemplated;

(2) The clause at 52.232-2, Payment under Fixed-Price Research and Development Contracts, in solicitations and contracts when a fixed-price research and development contract is contemplated;

(3) The clause at 52.232-3, Payments under Personal Services Contracts, in solicitations and contracts for personal services;

(4) The clause at 52.232-4, Payments under Transportation Contracts and Transportation-Related Services Contracts, in solicitations and contracts for transportation or transportation-related services;

(5) The clause at 52.232-5, Payments under Fixed-

**Price Construction Contracts, in solicitations and contracts for construction when a fixed-price contract is contemplated; and**

**(6) The clause at 52.232-6, Payments under Communication Service Contracts with Common Carriers, in solicitations and contracts for regulated communication services by common carriers.**

**(b) The contracting officer shall insert the clause at 52.232-7, Payments under Time-and-Materials and**

**Labor-Hour Contracts, appropriately modified with respect to payment due dates in accordance with agency regulations, in solicitations and contracts when a time-and-materials or labor-hour contract is contemplated. If (i) the nature of the work to be performed requires the contractor to furnish material that is regularly sold to the general public in the normal course of business by the contractor and (ii) the price is under the limitations**

**(The next page is 32-3)**

prescribed in 16.601(b)(3), the contracting officer shall use the clause with its Alternate I. If a labor-hour contract is contemplated, and if no specific reimbursement for materials furnished is intended, the contracting officer may use the clause with its Alternate II.

(c) The contracting officer shall insert the following clauses, appropriately modified with respect to payment due dates in accordance with agency regulations:

(1) The clause at 52.232-8, Discounts for Prompt Payments, in solicitations and contracts when a fixed-price supply contract or fixed-price service contract is contemplated.

(2) A clause, substantially the same as the clause at 52.232-9, Limitation on Withholding of Payments, in solicitations and contracts when a supply contract, research and development contract, service contract, time-and-materials contract, or labor-hour contract is contemplated that includes two or more terms authorizing the temporary withholding of amounts otherwise payable to the contractor for supplies delivered or services performed.

(d) The contracting officer shall insert the following clauses, appropriately modified with respect to payments due dates in accordance with agency regulations:

(1) The clause at 52.232-10, Payments under Fixed-Price Architect-Engineer Contracts, in fixed-price architect-engineer contracts.

(2) The clause at 52.232-11, Extras, in solicitations and contracts when a fixed-price supply contract, fixed-price service contract, or a transportation contract is contemplated.

#### SUBPART 32.2—RESERVED

#### SUBPART 32.3—LOAN GUARANTEES FOR DEFENSE PRODUCTION

##### 32.300 Scope of subpart.

This subpart prescribes policies and procedures for designated agencies' guarantees of loans made by private financial institutions to borrowers performing contracts related to national defense (see 30.102).

##### 32.301 Definitions.

"Borrower," as used in this subpart, means a contractor, subcontractor (at any tier), or other supplier who receives a guaranteed loan.

"Federal Reserve Board" means the Board of Governors of the Federal Reserve System.

"Guaranteed loan" or "V loan," as used in this subpart, means a loan, revolving credit fund, or other financial arrangement made pursuant to Regulation V of the Federal Reserve Board, under which the guaranteeing agency is obligated, on demand of the lender, to purchase a stated percentage of the loan and to share any losses in the amount of the guaranteed percentage.

"Guaranteeing agency," as used in this subpart, means any agency that the President has authorized to guarantee loans, through Federal Reserve Banks, for expediting national defense production.

##### 32.302 Authority.

Congress has authorized Federal Reserve Banks to act, on behalf of guaranteeing agencies, as fiscal agents of the United States in the making of loan guarantees for defense production (Section 301, Defense Production Act of 1950 (50 U.S.C. App. 2091)). By Executive Order 10480, August 14, 1953 (3 CFR 1949-53), as amended, the President has designated the following agencies as guaranteeing agencies:

- (a) Department of Defense.
- (b) Department of Energy.
- (c) Department of Commerce.
- (d) Department of the Interior.
- (e) Department of Agriculture.
- (f) General Services Administration.
- (g) National Aeronautics and Space Administration.

##### 32.303 General.

(a) Section 301 of the Defense Production Act authorizes loan guarantees for contract performance or other operations related to national defense, subject to amounts annually authorized by Congress on the maximum obligation of any guaranteeing agency under any loan, discount, advance, or commitment in connection therewith, entered into under section 301. (See 50 U.S.C. App. 2091 for statutory limitations and exceptions concerning the authorization of loan guarantee amounts and the use of loan guarantees for the prevention of insolvency or bankruptcy.)

(b) The guarantee shall be for less than 100 percent of the loan unless the agency determines that—

- (1) The circumstances are exceptional;
- (2) The operations of the contractor are vital to the national defense; and
- (3) No other suitable means of financing are available.

(c) Loan guarantees are not issued to other agencies of the Government.

(d) Guaranteed loans are essentially the same as conventional loans made by private financial institutions, except that the guaranteeing agency is obligated, on demand of the lender, to purchase a stated percentage of the loan and to share any losses in the amount of the guaranteed percentage. It is the responsibility of the private financial institution to disburse and collect funds and to administer the loan. Under Regulation V of the Federal Reserve Board (12 CFR 245), any private financing institution may submit an application to the Federal Reserve Bank of its district for guarantee of a loan or credit.

(e) Federal Reserve Banks will make the loan guarantee agreements on behalf of the guaranteeing agencies.

(f) Under Section 302(c) of Executive Order 10480, August 14, 1953 (3 CFR 1949-53), as amended, all actions and operations of Federal Reserve Banks, as fiscal agents, are subject to the supervision of the Federal Reserve Board. The Federal Reserve Board is

authorized to prescribe the following, after consultation with the heads of guaranteeing agencies:

- (1) Regulations governing the actions and operations of fiscal agents.
- (2) Rates of interest, guarantee and commitment fees, and other charges that may be made for loans, discounts, advances, or commitments guaranteed by the guaranteeing agencies through the Federal Reserve Banks. These prescriptions may be in the form of specific rates or limits, or in other forms.
- (3) Uniform forms and procedures to be used in connection with the guarantees.
- (g) The guaranteeing agency is responsible for certifying eligibility for the guarantee and fixing the maximum dollar amount and maturity date of the guaranteed loan to meet the contractor's requirement for financing performance of the defense production contract on hand at the time the guarantee application is submitted.

### 32.304 Procedures.

#### 32.304-1 Application for guarantee.

(a) A contractor, subcontractor, or supplier that needs operating funds to perform a contract related to national defense may apply to a financing institution for a loan. If the financing institution is willing to extend credit, but considers a Government guarantee necessary, the institution may apply to the Federal Reserve Bank of its district for the guarantee. Application forms and guidance are available at all Federal Reserve Banks.

(b) The Federal Reserve Bank will promptly send a copy of the application, including a list of the relevant defense contracts held by the contractor, to the Federal Reserve Board. The Board will transmit the application and the list of contracts to the interested guaranteeing agency, so that the agency can determine the eligibility of the contractor.

(c) To expedite the process, the Federal Reserve Bank may, pursuant to instructions of a guaranteeing agency, submit lists of the defense contracts to the interested contracting officers.

(d) While eligibility is being determined, the Federal Reserve Bank will make any necessary credit investigations to supplement the information furnished by the applicant financing institution in order to—

- (1) Expedite necessary defense financing; and
- (2) Protect the Government against monetary loss.

(e) The Federal Reserve Bank will send its report and recommendation to the Federal Reserve Board. The Board will transmit them to the interested guaranteeing agency.

#### 32.304-2 Certificate of eligibility.

(a) The contracting officer shall prepare the certificate of eligibility for a contract that the contracting officer deems to be of material consequence, when—

- (1) The contract financing office requests it;
- (2) Another interested agency requests it; or

(3) The application for a loan guarantee relates to a contract or subcontract within the cognizance of the contracting officer.

(b) The agency shall evaluate the relevant data, including the certificate of eligibility, the accompanying data, and any other relevant information on the contractor's financial status and performance, to determine whether authorization of a loan guarantee would be in the Government's interest.

(c) If the contractor has several major national defense contracts, it is normally not necessary to evaluate the eligibility of relatively minor contracts. The determination of eligibility should be processed, without delay, based on the the preponderance of the amount of the contracts.

(d) The certificate of eligibility shall include the following determinations:

(1) The supplies or services to be acquired are essential to the national defense.

(2) The contractor has the facilities and the technical and management ability required for contract performance.

(3) There is no practicable alternate source for the acquisition without prejudice to the national defense. (This statement shall not be included if the contractor is a small business concern.)

(e) The contracting officer shall consider the following factors in determining if a practicable alternate source exists:

(1) Prejudice to the national defense, because reletting of a contract with another source would conflict with a major policy on defense acquisition; e.g., policies relating to the mobilization base.

(2) The urgency of contract performance schedules.

(3) The technical ability and facilities of other potential sources.

(4) The extent to which other sources would need contract financing to perform.

(5) The willingness of other sources to enter into contracts.

(6) The time and expense involved in repurchasing for contracts or parts of contracts. This may include potential claims under a termination for convenience or delays incident to default at a later date.

(7) The comparative prices available from other sources.

(8) The disruption of established subcontracting arrangements.

(9) Other pertinent factors.

(f) The contracting officer shall attach sufficient data to the certificate of eligibility to support the determinations made. Available pertinent information shall be included on—

- (1) The contractor's past performance;
- (2) The relationship of the contractor's operations to performance schedules; and

(3) Other factors listed in paragraph (e) above, if relevant to the case under consideration.

(g) If the contracting officer determines that a certificate of eligibility is not justified, the facts and reasons supporting that conclusion shall be documented and furnished to the agency contract finance office.

(h) The guaranteeing agency shall review the proposed guarantee terms and conditions. If they are considered appropriate, the guaranteeing agency shall complete a standard form of authorization as prescribed by the Federal Reserve Board. The agency shall transmit the authorization through the Federal Reserve Board to the Federal Reserve Bank. The Bank is authorized to execute and deliver to the financing institution a standard form of guarantee agreement, with the terms and conditions approved for the particular case. The financing institution will then make the loan.

(i) Substantially the same procedure may be followed for the application of an offeror who is actively negotiating or bidding for a defense contract, except that the guarantee shall not be authorized until the contract has been executed.

(j) The contracting officer shall report to the agency contract finance office any information about the contractor that would have a potentially adverse impact on a pending guarantee application. The contracting officer is not required, however, to initiate any special investigation for this purpose.

(k) With regard to existing contracts, the agency shall not consider the percentage of guarantee requested by the financing institution in determining the contractor's eligibility.

#### 32.304-3 Asset formula.

(a) Under guaranteed loans made primarily for working capital purposes, the agency shall normally limit the guarantee, by use of an asset formula, to an amount that does not exceed a specified percentage (90 percent or less) of the contractor's investment (e.g., payrolls and inventories) in defense production contracts. The asset formula may include all items under defense contracts for which the contractor would be entitled to payment on performance or termination. The formula shall exclude—

- (1) Amounts for which the contractor has not done any work or made any expenditure;
- (2) Amounts that would become due as the result of later performance under the contracts; and
- (3) Cash collateral or bank deposit balances.

(b) Progress payments are deducted from the asset formula.

(c) The agency may relax the asset formula to an appropriate extent for the time actually necessary for contract performance, if the contractor's working capital and credit are inadequate.

#### 32.304-4 Guarantee amount and maturity.

The agency may change the guarantee amount or maturity date, within the limitations at 32.304-3, as follows:

(a) If the contractor enters into additional defense production contracts after the application for, but before authorization of, a guarantee, the agency may adjust the loan guarantee amount or maturity date to meet any significant increase in financing need.

(b) If the contractor enters into defense production contracts during the term of the guaranteed loan, the parties may adjust the existing guarantee agreement to provide for financing the new contracts. Pertinent information and the Federal Reserve Bank reports will be submitted to the guaranteeing agency under the procedures for the original guarantee application, described in 32.304-1. Normally, a new certificate of eligibility is required.

#### 32.304-5 Assignment of claims under contracts.

(a) The agency shall generally require a contractor that is provided a guaranteed loan to execute an assignment of claims under defense production contracts (including any contracts entered into during the term of the guaranteed loan that are eligible for financing under the loan); however, the agency need not require assignment if any of the following conditions are present:

(1) The contractor's financial condition is so strong that the protection to the Government provided by an assignment of claims is unnecessary.

(2) In connection with the assignment of claims under a major contract, the increased protection of the loan that would be provided by the assignments under additional, relatively smaller contracts is not considered necessary by the agency.

(3) The assignment of claims would create an administrative burden disproportionate to the protection required; e.g., if the contractor has a large number of contracts with individually small dollar amounts.

(b) The contractor shall also execute an assignment of claims if requested to do so by the guarantor or the financing institution.

(c) A subcontract or purchase order issued to a subcontractor shall not be considered eligible for financing under guaranteed loans when the issuer of the subcontract or purchase order reserves (1) the privilege of making payments directly to the assignor or to the assignor and assignee jointly, after notice of the assignment, or (2) the right to reduce or set off assigned proceeds under defense production contracts by reason of claims against the borrower arising after notice of assignment and independently of defense production contracts under which the borrower is the seller.

#### 32.304-6 Other collateral security.

The following are examples of other forms of security that, although seldom invoked under guaranteed

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loans, may be required when considered necessary for protection of the Government interest:

- (a) Mortgages on fixed assets.
- (b) Liens against inventories.
- (c) Endorsements.
- (d) Guarantees.
- (e) Subordinations or standbys of other indebtedness.

#### 32.304-7 Contract surety bonds and loan guarantees.

(a) Contract surety bonds are incompatible with the Government's interests under guaranteed loans, unless the interests of the surety are subordinated to the guaranteed loan.

(b) If a substantial share of the contractor's defense contracts are covered by surety bonds, or the amount of the bond is substantial in relation to the contractor's net worth, the agency shall not authorize the guarantee of a loan on a bonded contract unless the surety enters into an agreement with the financing institution to subordinate the surety's rights and claims in favor of the guaranteed loan.

(c) The agency approval of a guarantee for a loan involving relatively substantial subcontracts covered by surety bonds shall also depend on the establishment of a reasonable allocation agreement between the sureties and the financing institution. The agreement should give the financing institution the benefit, with regard to payments to be made on the contract, of the portion of its loans fairly attributable to expenditures made under the bonded subcontracts before notice of default.

#### 32.304-8 Other borrowing.

(a) Because of the limitations under guaranteed loans, some contractors seek to supplement the loan by other borrowing (outside the guarantee) from the financing institution or other sources. It has been recognized in practice that, while prohibition of borrowings outside the guaranteed loan is preferable when practicable in a given V-loan case, such other borrowings should be permitted when necessary.

(b) If the agency consents to the contractor obtaining other borrowing during the guaranteed loan period, the agency shall apply the following restrictions:

- (1) A reasonable limit on the amount of other borrowing.
- (2) If guaranteed and unguaranteed loans are made by the same financing institution, a requirement that any collateral security requested by the institution under the unguaranteed loan is also to be secondary collateral for the guaranteed loan.
- (3) A requirement that the contractor provide appropriate certificates to the guaranteeing agency, at intervals not longer than 30 days, to disclose outstanding unguaranteed borrowings.

#### 32.305 Loan guarantees for terminated contracts.

(a) The purpose of guaranteed loans; i.e., to provide for financing based on the borrower's recoverable investment in defense production contracts, may also apply to contracts that have been terminated (partially

or totally) for the convenience of the Government. Guaranteed loans also may be made before such termination if it is known that termination of particular contracts for the convenience of the Government is about to occur. These loans are expected to provide necessary financing pending termination settlements and payments. They may also finance continuing performance of defense production contracts that are eligible for guaranteed loans.

(b) The procedure for such guarantees is substantially the same as that outlined in 32.304, except that certificates of eligibility are not required for (1) contracts that have been totally terminated or (2) the terminated portion of contracts that have been partially terminated. The agency shall take precautions necessary to avoid Government losses and to ensure the loans will be self-liquidating from the proceeds of defense production contracts.

(c) Loan guarantees for contract termination financing shall not be provided before specific contract terminations are certain.

#### 32.306 Loan guarantees for subcontracts.

If the request for a loan guarantee concerns a subcontractor that is financially weak in comparison with its contractor, the Government's interests may be fostered by the contractor making progress payments to the subcontractor. If so, the agency shall try to arrange for the contractor to provide the progress payments. As a result, the need for the loan guarantee may be reduced or eliminated and the contractor would bear part or all of the risk of loss arising from the selection of the subcontractor.

### SUBPART 32.4—ADVANCE PAYMENTS

#### 32.400 Scope of subpart.

This subpart provides policies and procedures for advance payments on prime contracts and subcontracts. It does not include policies and procedures for advance payments for the types of transactions listed in 32.404.

#### 32.401 Statutory authority.

The agency may authorize advance payments in negotiated and sealed bid contracts if the action is appropriate under (a) section 305 of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 255), (b) the Armed Services Procurement Act (10 U.S.C. 2307), or (c) Pub. L. 85-804 (50 U.S.C. 1431-1435) and Executive Order 10789, November 14, 1958 (3 CFR 1958 Supp. pp. 72-74) (see Part 50 of the Federal Acquisition Regulation (FAR) for other applications of this statute).

#### 32.402 General.

(a) A limitation on authority to grant advance payments under Pub. L. 85-804 (50 U.S.C. 1431-1435) is described at FAR 50.203(b)(4). This limitation also applies to advance payments authorized under 10 U.S.C. 2307.

(b) Advance payments may be provided on any type of contract; however, the agency shall authorize advance payments sparingly. Except for the contracts described in 32.403(a) and (b), advance payment is the least preferred method of contract financing (see 32.106) and generally they should not be authorized if other types of financing are reasonably available to the contractor in adequate amounts. Loans and credit at excessive interest rates or other exorbitant charges, or loans from other Government agencies, are not considered reasonably available financing.

(c) If statutory requirements and standards for advance payment determinations are met, the contracting officer shall generally recommend that the agency authorize advance payments.

(1) The statutory requirements are that—

- (i) The contractor gives adequate security;
- (ii) The advance payments will not exceed the unpaid contract price (see 32.410(b), subparagraph (a)(2)); and
- (iii) The agency head or designee determines, based on written findings, that the advance payment—

(A) Is in the public interest (under 32.401(a) or (b)); or

(B) Facilitates the national defense (under 32.401(c)).

(2) The standards for advance payment determinations are that—

(i) The advance payments will not exceed the contractor's interim cash needs based on—

(A) Analysis of the cash flow required for contract performance;

(B) Consideration of the reimbursement or other payment cycle; and

(C) To the extent possible, employment of the contractor's own working capital;

(ii) The advance payments are necessary to supplement other funds or credit available to a contractor;

(iii) The recipient is otherwise qualified as a responsible contractor;

(iv) The Government will benefit from performance prospects or there are other practical advantages; and

(v) The case fits one or more of the categories described in 32.403.

(d) If necessary, the agency may authorize advance payments in addition to progress or partial payments on the same contract (see 32.501-1(c)).

(e) Each agency that provides advance payments shall—

(1) Place the responsibility for making findings and determinations, and for approval of contract terms concerning advance payments (see 32.410), at an organizational level high enough to ensure uniform application of this subpart (see the limitation at 50.201(b) which also applies to advance payments

authorized under Pub. L. 85-804 (50 U.S.C. 1431-1435)); and

(2) Establish procedures for coordination, before advance payment authorization, with the activity that provides contract financing support.

(f) If the contract provides for advance payments under Pub. L. 85-804, the contracting officer shall ensure conformance with the requirements of FAR 50.307.

#### 32.403 Applicability.

Advance payments may be considered useful and appropriate for the following:

(a) Contracts for experimental, research, or development work with nonprofit educational or research institutions.

(b) Contracts solely for the management and operation of Government-owned plants.

(c) Contracts for acquisition at cost of facilities for Government ownership.

(d) Contracts of such a highly classified nature that the agency considers it undesirable for national security to permit assignment of claims under the contract.

(e) Contracts entered into with financially weak contractors whose technical ability is considered essential to the agency. In these cases, the agency shall closely monitor the contractor's performance and financial controls to reduce the Government's financial risk.

(f) Contracts for which a loan by a private financial institution is not practicable, whether or not a loan guarantee under this part is issued; for example, if—

(1) Financing institutions will not assume a reasonable portion of the risk under a guaranteed loan;

(2) Loans with reasonable interest rates or finance charges are not available to the contractor; or

(3) Contracts involve operations so remote from a financial institution that the institution could not be expected to suitably administer a guaranteed loan.

(g) Contracts with small business concerns, under which circumstances that make advance payments appropriate often occur (but see 32.104(b)).

(h) Contracts under which exceptional circumstances make advance payments the most advantageous contract financing method for both the Government and the contractor.

#### 32.404 Exclusions.

(a) This subpart does not apply to advance payments authorized by law for—

(1) Rent;

(2) Tuition;

(3) Insurance premiums;

(4) Expenses of investigations in foreign countries;

(5) Extension or connection of public utilities for Government buildings or installations;

(6) Subscriptions to publications;

(7) Purchases of supplies or services in foreign countries, if—

(i) The purchase price does not exceed \$10,000 (or equivalent amount of the applicable foreign currency); and

(ii) The advance payment is required by the laws or government regulations of the foreign country concerned;

(8) Enforcement of the customs or narcotics laws; or

(9) Other types of transactions excluded by agency procedures under statutory authority.

(b) Agencies may issue their own instructions to deal with advance payment items in paragraph (a) above authorized under statutes relevant to their agencies.

### 32.405 Applying Pub. L. 85-804 to advance payments under sealed bid contracts.

(a) Actions that designated agencies may take to facilitate the national defense without regard to other provisions of law relating to contracts, as explained in 50.101(a), also include making advance payments. These advance payments may be made at or after award of sealed bid contracts, as well as negotiated contracts.

(b) Bidders may request advance payments before or after award, even if the invitation for bids does not contain an advance payment provision. However, the contracting officer shall reject any bid requiring that advance payments be provided as a basis for acceptance.

(c) When advance payments are requested, the agency may—

(1) Enter into the contract and provide for advance payments conforming to this Part 32;

(2) Enter into the contract without providing for advance payments if the contractor does not actually need advance payments; or

(3) Deny award of the contract if the request for advance payments has been disapproved under 32.409-2 and funds adequate for performance are not otherwise available to the offeror.

### 32.406 Letters of credit.

(a) The Department of the Treasury (Treasury) prescribes regulations and instructions covering the use of letters of credit for advance payments under contracts. See Treasury Department Circular 1075 (31 CFR 205), and the implementing instructions in the Treasury Financial Manual, available in offices providing financial advice and assistance.

(b) If agencies provide advance payments to contractors, use of the following methods is required unless the agency has obtained a waiver from the Treasury Department:

(1) By letter of credit if the contracting agency expects to have a continuing relationship with the contractor for a year or more, with advances totaling at least \$120,000 a year.

(2) By direct Treasury check if the circumstances do not meet the criteria in subparagraph (1) above.

(c) If the agency has entered into multiple contracts (or a combination of contract(s) and assistance agreement(s)) involving eligibility of a contractor for more than one letter of credit, the agency shall follow arrangements made under Treasury procedures for (1) consolidating funding to the same contractor under one letter of credit or (2) replacing multiple letters of credit with a single letter of credit.

(d) The letter of credit enables the contractor to withdraw Government funds in amounts needed to cover its own disbursements of cash for contract performance. Whenever feasible, the agency shall, under the direction and approval of the Department of the Treasury, use a letter of credit method that requires the contractor not to withdraw the Government funds until the contractor's checks have been (1) forwarded to the payees (delay of drawdown technique), or (2) presented to the contractor's bank for payment (checks paid technique) (see 31 CFR 205.3 and 205.4(d)).

(e) The Treasury regulations provide for terminating the advance financing arrangement if the contractor is unwilling or unable to minimize the elapsed time between receipt of the advance and disbursement of the funds. In such cases, if reversion to normal payment methods is not feasible, the Treasury regulation provides for use of a working capital method of advance; i.e., for limiting advances to (1) only the estimated disbursements for a given initial period and (2) subsequently, for only actual cash disbursements (31 CFR 205.3(k) and 205.7).

### 32.407 Interest.

(a) Except as provided in paragraph (d) below, the contracting officer shall charge interest on the daily unliquidated balance of all advance payments at the higher of—

(1) The published prime rate of the banking institution (depository) in which the special bank account (see 32.409-3) is established; or

(2) The rate established by the Secretary of the Treasury under 50 U.S.C. App. 1215(b)(2).

(b) The interest rate for advance payments shall be adjusted for changes in the prime rate of the depository and the semiannual determination by the Secretary of the Treasury under 50 U.S.C. App. 1215(b)(2). The contracting officer shall obtain data from the depository on changes in the interest rate during the month. Interest shall be computed at the end of each month on the daily unliquidated balance of advance payments at the applicable daily interest rate.

(c) Interest shall be required on contracts that are for acquisition, at cost, of facilities for Government ownership, if the contracts are awarded in combination with, or in contemplation of, supply contracts or subcontracts.



(d) The agency head or designee may authorize advance payments without interest under the following types of contracts, if in the Government's interest:

(1) Contracts for experimental, research, or development work (including studies, surveys, and demonstrations in socio-economic areas) with nonprofit education or research institutions.

(2) Contracts solely for the management and operation of Government-owned plants.

(3) Cost-reimbursement contracts with governments, including State or local governments, or their instrumentalities.

(4) Other classes of contracts, or unusual cases, for which the exclusion of interest on advances is specifically authorized by agency procedures.

(e) If a contract provides for interest-free advance payments, the contracting officer may require the contractor to charge interest on advances or downpayments to subcontractors and credit the Government for the proceeds from the interest charges. Interest rates shall be determined as described in paragraphs (a) and (b) above. The contracting officer need not require the contractor to charge interest on an advance to a subcontractor that is an institution of the kind described in subparagraph (d)(1).

(f) The contracting officer shall not allow interest charges, required by this 32.407, as reimbursable costs under cost-reimbursement contracts, whether the interest charge was incurred by the prime contractor or a subcontractor.

#### 32.408 Application for advance payments.

(a) A contractor may apply for advance payments before or after the award of a contract.

(b) The contractor shall submit any advance payment request in writing to the contracting officer and provide the following information:

(1) A reference to the contract if the request concerns an existing contract, or a reference to the solicitation if the request concerns a proposed contract.

(2) A cash flow forecast showing estimated disbursements and receipts for the period of contract performance. If the application pertains to a type of contract described in 32.403(a) or (b), the contractor shall limit the forecast to the contract to be financed by advance payments.

(3) The proposed total amount of advance payments.

(4) The name and address of the bank at which the contractor expects to establish a special account as depository for the advance payments. If advance payments in the form of a letter of credit are anticipated, the contractor shall identify the specific account at the bank to be used. This subparagraph (4) is not applicable if an alternate method is used under agency procedures.

(5) A description of the contractor's efforts to obtain unguaranteed private financing or a V-loan (see 32.301) under eligible contracts. This require-

ment is not applicable to the contract types described in 32.403(a) or (b).

(6) Other information appropriate to an understanding of (i) the contractor's financial condition and need, (ii) the contractor's ability to perform the contract without loss to the Government, and (iii) financial safeguards needed to protect the Government's interest. Ordinarily, if the contract is a type described in 32.403(a) or (b), the contractor may limit the response to this subparagraph (6) to information on the contractor's reliability, technical ability, and accounting system and controls.

#### 32.409 Contracting officer action.

After analysis of the contractor's application and any appropriate investigation, the contracting officer shall recommend approval or disapproval and transmit the request and recommendation to the approving authority designated under 32.402(e).

##### 32.409-1 Recommendation for approval.

If recommending approval, the contracting officer shall transmit the following, under agency procedures, to the approving authority:

(a) Contract data, including—

(1) Identification and date of the award;

(2) Citation of the appropriation;

(3) Type and dollar amount of the contract;

(4) Items to be supplied, schedule of deliveries or performance, and status of any deliveries or performance;

(5) The contract fee or profit contemplated; and

(6) A copy of the contract, if available.

(b) The contractor's request and supporting information.

(c) A report on the contractor's past performance, responsibility, technical ability, and plant capacity.

(d) Comments on (1) the contractor's need for advance payments and (2) potential Government benefits from the contract performance.

(e) Proposed advance payment contract terms, including proposed security requirements.

(f) The findings, determination, and authorization (see 32.410).

(g) The recommendation for approval of the advance payment request.

(h) Justification of any proposal for waiver of interest charges (see 32.407).

##### 32.409-2 Recommendation for disapproval.

If recommending disapproval, the contracting officer shall, under agency procedures, transmit—

(a) The items prescribed in 32.409-1(a), (b), and (c); and

(b) The recommendation for disapproval and the reasons.

##### 32.409-3 Security, supervision, and covenants.

(a) If advance payments are approved, the contracting officer shall enter into an agreement with the con-

tractor covering bank accounts and suitable covenants protecting the Government's interest (see 32.411). This requirement generally applies under all statutory authorities, but modified requirements applicable to certain specific cases are prescribed in paragraphs (e) through (g) below.

(b) The agency shall (1) ensure that the amount of advance payments does not exceed the contractor's financial needs, and (2) closely supervise the contractor's withdrawal of funds from special bank accounts in which the advance payments are deposited.

(c) In the terms of the agreement, the contracting officer should provide for a paramount lien in favor of the Government. This lien may supplement or replace other security requirements. The lien should cover—

- (1) Supplies being acquired;
- (2) Any credit balance in the special bank account in which advance payments are deposited; and

(3) All property that the contractor acquires for performing the contract, except to the extent to which the Government otherwise has valid title to the property.

(d) Security requirements vary to fit the circumstances of different cases. Minimum security requirements are covered by the clauses prescribed in the contract. The contracting officer may supplement these as necessary in each case for protection of the Government's interest. Examples of additional security terms are—

- (1) Personal or corporate endorsements or guarantees;
- (2) Pledges of collateral;
- (3) Subordination or standby of other indebtedness;
- (4) Controls or limitations on profit distributions, salaries, bonuses or commissions, rentals and royalties, capital expenditures, creation of liens, retirement of stock or debt, and creation of additional obligations; and
- (5) Advance payment bonds (rarely required).

(e) In an advance payment agreement with an instrumentality of the Government, a State, a local government, or an agency or instrumentality of a State or local government, the contracting officer may omit the requirement for deposit of the advances in a special bank account, if the official approving the advance determines that other adequate security exists to protect the Government's interest.

(f) The requirements of this 32.409-3 do not apply when using letters of credit if an agency's procedures provide for—

- (1) The use under a cost-reimbursement contract of Federal funds deposited in the contractor's bank account (without the contractor acquiring title to the funds); and
- (2) The security of such deposit of public moneys in accordance with governing regulations of the Treasury Department.

(g) If a separate special bank account is not required; e.g., advance payment by a letter of credit, an agency may require a special bank account for an individual case, or classes of cases, if the circumstances warrant.

#### 32.410 Findings, determination, and authorization.

(a) Each determination concerning advance payments shall be supported by written findings (see 32.402(c)(1)(iii)).

(b) The following is an example of the format and text of findings, determination, and authorization with alternative words, phrases, and paragraphs to be selected to conform to the circumstances involved:

#### FINDINGS, DETERMINATION, AND AUTHORIZATION FOR ADVANCE PAYMENTS FINDINGS

(a) The undersigned hereby finds that:

(1) The ..... [insert the name of the contracting activity] and ..... [insert the name of the contractor] (have entered) (propose to enter) into (negotiated) (sealed bid) Contract No. ...., dated .....

[Summarize the specific facts and significant circumstances concerning the contract and the contractor, that, together with the other findings, will clearly support the determination below.]

(2) Advance payments (in an amount not to exceed \$..... at any time outstanding) (in an aggregate amount not exceeding \$....., less the aggregate amounts repaid, or withdrawn by the Government) are required by the Contractor to perform under the contract. The amount does not exceed the unpaid contract price or the estimated interim cash needs arising during the reimbursement cycle.

(3) The advance payments are necessary for prompt, efficient contract performance that will benefit the Government.

(4) The proposed advance payment clause provides for security for the protection of the Government. The clause requires that all payments will be desposited in a special bank account and that the Government will have a paramount lien on (i) the credit balance in the special bank account, (ii) any supplies contracted for, and (iii) any material or other property acquired for performance of the contract. [Insert the following, if applicable (The Contractor's financial management system provides for effective control over and accountability for all Federal funds under governing regulations of the Treasury Department.) (An advance payment bond is required.)] This security is considered adequate.

(5) Advance payments are the only adequate means of financing available to the Contractor, and the amount designated in (2) above is based, to the extent possible, on the use of the Contractor's own working capital in performing the contract.

[Insert paragraph (6), (7), or (8), as applicable].

(6) The Contractor is a nonprofit (educational) (and) (research) institution, and the contract is for (experimental) (,) (research and development) work.

(7) The contract is solely for the management and operation of a Government-owned plant.

(8) The following unusual facts and circumstances favor making advance payments to the Contractor without interest:

[List the pertinent facts and circumstances.]

DETERMINATION

(b) Based on the findings in (a) above, the undersigned determined that the making of the proposed advance payments, (with interest at the rate of ...[Insert the interest rate computed in accordance with 32.407] percent on the daily unliquidated balance of the advance payments,) (without interest, except as provided by the proposed advance payment clause,) (is in the public interest) (will facilitate the national defense).

AUTHORIZATION

(c) The advance payments, of which (the amount at any time outstanding) (the aggregate amount, less the aggregate amounts repaid, or withdrawn by the Government), shall not exceed \$....., are hereby authorized under (section 305 of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 255)) (the Armed Services Procurement Act (10 U.S.C. 2307)) (the Extraordinary Contracting Authority of Government Agencies in Connection with National Defense Functions (50 U.S.C. 1431-1435) and Executive Order No. 10789 of November 14, 1958 (3 CFR 1958 Supp. pp. 72-74)) [or, if other, cite appropriate authority] on (terms substantially as contained in the proposed advance payment clause, a copy (an outline) of which is annexed to this authorization) (the following terms:) [Insert the appropriate terms.]

(All prior authorizations for advance payments under Contract No. .... are superseded.)

.....  
(Signature)

.....  
(Name typed)

.....  
(Title of authorized official)

[Each Findings, Determination, and Authorization shall be individually prepared to fit the particular circumstances at hand. Subparagraphs (a)(1), (2), (3) and (4) and paragraphs (b) and (c) shall be used in each case. If the contract is (a) for experimental, developmental, or research work and with a nonprofit educational or research institution, or (b) only for management and operation of a Government-owned plant, subparagraph (a)(5) should not be included. If the advance payment is to be made without interest to the contractor, include subparagraph (a)(6), (7), or (8). If any advance payments have previously been authorized for the contract, include the final sentence of

paragraph (c). The alternate parenthetical wording or other modifications may be used as appropriate. The paragraphs actually used shall be renumbered sequentially].

32.411 Agreement for special bank account.

The contracting officer shall use substantially the following form of agreement for a special bank account for advance payments:

AGREEMENT FOR SPECIAL BANK ACCOUNT

This agreement is entered into this .... day of ....., 19.., between the United States of America, (the Government), represented by the Contracting Officer executing this agreement, ..... [Insert the name of the contractor], a ..... [Insert the name of the State of incorporation] corporation (the Contractor), and ....., a banking corporation under the laws of ....., located at ..... (the Bank).

RECITALS

(a) Under date of ....., 19.., the Government and the Contractor entered into Contract No. ...., or a related supplemental agreement, providing for advance payments to the Contractor. A copy of the advance payment terms was furnished to the Bank.

(b) The contract or supplemental agreement requires that amounts advanced to the Contractor be deposited separate from the Contractor's general or other funds, in a Special Bank Account at a member bank of the Federal Reserve System or any "insured" bank within the meaning of the Act creating the Federal Deposit Insurance Corporation (12 U.S.C. 1811). The parties agree to deposit the amounts with the Bank, which meets the requirement.

(c) This Special Bank Account is designated "..... [Insert the contractor's name], ..... [Insert the name of the Government agency] Special Bank Account."

COVENANTS

In consideration of the foregoing, and for other good and valuable considerations, the parties agree to the following conditions:

(a) The Government shall have a lien on the credit balance in the account to secure the repayment of all advance payments made to the Contractor. The lien is paramount to any lien or claim of the Bank regarding the account.

(b) The Bank is bound by the terms of the contract relating to the deposit and withdrawal of funds in the Special Bank Account, but is not responsible for the application of funds withdrawn from the account. The Bank shall act on written directions from the Contracting Officer, the administering office, or a duly authorized representative of either. The Bank is not liable to any party to this agreement for any action that complies with the written directions. Any written directions received by the Bank through the Contracting Officer on ..... [Insert the name of the agency] stationery and purporting to be signed by, or by the direction of ..... or duly authorized representa-

tive, shall be, as far as the rights, duties, and liabilities of the Bank are concerned, considered as being properly issued and filed with the Bank by the .....[Insert the name of the agency].

(c) The Government, or its authorized representatives, shall have access to the books and records maintained by the Bank regarding the Special Bank Account at all reasonable times and for all reasonable purposes, including (but not limited to), the inspection or copying of the books and records and any and all pertinent memoranda, checks, correspondence, or documents. The Bank shall preserve the books and records for a period of 6 years after the closing of this Special Bank Account.

(d) In the event of the service of any writ of attachment, levy of execution, or commencement of garnishment proceedings regarding the Special Bank Account, the Bank will promptly notify .....[Insert the name of the administering office].

(e) While this Special Bank Account exists, the Bank shall inform the Government each month of the Bank's published prime interest rate and changes to the rate during the month. The Bank shall give this information to the Contracting Officer on the last business day of the month. [This covenant will not be included in Special Bank Account Agreements covering interest-free advance payments].

Each of the parties to this agreement has executed the agreement on ....., 19...

.....  
.....  
[Signatures and official titles]

**32.412 Contract clause.**

(a) The contracting officer shall insert the clause at 52.232-12, Advance Payments, in solicitations and contracts under which the Government will provide advance payments, except as provided in 32.412(b).

(b) If the agency desires to waive the countersignature requirement because of the contractor's financial strength, good performance record, and favorable experience concerning cost disallowances, the contracting officer shall use the clause with its Alternate I.

(c) If a cost-reimbursement contract is contemplated, the contracting officer shall use the clause with its Alternate II.

(d) If the agency considers a more rapid liquidation appropriate, the contracting officer shall use the clause with its Alternate III.

(e) If the agency provides advance payments under the contract at no interest to the prime contractor, the contracting officer shall use the clause with its Alternate IV.

(f) If the requirement for a special bank account is eliminated in accordance with 32.409-3(e) or (g), the contracting officer shall insert in the solicitation or contract a clause substantially the same as the one at 52.232-12, Advance Payments, omitting the terms pertaining to a special bank account.

**SUBPART 32.5-PROGRESS PAYMENTS BASED ON COSTS**

**32.500 Scope of subpart.**

This subpart prescribes policies, procedures, forms, solicitation provisions, and contract clauses for providing contract financing through progress payments based on costs. This subpart does not apply to—

(a) Payments under cost-reimbursement contracts, other than reimbursement of the contractor's progress payments to subcontractors and suppliers (see 32.504(f)); or

(b) Contracts for construction or for shipbuilding or ship conversion, alteration, or repair, when the contracts provide for progress payments based on a percentage or stage of completion.

**32.501 General.**

Progress payments may be customary or unusual. Customary progress payments are those made under the general guidance in this subpart, using the customary progress payment rate, the cost base, and frequency of payment established in the Progress Payments clause, and either the ordinary liquidation method or the alternate method as provided in subsections 32.503-8 and 32.503-9. Any other progress payments are considered unusual, and may be used only in exceptional cases when authorized in accordance with subsection 32.501-2.

**32.501-1 Customary progress payment rates.**

(a) The customary progress payment rate is 80 percent, applicable to the total costs of performing the contract. The customary rate for contracts with small business concerns is 85 percent. The Department of Defense (DOD) may establish other customary rates for foreign military sales and for flexible progress payments.

(b) Any rate higher than those permitted in paragraph (a) above shall be considered an unusual progress payment. The contracting officer shall not include a higher rate in a contract unless advance agency approval is obtained as prescribed in 32.501-2.

(c) When advance payments and progress payments are authorized under the same contract, a progress payment rate higher than the customary rate shall not be authorized.

(d) In accordance with the Defense Procurement Improvement Act of 1986 (Pub. L. 99-145) and, for civilian agencies, as a matter of policy, progress payments are limited to 80 percent on work accomplished under undefinitized contract actions. A higher rate is not authorized under unusual progress payments or flexible progress payments for the undefinitized actions.

**32.501-2 Unusual progress payments.**

(a) The contracting officer may provide unusual progress payments only if—

(1) The contract necessitates predelivery expenditures that are large in relation to contract price and in relation to the contractor's working capital and credit;

(2) The contractor fully documents an actual need to supplement any private financing available, including guaranteed loans; and

(3) The contractor's request is approved by the head of the contracting activity or a designee. In addition, see 32.502-2.

(b) The excess of the unusual progress payment rate approved over the customary progress payment rate should be the lowest amount possible under the circumstances.

(c) Progress payments will not be considered unusual merely because they are on letter contracts or the definitive contracts that supersede letter contracts.

#### 32.501-3 Contract price.

(a) For the purpose of making progress payments and determining the limitation on progress payments, the contract price shall be as follows:

(1) Under firm-fixed-price contracts, the contract price is the current contract price plus any unpriced modifications for which funds have been obligated.

(2) If the contract is redeterminable or subject to economic price adjustment, the contract price is the initial price until modified.

(3) Under a fixed-price incentive contract, the contract price is the target price plus any unpriced modifications for which funds have been obligated. However, if the contractor's properly incurred costs exceed the target price, the contracting officer may provisionally increase the price up to the ceiling or maximum price.

(4) Under a letter contract, the contract price is the maximum amount obligated by the contract as modified.

(5) Under an unpriced order issued against a basic ordering agreement, the contract price is the maximum amount obligated by the order, as modified.

(6) Any portion of the contract specifically providing for reimbursement of costs only shall be excluded from the contract price.

(b) The contracting officer shall not make progress payments or increase the contract price beyond the funds obligated under the contract, as amended.

#### 32.501-4 Consideration for progress payments.

(a) There is no requirement for a separate consideration for providing progress payments or changing progress payment or liquidation rates, if coverage is included in the terms of the contract when awarded.

(b) Occasionally, unanticipated circumstances arise during contract performance which, under the policies of this subpart, result in the contract being amended to provide progress payments. In such a case, adequate new consideration is required.

(c) The contractor may provide the new consideration by monetary or nonmonetary means. A monetary consideration could be a reduction in the contract price. A nonmonetary consideration could be the incor-

poration of terms in the contract modification giving the Government a new and substantial benefit.

(d) The fair and reasonable consideration should approximate as nearly as practicably ascertainable the amount by which the price would have been smaller had the Progress Payments clause been contained in the initial contract. In the absence of definite information on this point, the contracting officer should apply the following criteria in evaluating whether the proposed new consideration is adequate:

(1) The value to the contractor of the anticipated amount and duration of unliquidated progress payments at the imputed financial costs of the equivalent working capital.

(2) The estimated profit rate to be earned through contract performance.

(e) The contracting officer shall not provide for any other type of specific charges, such as interest, for progress payments.

#### 32.501-5 Other protective terms.

If the contracting officer considers it necessary for protection of the Government's interest, protective terms such as the following may be used in addition to the Progress Payments clause of the contract:

(a) Personal or corporate guarantees.

(b) Subordinations or standbys of indebtedness.

(c) Special bank accounts.

(d) Protective covenants of the kinds in paragraph (p) of the clause at 52.232-12, *Advance Payments*.

#### 32.502 Preaward matters.

This section covers matters that generally are relevant only before contract award. This does not preclude taking actions discussed here after award, if appropriate; e.g., postaward addition of a Progress Payments clause for consideration.

#### 32.502-1 Use of customary progress payments.

The use of a Progress Payments clause in solicitations and resulting contracts generally shall be based upon considerations of the criteria in this subsection. Reasonable doubts should be resolved in favor of including the Progress Payments clause in the solicitation. Bids conditioned on progress payments when the solicitation did not provide for progress payments shall be rejected as nonresponsive.

(a) Subject to paragraphs (b) and (c) below, the contracting officer may provide for customary progress payments if the contractor (1) will not be able to bill for the first delivery of products, or other performance milestones, for a substantial time after work must begin (normally 4 months or more for small business concerns; 6 months or more for others), and (2) will make expenditures for contract performance during the pre-delivery period that have a significant impact on the contractor's working capital. Progress payments may also be authorized, particularly for small suppliers, if

the contractor demonstrates actual financial need or the unavailability of private financing (see 32.106(a)).

(b) To reduce undue administrative effort and expense, the contracting officer generally should not provide for progress payments on contracts of less than \$1,000,000 unless—

- (1) The contractor is a small business concern and the contract will involve approximately \$100,000 or more; or
- (2) The contractor will perform a group of small contracts at the same time and the total impact on working capital is equivalent to a single contract of \$1,000,000 or more.

(c) The contracting officer shall not provide for progress payments if the contract items are quick turnover types for which progress payments are not a customary commercial practice. Examples of items customarily not subject to progress payments include (1) subsistence, (2) clothing, (3) medical and dental supplies, and (4) standard commercial items not requiring a substantial accumulation of predelivery expenditures by the contractor.

(d) (1) In considering whether to provide for progress payments in circumstances under which a series of orders are awarded (e.g., indefinite delivery contracts or basic ordering agreements contemplating requisitions, task orders, etc., or their equivalent), the contracting officer shall apply the standards in paragraphs (a) through (c) above, based on—

- (i) An estimate of the total work to be done; and
- (ii) The probable impact on working capital of the predelivery expenditures and production lead times of the majority of the individual orders.

(2) In authorizing progress payments under multiple-order contracts, the contracting officer should establish a single liquidation rate applicable to all orders.

**32.502-2 Contract finance office clearance.**

The contracting officer shall obtain the approval of the contract finance office or other offices designated under agency procedures before taking any of the following actions:

- (a) Providing a progress payment rate higher than the customary rate (see 32.501-1).
- (b) Deviating from the progress payments terms prescribed in this part.
- (c) Providing progress payments to a contractor—
  - (1) Whose financial condition is in doubt;
  - (2) Who has had an advance payment request or loan guarantee denied for financial reasons (or approved but withdrawn or lapsed) within the previous 12 months; or
  - (3) Who is named in the consolidated list of contractors indebted to the United States (known commonly as the "Hold-up List").

**32.502-3 Solicitation provisions.**

(a) The contracting officer shall insert the provision at 52.232-13, Notice of Progress Payments, in invitations for bids and requests for proposals that include a Progress payments clause.

(b) (1) Under the authority of the statutes cited in 32.101,

an invitation for bids may restrict the availability of progress payments to small business concerns only.

(2) The contracting officer shall insert the provision at 52.232-14, Notice of Availability of Progress Payments Exclusively for Small Business Concerns, in invitations for bids if it is anticipated that (1) both small business concerns and others may submit bids in response to the same invitation and (2) only the small business bidders would need progress payments.

(c) The contracting officer shall insert the provision at 52.232-15, Progress Payments Not Included, in invitations for bids if the solicitation will not contain one of the provisions prescribed in paragraphs (a) and (b) above.

**32.502-4 Contract clauses.**

(a) The contracting officer shall insert the clause at 52.232-16, Progress Payments, in solicitations and fixed-price contracts under which the Government will provide progress payments based on costs.

(b) If the contractor is a small business concern, the contracting officer shall use the clause with its Alternate I.

(c) If the contract is a letter contract, the contracting officer shall use the clause with its Alternate II.

(d) If the nature of the contract necessitates separate progress payment rates for portions of work that are clearly severable and accounting segregation would be maintained (e.g., annual production requirements), the application of separate progress payment rates shall be fully described in a supplementary special provision within the contract. Separate progress payment requests and subsequent invoices shall be submitted by the contractor for the severable portions of work in order to maintain accounting integrity.

**32.503 Postaward matters.**

This section covers matters that are generally relevant only after award of a contract. This does not preclude taking actions discussed here before award, if appropriate; e.g., preaward review of accounting systems and controls.

**32.503-1 Contractor requests.**

Each contractor request for progress payment shall—

- (a) Be submitted on Standard Form 1443, Contractor's Request for Progress Payment;
- (b) Comply with the instructions on the reverse of the applicable form, and the contract terms; and
- (c) Include any additional information reasonably requested by the contracting officer.

**32.503-2 Supervision of progress payments.**

(a) The extent of progress payments supervision, by prepayment review or periodic review, should vary inversely with the contractor's experience, performance record, reliability, quality of management, and financial strength, and with the adequacy of the contractor's accounting system and controls. Supervision shall be of a kind and degree sufficient to provide timely knowledge of the need for, and timely opportunity for, any actions necessary to protect Government interests.

(b) The administering office must keep itself informed of the contractor's overall operations and finan-

cial condition, since difficulties encountered and losses suffered in operations outside the particular progress payment contract may affect adversely the performance of that contract and the liquidation of the progress payments.

(c) For contracts with contractors (1) whose financial condition is doubtful or not strong in relation to progress payments outstanding or to be outstanding, (2) with management of doubtful capacity, (3) whose accounting controls are found by experience to be weak, or (4) experiencing substantial difficulties in performance, full information on progress under the contract involved (including the status of subcontracts) and on the contractor's other operations and overall financial condition should be obtained and analyzed frequently, with a view to protecting the Government's interests better and taking such action as may be proper to make contract performance more certain.

(d) So far as practicable, all cost problems, particularly those involving indirect costs, that are likely to create disagreements in future administration of the contract should be identified and resolved at the inception of the contract (see 31.109).

#### **32.503-3 Initiation of progress payments and review of accounting system.**

(a) For contractors that the administrative contracting officer (ACO) has found by previous experience or recent audit review (within the last 12 months) to be (1) reliable, competent, and capable of satisfactory performance, (2) possessed of an adequate accounting system and controls, and (3) in sound financial condition, progress payments in amounts requested by the contractor should be approved as a matter of course.

(b) For all other contractors, the ACO shall not approve progress payments before determining (1) that (i) the contractor will be capable of liquidating any progress payments or (ii) the Government is otherwise protected against loss by additional protective provisions, and (2) that the contractor's accounting system and controls are adequate for proper administration of progress payments. The services of the cognizant independent audit agency or office should be used to the greatest extent practicable. However, if the auditor so advises, a complete audit may not be necessary.

#### **32.503-4 Approval of progress payment requests.**

(a) When the reliability of the contractor and the adequacy of the contractor's accounting system and controls have been established (see 32.503-3 above) the ACO may, in approving any particular progress payment request (including initial requests on new contracts), rely upon that accounting system and upon the contractor's certification, without requiring audit or review of the request before payment.

(b) The ACO should not routinely ask for audits of progress payment requests. However, when there is reason to (1) question the reliability or accuracy of the contractor's certification or (2) believe that the con-

tract will involve a loss, the ACO should ask for a review or audit of the request before payment is approved or the request is otherwise disposed of.

(c) When there is reason to doubt the amount of a progress payment request, only the doubtful amount should be withheld, subject to later adjustment after review or audit; any clearly proper and due amounts should be paid without awaiting resolution of the differences.

#### **32.503-5 Administration of progress payments.**

(a) While the ACO may, in approving progress payment requests under 32.503-3 above, rely on the contractor's accounting system and certification without prepayment review, postpayment reviews (including audits when considered necessary) shall be made periodically, or when considered desirable by the ACO to determine the validity of progress payments already made and expected to be made.

(b) These postpayment reviews or audits shall, as a minimum, include a determination of whether or not—

(1) The unliquidated progress payments are fairly supported by the value of the work accomplished on the undelivered portion of the contract;

(2) The applicable limitation on progress payments in the Progress Payments clause has been exceeded;

(3) (i) The unpaid balance of the contract price will be adequate to cover the anticipated cost of completion, or

(ii) The contractor has adequate resources to complete the contract; and

(4) There is reason to doubt the adequacy and reliability of the contractor's accounting system and controls and certification.

(c) (1) Generally, the progress payments made under multiple-order contracts should be administered under each individual order as if the order constituted a separate contract.

(2) If the contractor requests it and the contracting officer approving individual progress payments agrees, the administration of progress payments may be based on the overall contract or agreement. Under this method, the contractor shall include a supporting schedule with each request for a progress payment. The schedule should identify the costs applicable to each order.

(3) The contracting officer may treat a group of orders as a single unit for administration of progress payments if each order in the group is (i) subject to a uniform liquidation rate, and (ii) under the jurisdiction of the same payment office.

#### **32.503-6 Suspension or reduction of payments.**

(a) *General.* The Progress Payments clause provides a Government right to reduce or suspend progress payments, or to increase the liquidation rate, under specified conditions. These conditions and actions are discussed in paragraphs (b) through (g) below.

(1) The contracting officer shall take these actions only in accordance with the contract terms and never precipitately or arbitrarily. These actions should be taken only after—

(i) Notifying the contractor of the intended action and providing an opportunity for discussion;

(ii) Evaluating the effect of the action on the contractor's operations, based on the contractor's financial condition, projected cash requirements, and the existing or available credit arrangements; and

(iii) Considering the general equities of the particular situation.

(2) The contracting officer shall take immediate unilateral action only if warranted by circumstances such as overpayments or unsatisfactory contract performance.

(3) In all cases, the contracting officer shall (i) act fairly and reasonably, (ii) base decisions on substantial evidence, and (iii) document the contract file. Findings made under paragraph (c) of the Progress Payments clause shall be in writing.

(b) *Contractor noncompliance.* (1) The contractor must comply with all material requirements of the contract. This includes the requirement to maintain an efficient and reliable accounting system and controls, adequate for the proper administration of progress payments. If the system or controls are deemed inadequate, progress payments shall be suspended until the necessary changes have been made.

(2) If the contractor fails to comply with the contract without fault or negligence, the contracting officer will not take action permitted by paragraph (c)(1) of the Progress Payments clause, other than to correct overpayments and collect amounts due from the contractor.

(c) *Unsatisfactory financial condition.* (1) If the contracting officer finds that contract performance (including full liquidation of progress payments) is endangered by the contractor's financial condition, or by a failure to make progress, the contracting officer shall require the contractor to make additional operating or financial arrangements adequate for completing the contract without loss to the Government.

(2) If the contracting officer concludes that further progress payments would increase the probable loss to the Government, the contracting officer shall suspend progress payments and all other payments until the unliquidated balance of progress payments is eliminated.

(d) *Excessive inventory.* If the inventory allocated to the contract exceeds reasonable requirements (including a reasonable accumulation of inventory for continuity of operations), the contracting officer should, in addition to requiring the transfer of excessive inventory from the contract, take one or more of the following actions, as necessary, to avoid or correct overpayment:

(1) Eliminate the costs of the excessive inventory from the costs eligible for progress payments, with appropriate reduction in progress payments outstanding.

(2) Apply additional deductions to billings for deliveries (increase liquidation).

(e) *Delinquency in payment of costs of performance.* (1) If the contractor is delinquent in paying the costs of contract performance in the ordinary course of business, the contracting officer shall evaluate whether the delinquency is caused by an unsatisfactory financial condition and, if so, shall apply the guidance in paragraph (c) above. If the contractor's financial condition is satisfactory, the contracting officer shall not deny progress payments if the contractor agrees to—

(i) Cure the payment delinquencies;

(ii) Avoid further delinquencies; and

(iii) Make additional arrangements adequate for completing the contract without loss to the Government.

(2) If the contractor has, in good faith, disputed amounts claimed by subcontractors, suppliers, or others, the contracting officer shall not consider the payments delinquent until the amounts due are established by the parties through litigation or arbitration. However, the amounts shall be excluded from costs eligible for progress payments so long as they are disputed.

(3) *Determinations of delinquency in making contributions under employee pension, profit sharing, or stock ownership plans, and exclusion of costs for such contributions from progress payment requests, shall be in accordance with paragraph (a)(2) of the clause at 52.232-6, Progress Payments, without regard to the provisions of 32.503-6.*

(f) *Fair value of undelivered work.* (1) For the purposes of Subpart 32.5, the fair value of undelivered work is the lesser of (i) the contract price of the undelivered work, minus the estimated costs required for completing contract performance, or (ii) the incurred costs applicable to the undelivered items.

(2) The contracting officer shall monitor the relationship of unliquidated progress payments to the fair value of undelivered work under the contract. If the unliquidated progress payments exceed the fair value of undelivered work, the contracting officer shall, governed by the principles in paragraphs (c) and (e) above, take appropriate action to eliminate this excess using the loss ratio adjustment described in paragraph (g) below, and based on full consideration of—

(i) The degree of completion of contract performance;

(ii) The quality and amount of work performed on the undelivered portion of the contract;



(iii) The amount of work remaining to be done and the estimated costs of completion of performance; and

(iv) The amount remaining unpaid under the contract.

(g) *Loss contracts.* (1) If the sum of the total costs incurred under a contract plus the estimated costs to complete the performance are likely to exceed the contract price, the contracting officer shall compute a loss ratio factor and adjust future progress payments to exclude the element of loss. The loss ratio factor is computed as follows:

(i) Revise the current contract price used in progress payment computations (the current ceiling price under fixed-price incentive contracts) to include any pending change orders and unpriced orders to the extent funds for the orders have been obligated.

(ii) Divide the revised contract price by the sum of the total costs incurred to date plus the estimated additional costs of completing the contract performance.

(2) If the contracting officer believes a loss is probable, future progress payment requests shall be modified as follows:

(i) The contract price shall be the revised amount computed under subparagraph (1)(i) above.

(ii) The total costs eligible for progress payments shall be the product of (A) the sum of paid costs eligible for progress payments times (B) the loss ratio factor computed under subparagraph (1)(ii) above.

(iii) The costs applicable to items delivered, invoiced, and accepted shall not include costs in excess of the contract price of the items.

(3) The contracting officer may use audit assistance, technical services, management reports, and other sources of pertinent data to evaluate progress payment requests. If the contracting officer concludes that the contractor's figures in the contractor's progress payment request are not correct, the contracting officer shall—

(i) In the manner prescribed in paragraph (4) below, prepare a supplementary analysis to be attached to the contractor's request;

(ii) Advise the contractor in writing of the differences; and

(iii) Adjust all further progress payments in accordance with paragraph (1) above, using the contracting officer's figures, until the difference is resolved.

(4) The following is an example of the supplementary analysis required in paragraph (3) above:

Section I:	
Contract price .....	\$950,000
Change orders and unpriced orders (to extent funds have been obligated) .....	50,000
Revised contract price .....	<u>\$1,000,000</u>
Section II:	
Total costs incurred to date .....	\$1,080,000
Estimated additional costs to complete .....	120,000
Total costs to complete .....	<u><u>\$1,200,000</u></u>

$$\text{Loss ratio factor} = \frac{\$1,000,000}{\$1,200,000} = 83.3\%$$

Total costs eligible for progress payments .....	\$900,000
Loss ratio factor .....	x 83.3%
Recognized costs for progress payments .....	\$749,700
Progress payment rate .....	x 80.0%
Alternate amount to be used .....	\$599,760
Section III:	
Factored costs of items delivered* .....	\$250,000
Recognized costs applicable to undelivered items (\$749,700-\$250,000) .....	\$499,700

\* This amount shall be the same as the contract price of the items delivered.

**32.503-7 Limitation on general and administrative expenses (G&A) for progress payments.**

If the contractor established an inventory suspense account under Appendix A of Cost Accounting Standard (CAS) 410, Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives (4 CFR Part 410), and the account is \$5 million or more, the following limitations shall apply to progress payments:

(a) G&A shall not be eligible for progress payments until the value of work in process inventories under new contracts exceeds that under the old. For this purpose, new contracts shall be considered to be those awarded after CAS 410 became applicable to the work of the contractor. Old contracts are those included in the suspense account prescribed in CAS 410.

(b) The amount of G&A eligible for progress payments under the contract shall be the contractor's pro rata share of G&A allocable to the excess under paragraph (a) above.

**32.503-8 Liquidation rates—ordinary method.**

Progress payments are recouped by the Government through the deduction of liquidations from payments that would otherwise be due to the contractor for completed contract item. To determine the amount of the liquidation, a liquidation rate is applied to the contract price of contract items delivered and accepted. The ordinary method is that the liquidation rate is the same as the progress payment rate; at the beginning of a contract, only this method may be used. If the contract is subject to the CAS limitation in 32.503-7 on G&A eligible for progress payments, the ordinary method includes the use of an adjusted liquidation rate to reflect the applicable G&A suspense account. The adjusted liquidation rate shall be established by (a) dividing the unbilled G&A by the contract price, (b)

multiplying the quotient by the progress payment rate stated in the contract, and (c) subtracting the resulting rate from the progress payment rate. For example, if the price is \$1,100,000 and the unbilled G&A is \$47,600, the adjusted liquidation rate would be 76.5 percent, computed as follows:

Unbilled G&A divided by contract price (47,600/1,100,000)	4.33%
Result x progress payment rate (4.33% x 80%)	3.46%
Result subtracted from progress payment rate (80% - 3.46%)	76.54%

**32.503-9 Liquidation rates—alternate method.**

(a) The liquidation rate determined under 32.503-8 shall apply throughout the period of contract performance unless the contracting officer adjusts the liquidation rate under the alternate method in this 32.503-9. The objective of the alternate liquidation rate method is to permit the contractor to retain the earned profit element of the contract prices for completed items in the liquidation process. The contracting officer may reduce the liquidation rate if—

- (1) The contractor requests a reduction in the rate;
- (2) The rate has not been reduced in the preceding 12 months;
- (3) The contract delivery schedule extends at least 18 months from the contract award date;
- (4) Data on actual costs are available (i) for the products delivered, or (ii) if no deliveries have been made, for a performance period of at least 12 months;
- (5) The reduced liquidation rate would result in the Government recouping under each invoice the full extent of the progress payments applicable to the costs allocable to that invoice;
- (6) The contractor would not be paid for more than the costs of items delivered and accepted (less allocable progress payments) and the earned profit on those items;
- (7) The unliquidated progress payments would not exceed the limit prescribed in paragraph (a)(4) of the Progress Payments clause;
- (8) The parties agree on an appropriate rate; and
- (9) The contractor agrees to certify annually, or more often if requested by the contracting officer, that the alternate rate continues to meet the conditions of subsections 5, 6, and 7 above. The certificate must be accompanied by adequate supporting information.

(b) The contracting officer shall change the liquidation rate in the following circumstances:

- (1) The rate shall be increased for both previous and subsequent transactions, if the contractor experiences a lower profit rate than the rate anticipated at the time the liquidation rate was associated with contract items already delivered, as well as subsequent progress payments.

(2) The rate shall be increased or decreased in keeping with the successive changes to the contract price or target profit when—

- (i) The target profit is changed under a fixed-price incentive contract with successive targets; or
- (ii) A redetermined price involves a change in the profit element under a contract with prospective price redetermination at stated intervals.

(c) Whenever the liquidation rate is changed, the contracting officer shall issue a contract modification to specify the new rate in the Progress Payments clause. Adequate consideration for these contract modifications is provided by the consideration included in the initial contract. The parties shall promptly make the payment or liquidation required in the circumstances.

**32.503-10 Establishing alternate liquidation rates.**

(a) The contracting officer shall ensure that the liquidation rate is—

- (1) High enough to result in Government recoupment of the applicable progress payments on each billing; and
- (2) Supported by documentation included in the administration office contract file.

(b) The minimum liquidation rate is the expected progress payments divided by the contract price. Each of these factors is discussed below:

- (1) Usually, the contracting officer shall compute the expected progress payments by multiplying the estimated cost of performing the contract by the progress payment rate. In certain cases, part of the contractor's G&A is excluded from the estimated cost for the purpose of calculating expected progress payments for the liquidation rate. These cases pertain to the implementation of CAS 410 (see 32.503-7 and 32.503-8).

(2) For purposes of computing the liquidation rate, the contracting officer may adjust the estimated cost and the contract price to include the estimated value of any work authorized but not yet priced and any projected economic adjustments; however, the contracting officer's adjustment shall not exceed the Government's estimate of the price of all authorized work or the funds obligated for the contract.

(3) The following are examples of the computation. Assuming an estimated price of \$1,100,000 and total estimated costs eligible for progress payments of \$1,000,000:

- (i) If the progress payment rate is 80 percent, the minimum liquidation rate should be 72.7 percent, computed as follows:

$$\frac{(\$1,000,000 \times 80\%)}{\$1,100,000} = 72.7\%$$

(ii) If the progress payment rate is 85 percent, the minimum liquidation rate should be 77.3 percent, computed as follows:

$$\frac{(\$1,000,000 \times 85\%)}{\$1,100,000} = 77.3\%$$

(iii) If the contract is subject to CAS limitation on G&A eligible for progress payments (see 32.503-7), an adjusted alternate liquidation rate shall be established by subtracting the estimated G&A not eligible for progress payments from the total estimated contract costs. For example, if the price is \$1,100,000, costs are \$1,000,000, and unbilled G&A is \$47,600, the liquidation rate should be 69.3 percent, computed as follows:

$$\frac{\$1,000,000 - \$47,600}{\$1,100,000} \times 80\% = 69.3\%$$

(4) Minimum liquidation rates will generally be expressed to tenths of a percent. Decimals between tenths will be rounded up to the next highest tenth (not necessarily the nearest tenth), since rounding down would produce a rate below the minimum rate calculated.

**32.503-11 Adjustments for price reduction.**

(a) If a retroactive downward price reduction occurs under a redeterminable contract that provides for progress payments, the contracting officer shall—

(1) Determine the refund due and obtain repayment from the contractor for the excess of payments made for delivered items over amounts due as recomputed at the reduced prices; and

(2) Increase the unliquidated progress payments amount for overdeductions made from the contractor's billings for items delivered.

(b) The contracting officer shall also increase the unliquidated progress payments amount if the contractor makes an interim or voluntary price reduction under a redeterminable or incentive contract.

**32.503-12 Maximum unliquidated amount.**

(a) The contracting officer shall ensure that any excess of the unliquidated progress payments over the contractual limitation in paragraph (a) of the Progress Payments clause in the contract is promptly corrected through one or more of the following actions:

- (1) Increasing the liquidation rate.
- (2) Reducing the progress payment rate.
- (3) Suspending progress payments.

(b) The excess described in paragraph (a) above is most likely to arise under the following circumstances:

- (1) The costs of performance exceed the contract price.
- (2) The alternate method of liquidation (see 32.503-9)

is used and the actual costs of performance exceed the cost estimates used to establish the liquidation rate.

(3) The rate of progress or the quality of contract performance is unsatisfactory.

(4) The rate of rejections, waste, or spoilage is excessive.

(c) As required, the services of the cognizant independent audit agency or office should be fully utilized, along with the services of qualified cost analysis and engineering personnel.

**32.503-13 Quarterly statements for price revision contracts.**

Under price revision or redeterminable contracts that include progress payments clauses, the contracting officer shall occasionally compare the quarterly statements submitted under the price revision or renegotiation clause at 52.216-5, 52.216-6, 52.216-16, or 52.216-17 with the contractor's requests for progress payments. The contracting officer should ensure, as far as is reasonably possible, that costs of delivered items in the quarterly statements are excluded from the costs of undelivered items (the basis for unliquidated progress payments) in the contractor's request for progress payments.

**32.503-14 Protection of Government title.**

(a) Since the Progress Payments clause gives the Government title to all of the materials, work-in-process, finished goods, and other items of property described in paragraph (d) of the Progress Payments clause, under the contract under which progress payments have been made, the ACO must ensure that the Government title to these inventories is not compromised by other encumbrances. Ordinarily, the ACO, in the absence of reason to believe otherwise, may rely upon the contractor's certification contained in the progress payment request.

(b) If the ACO becomes aware of any arrangement or condition that would impair the Government's title to the property affected by progress payment, the ACO shall require additional protective provisions (see 32.501-5) to establish and protect the Government's title.

(c) The existence of any such encumbrance is a violation of the contractor's obligations under the contract, and the ACO may, if necessary, suspend or reduce progress payments under the terms of the Progress Payments clause covering failure to comply with any material requirement of the contract. In addition, if the contractor fails to disclose an existing encumbrance in the progress payments certification, the ACO should consult with legal counsel concerning possible violation of 31 U.S.C. 3729, the False Claims Act.

**32.503-15****32.503-15 Application of Government title terms.**

(a) Property to which the Government obtains title by operation of the Progress Payments clause solely is not, as a consequence, Government-furnished property.

(b) Although property title is vested in the Government under the Progress Payments clause, the acquisition, handling, and disposition of certain types of property are governed by other clauses, as follows:

(1) The clause at 52.245-17, Special Tooling, for special tooling.

(2) The termination clauses at 52.249, for termination inventory.

(c) The contractor may sell or otherwise dispose of current production scrap in the ordinary course of business on its own volition, even if title has vested in the Government under the Progress Payments clause. The contracting officer shall require the contractor to credit the costs of the contract performance with the proceeds of the scrap disposition.

(d) When the title to materials or other inventories is vested in the Government under the Progress Payments clause, the contractor may transfer the inventory items from the contract for its own use or other disposition only if, and on terms, approved by the contracting officer. The contractor shall (1) eliminate the costs allocable to the transferred property from the costs of contract performance, and (2) repay or credit to the Government an amount equal to the unliquidated progress payments, allocable to the transferred property.

(e) If excess property remains after the contract performance is complete and all contractor obligations under the contract are satisfied, including full liquidation of progress payments, the excess property is outside the scope of the Progress Payments clause. Therefore, the contractor holds title to it.

**32.503-16 Risk of loss.**

(a) Under the Progress Payments clause, and except for normal spoilage, the contractor bears the risk for loss, theft, destruction, or damage to property affected by the clause, even though title is vested in the Government, unless the Government has expressly assumed this risk. The clauses prescribed in this regulation related to progress payments, default, and terminations do not constitute a Government assumption of this risk.

(b) If a loss occurs in connection with property for which the contractor bears the risk, the contractor is obligated to repay to the Government the amount of unliquidated progress payments based on costs allocable to the property.

(c) The contractor is not obligated to pay for the loss of property for which the Government has assumed the risk of loss. However, a serious loss may impede the satisfactory progress of contract performance, so that the contracting officer may need to act under paragraph (c)(5) of the Progress Payments clause.

**32.504 Subcontracts.**

(a) The contracting officer shall encourage the con-

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tractor to provide progress payments to subcontractors on terms that meet the standards in 32.502-1 for customary progress payments.

(b) The contractor's requests for progress payments may include the full amount paid to subcontractors as progress payments under the contract and subcontracts.

(c) If the contractor is considering making unusual progress payments to a subcontractor, the parties shall be guided by the policies in 32.501-2. If unusual progress payments for the subcontract are approved by the Government, the contracting officer shall issue a contract modification to specify the new rate in subdivision (j)(4) of the Progress Payments clause in the prime contract. This will allow the contractor to include the progress payments to the subcontractor in the cost basis for progress payments by the Government. This modification shall not be considered a deviation and shall not require the clearance prescribed in 32.502-2(b).

(d) The contractor has a duty to ensure that progress payments to subcontractors conform to the standards and principles prescribed in paragraph (j) of the Progress Payments clause in the prime contract. Although the contracting officer should, to the extent appropriate, review the subcontract as part of the overall administration of progress payments in the prime contract, there is no special requirement for contracting officer review or consent merely because the subcontract includes a progress payments clause except as provided in paragraph (c) above. However, the contracting officer shall ensure that the contractor has installed the necessary management control systems, including internal audit procedures.

(e) The subcontract terms shall include the substance of the Progress Payments clause in the prime contract, modified to indicate that the contractor, not the Government, awards the subcontract and administers the progress payments. The following exceptions apply to wording modifications:

(1) The subcontract terms on title to property under progress payments shall provide for vesting of title in the Government, not the contractor, as in paragraph (d) of the Progress Payments clause in the prime contract. A reference to the contractor may, however, be substituted for "Government" in subdivision (d)(2)(iv) of the clause.

(2) In the subcontract terms on reports and access to records, the contractor shall not delete the references to "Contracting Officer" and "Government" in adapting paragraph (g) of the Progress Payments clause in the contract, but may expand the terms as follows:

(i) The term "Contracting Officer" may be changed to "Contracting Officer or Prime Contractor."

(ii) The term "the Government" may be changed to "the Government or Prime Contractor."

(3) The subcontract special terms regarding default shall include paragraph (h) of the Progress Payments clause in the contract through its subdivision (i). The rest of paragraph (h) is optional.

(f) If the contractor makes progress payments to a subcontractor under a cost-reimbursement prime contract, the contracting officer shall accept the progress payments as reimbursable costs of the prime contract only under the following conditions:

(1) The payments are made under the criteria in 32.502-1 for customary progress payments.

(2) The payments do not exceed the progress payment rate in 32.501-1 unless unusual progress payments to the subcontractor have been approved in accordance with 32.501-2.

(3) The subcontractor complies with the liquidation principles of 32.503-8, 32.503-9, and 32.503-10.

(4) The subcontract contains progress payments terms as prescribed in this section.

### SUBPART 32.6—CONTRACT DEBTS

#### 32.600 Scope of subpart.

This subpart prescribes policies and procedures for the Government's actions in ascertaining and collecting contract debts, charging interest on the debts, deferring collections, and compromising and terminating certain debts.

#### 32.601 Definition.

"Responsible official," as used in this subpart, means the contracting officer (see Subpart 2.1) or other official designated under agency procedures to administer the collection of contract debts and applicable interest.

#### 32.602 General.

The contract debts covered in this subpart arise in various ways. The following are some examples:

(a) Damages or excess costs related to defaults in performance.

(b) Breach of contract obligations concerning progress payments, advance payments, or Government-furnished property or material.

(c) Government expense of correcting defects.

(d) Overpayments related to errors in quantity or billing or deficiencies in quality.

(e) Retroactive price reductions resulting from contract terms for price redetermination or for determination of prices under incentive type contracts.

(f) Overpayments disclosed by quarterly statements required under price redetermination or incentive contracts.

(g) Delinquency in contractor payments due under agreements or arrangements for deferral or postponement of collections.

#### 32.603 Applicability.

Except as otherwise specified, this subpart applies to all debts to the Government arising in connection with contracts and subcontracts for the acquisition of supplies or services.

#### 32.604 Exclusions.

This subpart does not apply to claims of the Government against military or civilian employees or their dependents arising in connection with current or past employment by the Government. Sections 32.613, 32.614, and 32.616 do not apply to claims against common carriers for transportation overcharges and freight and cargo losses.

#### 32.605 Responsibilities and cooperation among Government officials.

(a) To protect the Government's interests, contracting officers, contract financing offices, disbursing officials, and auditors shall cooperate fully with each other to—

(1) Discover promptly when a contract debt arises;

(2) Ascertain the correct amount of the debt;

(3) Act promptly and effectively to collect the debt;

(4) Administer deferment of collection agreements; and

(5) Provide up-to-date information on the status of the debt.

(b) For most kinds of contract debts, the contracting officer has the primary responsibility for determining the amounts of and collecting contract debt. Under some agency procedures, however, the individual who is responsible for payment under the contract; e.g., the disbursing officer, may have this primary responsibility.

#### 32.606 Debt determination and collection.

(a) If any indication of a contract debt arises, the responsible official shall determine promptly whether an actual debt is due the Government and the amount. Any unwarranted delay may contribute to—

(1) Loss of timely availability of the funds to the program for which the funds were initially provided;

(2) Increased difficulty in collecting the debt; or

(3) Actual monetary loss to the Government.

(b) In determining the amount of any contract debt, the responsible official shall fairly consider both the Government's claim and any contract claims by the contractor against the Government. This determination does not constitute a settlement of such claims, nor is it a contracting officer's final determination under the Contract Disputes Act of 1979.

(c) The responsible official shall establish a control record for each contract debt, to include at least the following information:

(1) The name and address of the contractor.

(2) The contract number, if any.

(3) A description of the debt.

(4) The amount of debt and the appropriation to be credited.

(5) The date the debt was determined.

(6) The dates of demands for payment.

(7) The amounts and dates of collections, as they occur.

(8) The date of any appeal filed or action brought in the Court of Claims under the Disputes clause.

(9) The status of collections. Examples include—

(i) Actions reported to the disbursing officer (name, location, and date);

(ii) Funds requested to be withheld by the disbursing officer;

(iii) Funds requested to be withheld by other offices (date and office);

(iv) Deferment or installment payment arrangement requested;

(v) Deferment or installment request reviewed;

(vi) Supplemental information requested to support deferment requests; and

(vii) Actions transferred to the contract financing office.

(d) Except in cases in which an agreement has been entered into for deferment of collections (32.613) or bankruptcy proceedings against the contractor have been initiated, the contractor shall be required to liquidate the debt by—

(1) Cash payment in a lump sum, on demand; or

(2) Credit against existing unpaid bills due the contractor.

(e) The responsible officials shall use all proper means available to them for collecting debts as rapidly as possible. Practices for ascertaining and collecting debts shall be comprehensive, dynamic, and as uniform as practicable. Full consideration shall be given to personal contact and followup.

#### 32.607 Tax credit.

(a) If the contractor is entitled to a tax credit under section 1481 of the Internal Revenue Code (26 U.S.C. 1481) and requests recognition of the credit in the debt collection, the responsible official shall comply.

(b) The tax credit shall be considered to reduce the amount of the debt as of the date when interest on the debt begins to accrue.

(c) The amount of the debt reduction shall be the amount of the tax credit certificate, if a certificate was issued by the Internal Revenue Service (IRS). If the IRS has not yet issued a certificate, the responsible official may accept the contractor's estimate of the tax credit amount until the certificate is issued, subject to any verification that the responsible official considers appropriate.

(d) A reduction for a tax credit does not apply to a debt arising from a subcontract.

#### 32.608 Negotiation of contract debts.

(a) The responsible official shall ensure that any negotiations concerning debt determinations are completed expeditiously. If consistent with the contract, the official shall make a unilateral determination promptly if the contractor is delinquent in any of the following actions:

(1) Furnishing pertinent information.

(2) Negotiating expeditiously.

(3) Entering into an agreement on a fair and reasonable price revision.

(4) Signing an interim memorandum evidencing a negotiated pricing agreement involving refund.

(5) Executing an appropriate contract modification reflecting the result of negotiations.

(b) The amount of indebtedness determined unilaterally shall be an amount that—

(1) Is proper based on the merits of the case;

(2) Does not exceed an amount that would have been considered acceptable in a negotiated agreement; and

(3) Is consistent with the contract terms.

(c) For unilateral debt determinations, the contracting officer shall issue a decision as required by the Disputes clause (52.233-1) at or before the time of making a demand under 32.610.

#### 32.609 Memorandum of pricing agreement with refund.

(a) If a refund to the Government is agreed upon in negotiations under a price revision type of contract, the responsible official shall promptly write a memorandum to document the agreement and the contract debt. The memorandum shall be signed by the negotiators for the Government and the contractor. If the procedures of either the agency or the contractor require approval of the negotiation results by higher authority, the memorandum shall be written without prejudice to the final pricing. After negotiations are completed, a supplemental agreement shall be executed without delay.

(b) The amount of refund shall be computed promptly, without waiting for itemization of adjustment of past billings, accounting adjustments, or the adjusted invoices.

#### 32.610 Demand for payment of contract debt.

(a) A demand for payment shall be made as soon as the responsible official has computed the amount of refund due. If the debt arises from excess costs for a default termination, the demand shall be made without delay, as explained in 49.402-6.

(b) The demand shall include the following:

(1) A description of the debt, including the debt amount.

(2) Notification that any amounts not paid within 30 days from the date of the demand will bear interest from the date of the demand, or from any earlier date specified in the contract and that the interest rate shall be the rate established by the Secretary of the Treasury, for the period affected, under 50 U.S.C. App. 1215(b)(2).

(3) A notification that the contractor may submit a proposal for deferment of collection if immediate payment is not practicable or if the amount is disputed.

(4) Identification of the responsible official designated for determining the amount of the debt and for its collection.

(c) Contracting officer decision under the Disputes clause is covered in 32.608. If subparagraph (b)(3) of the clause at 52.232-17, Interest, applies, the demand mentioned in paragraph (a) above shall accompany or be included in the transmittal mentioned in the clause.

**32.611 Routine setoff.**

If a disbursing officer is the responsible official for collection of a contract debt, or is notified of the debt by the responsible official and has contractor invoices on hand for payment, the disbursing officer shall make an appropriate setoff. The disbursing officer shall give the contractor an explanation of the setoff. To the extent that the setoff reduces the debt, the explanation shall replace the demand prescribed in 32.610.

**32.612 Withholding and setoff.**

During the 30 days following the issuance of a demand, the advisability of withholding payments otherwise due to the contractor shall be considered based on the circumstances of the individual cases. If payment is not completed within 30 days, and deferment is not requested, withholding of principal and interest shall be initiated immediately. In the event the contract is assigned under the Assignment of Claims Act of 1940 (31 U.S.C. 3727 and 41 U.S.C. 15), the rights of the assignee will be scrupulously respected and withholding of payments shall be consistent with those rights. For additional information on assignment of claims, see Subpart 32.8.

**32.613 Deferment of collection.**

(a) If the responsible official receives a written request from the contractor for a deferment of the debt collection or installment payments, the official shall promptly review the request to see if the information included is adequate for action on the request. If not, the contractor shall be asked to furnish the needed information. Any necessary changes to the terms of the proposed deferment/installment agreement shall also be suggested.

(b) If the contractor has appealed the debt under the procedures of the Disputes clause of the contract, the information with the request for deferment may be limited to an explanation of the contractor's financial condition.

(c) If there is no appeal pending or action filed under the Disputes clause of the contract, the following information about the contractor should be submitted with the request:

- (1) Financial condition.
- (2) Contract backlog.
- (3) Projected cash receipts and requirements.
- (4) The feasibility of immediate payment of the debt.
- (5) The probable effect on operations of immediate payment in full.

(d) Although the existence of a contractor appeal of the debt does not of itself require the Government to suspend or delay collection action, the responsible official shall consider whether deferment of the debt collection is advisable to avoid possible overcollection. The responsible official may authorize a deferment pending the resolution of appeal.

(e) Deferments pending disposition of appeal may be granted to small business concerns and financially weak contractors, with a reasonable balance of the need for Government security against loss and undue hardship on the contractor.

(f) If a contractor has not appealed the debt or filed an action under the Disputes clause of the contract, the responsible official may arrange for deferment/installment payments if the contractor is unable to pay at once in full or the contractor's operations under national defense contracts would be seriously impaired. The arrangement shall include appropriate covenants and securities and should be limited to the shortest practicable maturity.

(g) Contracts and arrangements for deferment may not provide that a claim of the Government will not become due and payable pending mutual agreement on the amount of the claim or, in the case of a dispute, until the decision is reached.

(h) At a minimum, the deferment agreement shall contain the following:

- (1) A description of the debt.
- (2) The date of first demand for payment.
- (3) Notice of an interest charge, in conformity with 32.614 and the clause at 52.232-17, Interest.
- (4) Identification of the office to which the contractor is to send debt payments.
- (5) A requirement for the contractor to submit financial information requested by the Government and for reasonable access to the contractor's records and property by Government representatives.
- (6) Provision for the Government to terminate the deferment agreement and accelerate the maturity of the debt if the contractor defaults or if bankruptcy or insolvency proceedings are instituted by or against the contractor.
- (7) Protective requirements that are considered by the Government to be prudent and feasible in the specific circumstances. The coverage of protective terms at 32.409 and 32.501-5 may be used as a guide.

(i) If a contractor appeal of the debt determination is pending, the deferment agreement shall also include a requirement that the contractor shall—

- (1) Diligently prosecute the appeal; and
- (2) Pay the debt in full when the appeal is decided, or when the parties reach agreement on the debt amount.

(j) If the contractor does not plan to appeal the debt or file an action under the Disputes clause of the contract, the deferment/installment agreement shall include a specific schedule or plan for payment. It should permit the Government to make periodic financial reviews of the contractor and to require prepayments if

the Government considers the contractor's ability to pay improved. It should also provide for required stated or measurable prepayments on the occurrence of specific events or contingencies that improve the contractor's ability to pay.

(k) If desired by the contractor, the deferment agreement may provide for the right to make prepayments without prejudice, for refund of overpayments, and for crediting of interest (see 32.614-2).

(l) Actions filed by contractors under the Disputes clause shall not suspend or delay collection. Until the action is decided, deferments shall only be granted if, within 30 days after the filing of such action, the contractor presents to the responsible official a good and sufficient bond, or other collateral acceptable to the responsible official, in the amount of the claim, and approved by the responsible official. Any amount collected by the Government in excess of the amount found to be due on appeal under the Disputes clause of the contract shall be refunded to the contractor with interest thereon from the date of collection by the Government at the annual rate established by the Secretary of Treasury under 50 U.S.C. App. 1215(b)(2). Simple interest shall be calculated through the period of indebtedness to reflect each 6-month period change in the rates established by the Secretary.

#### 32.614 Interest.

##### 32.614-1 Interest charges.

(a) Under the clause at 52.232-17, Interest, the responsible official shall apply interest charges to any contract debt unpaid after 30 days from the issuance of a demand, unless—

(1) The contract specifies another due date or procedure for charging or collecting interest;

(2) The contract is a kind excluded under 32.617; or

(3) The contract or debt has been exempted from interest charges under agency procedures.

(b) If not already applicable under the contract terms, interest on contract debt shall be made an element of any agreement entered into on deferment of collection.

(c) The interest charge shall be at the rate established by the Secretary of the Treasury under 50 U.S.C. App. 1215(b)(2) for the period in which the amount becomes due. The interest charge shall be computed for the actual number of calendar days involved beginning on the due date and ending on—

(1) The date on which the designated office receives payment from the contractor;

(2) The date of issuance of a Government check to the contractor from which an amount otherwise payable has been withheld as a credit against the contract debt;

(3) The date on which an amount withheld and applied to the contract debt would otherwise have become payable to the contractor; or

(4) The date of any applicable tax credit under 32.607.

##### 32.614-2 Interest credits.

(a) An equitable interest credit shall be applied under the following circumstances:

(1) When the amount of debt initially determined is subsequently reduced; e.g., through a successful appeal.

(2) When the collection procedures followed in a given case result in an overcollection of the debt due.

(3) When the responsible official determines that the Government has unduly delayed payments to the contractor on the same contract at some time during the period to which the interest charge applied, provided an interest penalty was not paid for such late payment.

(b) Any appropriate interest credits shall be computed under the following procedures:

(1) Interest at the rate under 32.614-1(c) shall be charged on the reduced debt from the date specified in the first demand made for payment of the higher debt.

(2) Interest may not be reduced for any time between the due date under the demand and the period covered by a deferment of collection, unless the contract includes an interest clause; e.g., the clause prescribed in 32.617.

(3) Interest shall not be credited in an amount that, when added to other amounts refunded or released to the contractor, exceeds the total amount that has been collected, or withheld for the purpose of collecting the debt. This limitation shall be further reduced by the amount of any limitation applicable under 32.614-2(b)(2).

##### 32.615 Delays in receipt of notices or demands.

If delivery of the demands or notices required by the clause at 52.232-17, Interest, is delayed by the Government (e.g., undue delay after dating at the originating office or delays in the mail), the date of the debt and accrual of interest shall be extended to a time that is fair and reasonable under the particular circumstances.

##### 32.616 Compromise actions.

For debts under \$20,000, excluding interest, if further collection is not practicable or would cost more than the amount of recovery, the agency may compromise the debt or terminate or suspend further collection action. Compromise is authorized by the Federal Claims Collection Act of 1966 (31 U.S.C. 3711). Compromise actions shall conform to Federal claims collection standards (4 CFR 101-105), and agency regulations.

##### 32.617 Contract clause.

(a) The contracting officer shall insert the clause at 52.232-17, Interest, in solicitations and contracts, unless



it is contemplated that the contract will be in one or more of the following categories:

- (1) Small purchases.
- (2) Contracts with Government agencies.
- (3) Contracts with a State or local government or instrumentality.
- (4) Contracts with a foreign government or instrumentality.
- (5) Contracts without any provision for profit or fee with a nonprofit organization.
- (6) Contracts described in Subpart 5.5, Paid advertisements.
- (7) Any other exceptions authorized under agency procedures.

(b) The contracting officer may insert the clause at 52.232-17, Interest, in solicitations and contracts when it is contemplated that the contract will be in any of the categories specified in 32.617(a).

### SUBPART 32.7—CONTRACT FUNDING

#### 32.700 Scope.

This subpart (a) describes basic requirements for contract funding and (b) prescribes procedures for using limitation of cost or limitation of funds clauses. Detailed acquisition funding requirements are contained in agency fiscal regulations.

#### 32.701 Reserved.

#### 32.702 Policy.

No officer or employee of the Government may create or authorize an obligation in excess of the funds available, or in advance of appropriations (Anti-Deficiency Act, 31 U.S.C. 1341), unless otherwise authorized by law. Before executing any contract, the contracting officer shall (a) obtain written assurance from responsible fiscal authority that adequate funds are available or (b) expressly condition the contract upon availability of funds in accordance with 32.703-2.

#### 32.703 Contract funding requirements.

##### 32.703-1 General.

(a) If the contract is fully funded, funds are obligated to cover the price or target price of a fixed-price contract or the estimated cost and any fee of a cost-reimbursement contract.

(b) If the contract is incrementally funded, funds are obligated to cover the amount allotted and any corresponding increment of fee.

##### 32.703-2 Contracts conditioned upon availability of funds.

(a) *Fiscal year contracts.* The contracting officer may initiate a contracting action properly chargeable to funds of the new fiscal year before these funds are available; *provided*, that the contract includes the clause at 52.232-18, Availability of Funds (see 32.705-1(a)). This authority may be used only for operation and maintenance and continuing services (e.g., rentals, utilities, and supply items not financed by stock funds) (1) necessary for normal operations and (2) for which Con-

gress previously had consistently appropriated funds, unless specific statutory authority exists permitting applicability to other requirements.

(b) *Indefinite-quantity or requirements contracts.* A one-year indefinite-quantity or requirements contract for services that is funded by annual appropriations may extend beyond the fiscal year in which it begins; *provided*, that (1) any specified minimum quantities are certain to be ordered in the initial fiscal year (see 37.106) and (2) the contract includes the clause at 52.232-19, Availability of Funds for the Next Fiscal Year (see 32.705-1(b)).

(c) *Acceptance of supplies or services.* The Government shall not accept supplies or services under a contract conditioned upon the availability of funds until the contracting officer has given the contractor notice, to be confirmed in writing, that funds are available.

#### 32.703-3 Contracts crossing fiscal years.

A contract that is funded by annual appropriations may not cross fiscal years, except in accordance with statutory authorization (see 41 U.S.C. 11a, 31 U.S.C. 1308, and 42 U.S.C. 2459a), or when the contract calls for an end product that cannot feasibly be subdivided for separate performance in each fiscal year (e.g., contracts for expert or consultant services).

#### 32.704 Limitation of cost or funds.

(a) (1) When a contract contains the clause at 52.232-20, Limitation of Cost; 52.232-21, Limitation of Cost (Facilities); or 52.232-22, Limitation of Funds, the contracting officer, upon learning that the contractor is approaching the estimated cost of the contract or the limit of the funds allotted, shall promptly obtain funding and programming information pertinent to the contract's continuation and notify the contractor in writing that—

(i) Additional funds have been allotted, or the estimated cost has been increased, in a specified amount;

(ii) The contract is not to be further funded and that the contractor should submit a proposal for an adjustment of fee, if any, based on the percentage of work completed in relation to the total work called for under the contract;

(iii) The contract is to be terminated; or

(iv) (A) The Government is considering whether to allot additional funds or increase the estimated cost, (B) the contractor is entitled by the contract terms to stop work when the funding or cost limit is reached, and (C) any work beyond the funding or cost limit will be at the contractor's risk.

(2) Upon learning that a partially funded contract containing any of the clauses referenced in subparagraph (1) above will receive no further funds, the contracting officer shall promptly give the contractor written notice of the decision not to provide funds.

32.705

(b) Under a cost-reimbursement contract, the contracting officer may issue a change order, a direction to replace or repair defective items or work, or a termination notice without immediately increasing the funds available. Since a contractor is not obligated to incur costs in excess of the estimated cost in the contract, the contracting officer shall ensure availability of funds for directed actions. The contracting officer may direct that any increase in the estimated cost or amount allotted to a contract be used for the sole purpose of funding termination or other specified expenses.

(c) Government personnel encouraging a contractor to continue work in the absence of funds will incur a violation of Revised Statutes Section 3679 (31 U.S.C. 1341) that may subject the violator to civil or criminal penalties.

**32.705 Contract clauses.****32.705-1 Clauses for contracting in advance of funds.**

(a) The contracting officer shall insert the clause at 52.232-18, Availability of Funds, in solicitations and contracts if the contract will be chargeable to funds of the new fiscal year and the contracting action is to be initiated before the funds are available.

(b) The contracting officer shall insert the clause at 52.232-19, Availability of Funds for the Next Fiscal Year, in solicitations and contracts if a one-year indefinite-quantity or requirements contract for services is contemplated and the contract (a) is funded by annual appropriations and (b) is to extend beyond the initial fiscal year (see 32.703-2(b)).

**32.705-2 Clauses for limitation of cost or funds.**

(a) The contracting officer shall insert the clause at 52.232-20, Limitation of Cost, in solicitations and contracts if a fully funded cost-reimbursement contract is contemplated, except those for consolidated facilities, facilities acquisition, or facilities use, whether or not the contract provides for payment of a fee.

(b) The contracting officer shall insert the clause at 52.232-21, Limitation of Cost (Facilities), in solicitations and contracts for consolidated facilities, facilities acquisition, or facilities use (see 45.301).

(c) The contracting officer shall insert the clause at 52.232-22, Limitation of Funds, in solicitations and contracts if an incrementally funded cost-reimbursement contract is contemplated.

**SUBPART 32.8—ASSIGNMENT OF CLAIMS.****32.800 Scope of subpart.**

This subpart prescribes policies and procedures for the assignment of claims under the Assignment of Claims Act of 1940, as amended, 31 U.S.C. 3727, 41 U.S.C. 15 (hereafter referred to as "the Act").

**32.801 Definitions.**

"Assignment of claims," as used in this subpart, means the transfer or making over by the contractor to a bank, trust company, or other financing institution, as

security for a loan to the contractor, of its right to be paid by the Government for contract performance.

"Designated agency," as used in this subpart, means any agency authorized to include a no-setoff commitment in its contracts. The designated agencies are the Department of Defense, the General Services Administration, the National Aeronautics and Space Administration, the Federal Aviation Administration, and any other agency authorized by statute or designated by the President.

"No-setoff commitment," as used in this subpart, means a contractual undertaking that, to the extent permitted by the Act, payments by the designated agency to the assignee under an assignment of claims will not be reduced to liquidate the indebtedness of the contractor to the Government.

**32.802 Conditions.**

Under the Assignment of Claims Act, a contractor may assign moneys due or to become due under a contract if all the following conditions are met:

(a) The contract specifies payments aggregating \$1,000 or more.

(b) The assignment is made to a bank, trust company, or other financing institution, including any Federal lending agency.

(c) The contract does not prohibit the assignment.

(d) Unless otherwise expressly permitted in the contract, the assignment—

(1) Covers all unpaid amounts payable under the contract;

(2) Is made only to one party, except that any assignment may be made to one party as agent or trustee for two or more parties participating in the financing of the contract; and

(3) Is not subject to further assignment.

(e) The assignee sends a written notice of assignment together with a true copy of the assignment instrument to the—

(1) Contracting officer or the agency head;

(2) Surety on any bond applicable to the contract; and

(3) Disbursing officer designated in the contract to make payment.

**32.803 Policies.**

(a) Any assignment of claims that has been made under the Act to any type of financing institution listed in 32.802(b) may thereafter be further assigned and reassigned to any such institution if the conditions in 32.802(d) and (e) continue to be met.

(b) A contract may prohibit the assignment of claims if the agency determines the prohibition to be in the Government's interest.

(c) Under a requirements or indefinite quantity type contract that authorizes ordering and payment by multiple Government activities, amounts due for individual orders for \$1,000 or more may be assigned.

the production quantity at the same facility, add the following paragraph (h) to the basic clause:

(h) The Contractor shall produce both the first article and the production quantity at the same facility and shall submit a certification to this effect with each first article.

(R 7-104.55(a)(h) 1974 APR)

*Alternate II* (APR 1984). If it is necessary to authorize the contractor to purchase material or to commence production before first article approval, substitute the following paragraph (g) for paragraph (g) of the basic clause:

(g) Before first article approval, the Contracting Officer may, by written authorization, authorize the Contractor to acquire specific materials or components or to commence production to the extent essential to meet the delivery schedules. Until first article approval is granted, only costs for the first article and costs incurred under this authorization are allocable to this contract for (1) progress payments, or (2) termination settlements if the contract is terminated for the convenience of the Government. If first article tests reveal deviations from contract requirements, the Contractor shall, at the location designated by the Government, make the required changes or replace all items produced under this contract at no change in the contract price.

(R 7-104.55(c) 1974 APR)

**52.209-4 First Article Approval—Government Testing.**

As prescribed in 9.308-2(a), insert the following clause in solicitations and contracts when a fixed-price contract is contemplated and it is intended that the contract require first article approval and that the Government will be responsible for conducting the first article test. As prescribed in 9.308-2(b), insert a clause substantially the same as the following clause in solicitations and contracts when a cost-reimbursement contract is contemplated and it is intended that the contract require first article approval and that the Government be responsible for conducting the first article test.

**FIRST ARTICLE APPROVAL—GOVERNMENT TESTING (APR 1984)**

*[Contracting Officer shall insert details]*

(a) The Contractor shall deliver ..... units(s) of Lot/Item ..... within ..... calendar days from the date of this contract to the Government at ..... *[insert name and address of the testing facility]* for first article tests. The shipping documentation shall contain this contract number and the Lot/Item identification. The characteristics that the first article must meet and the testing requirements are specified elsewhere in this contract.

(b) Within ..... calendar days after the Government receives the first article, the Contracting Officer shall notify the Contractor, in writing, of the conditional approval, approval, or disapproval of the first article. The notice of conditional approval or approval shall

not relieve the Contractor from complying with all requirements of the specifications and all other terms and conditions of this contract. A notice of conditional approval shall state any further action required of the Contractor. A notice of disapproval shall cite reasons for the disapproval.

(c) If the first article is disapproved, the Contractor, upon Government request, shall submit an additional first article for testing. After each request, the Contractor shall make any necessary changes, modifications, or repairs to the first article or select another first article for testing. All costs related to these tests are to be borne by the Contractor, including any and all costs for additional tests following a disapproval. The Contractor shall furnish any additional first article to the Government under the terms and conditions and within the time specified by the Government. The Government shall act on this first article within the time limit specified in paragraph (b) above. The Government reserves the right to require an equitable adjustment of the contract price for any extension of the delivery schedule or for any additional costs to the Government related to these tests.

(d) If the Contractor fails to deliver any first article on time, or the Contracting Officer disapproves any first article, the Contractor shall be deemed to have failed to make delivery within the meaning of the Default clause of this contract.

(e) Unless otherwise provided in the contract, the Contractor—

(1) May deliver the approved first article as a part of the contract quantity, provided it meets all contract requirements for acceptance and was not consumed or destroyed in testing; and

(2) Shall remove and dispose of any first article from the Government test facility at the Contractor's expense.

(f) If the Government does not act within the time specified in paragraph (b) or (c) above, the Contracting Officer shall, upon timely written request from the Contractor, equitably adjust under the Changes clause of this contract the delivery or performance dates and/or the contract price, and any other contractual term affected by the delay.

(g) The Contractor is responsible for providing operating and maintenance instructions, spare parts support, and repair of the first article during any first article test.

(h) Before first article approval, the acquisition of materials or components for, or the commencement of production of, the balance of the contract quantity is at the sole risk of the Contractor. Before first article approval, the costs thereof shall not be allocable to this contract for (1) progress payments, or (2) termination settlements if the contract is terminated for the convenience of the Government.

(End of clause)

(R 7-104.55(b) 1977 APR)

*Alternate I* (APR 1984). If it is intended that the contractor be required to produce the first article and the production quantity at the same facility, add the following paragraph (i) to the basic clause:

(i) The Contractor shall produce both the first article and the production quantity at the same facility and shall submit a certification to this effect with each first article.

(R 7-104.55(b)(i) 1974 APR)

*Alternate II* (APR 1984). If it is necessary to authorize the contractor to purchase material or to commence production before first article approval, substitute the following paragraph (h) for paragraph (h) of the basic clause:

(h) Before first article approval, the Contracting Officer may, by written authorization, authorize the Contractor to acquire specific materials or components or to commence production to the extent essential to meet the delivery schedules. Until first article approval is granted, only costs for the first article and costs incurred under this authorization are allocable to this contract for (1) progress payments, or (2) termination settlements if the contract is terminated for the convenience of the Government. If first article tests reveal deviations from contract requirements, the Contractor shall, at the location designated by the Government, make the required changes or replace all items produced under this contract at no change in the contract price.

(R 7-104.55(c) 1974 APR)

**52.210-1 Availability of Specifications Listed in the Index of Federal Specifications and Standards.**

As prescribed in 10.011(a), insert the following provision in solicitations that (a) are issued by civilian agency contracting offices and (b) cite specifications listed in the Index that are not furnished with solicitation:

**AVAILABILITY OF SPECIFICATIONS LISTED IN THE INDEX OF FEDERAL SPECIFICATIONS AND STANDARDS (APR 1984)**

(a) Single copies of specifications cited in this solicitation may be obtained by submitting a written request to the appropriate supply point listed below. The request must contain the title of the specification, its number, date, applicable amendment(s), and the solicitation or contract number. In case of urgency, telephone or telegraphic requests are acceptable. Voluntary standards listed in the Index are not available to offerors and contractors from the following Govern-

ment sources and may be obtained from the organization responsible for their preparation, maintenance, or publication.

Region	Address/Telephone No.	Service Area
1 .....	GSA Business Service Center John McCormack Post Office and Courthouse Boston, MA 02109 Telephone No. 617/223-2868	Connecticut, Maine, Vermont, New Hampshire, Massachusetts, and Rhode Island
2 .....	GSA Business Service Center 26 Federal Plaza New York, NY 10007 Telephone No. 212/264-1234	New Jersey, New York, Puerto Rico, and Virgin Islands
3 .....	GSA Specification and Con- sumer Information Distribu- tion Center 9th & Market Streets Philadelphia, PA 19107 Telephone No. 215/597-9613	Delaware, Maryland (except Prince Georges and Montgomery Counties), Pennsylvania, Virginia (except Prince William, Loudon, Fairfax, and Arlington Counties), and West Virginia.
4 .....	GSA Business Service Center 75 Spring Street SW Atlanta, GA 30303 Telephone No. 404/221-5103	Alabama, Florida, Georgia, Kentucky, North Carolina, South Carolina, and Tennessee
5 .....	GSA Business Service Center 230 South Dearborn Street Chicago, IL 60604 Telephone No. 312/353-5383	Illinois, Indiana, Ohio, Michigan, Minnesota, and Wisconsin
6 .....	GSA Business Service Center 1500 East Bannister Road Kansas City, MO 64131 Telephone No. 816/926-7203	Iowa, Kansas, Missouri, and Nebraska
7 .....	GSA Business Service Center 819 Taylor Street Fort Worth, TX 76102 Telephone No. 817/334-3284	Arkansas, Louisiana, Texas, New Mexico, and Oklahoma
8 .....	GSA Business Service Center Building 41 Denver Federal Center Denver, CO 80225 Telephone No. 303/236-7409	Colorado, North Dakota, Utah, South Dakota, Montana, and Wyoming
9 .....	GSA Business Service Center 525 Market San Francisco, CA 94105 Telephone No. 415/974-9000	Northern California, Hawaii, and Nevada (except Clark County)

*See B-58 for 278 thru 10*

tract work. Upon satisfactory completion and final acceptance of the construction work, the Contractor shall be paid any unpaid balance of money due under this contract.

(d) Before final payment under the contract, or before settlement upon termination of the contract, and as a condition precedent thereto, the Contractor shall execute and deliver to the Contracting Officer a release of all claims against the Government arising under or by virtue of this contract, other than any claims that are specifically excepted by the Contractor from the operation of the release in amounts stated in the release.

(End of clause)

**52.232-11 Extras.**

As prescribed in 32.111(d)(2), insert the following clause, appropriately modified with respect to payment due dates in accordance with agency regulations, in solicitations and contracts when a fixed-price supply contract, fixed-price service contract, or transportation contract is contemplated:

EXTRAS (APR 1984)

Except as otherwise provided in this contract, no payment for extras shall be made unless such extras and the price therefor have been authorized in writing by the Contracting Officer.

(End of clause)

(V 7-103.3 1949 JUL)

(V 1-7.102-3)

**52.232-12 Advance Payments.**

As prescribed in 32.412(a), insert the following clause in solicitations and contracts under which the Government will provide advance payments, except as provided in 32.412(b):

ADVANCE PAYMENTS (APR 1984)

(a) *Requirements for payment.* Advance payments will be made under this contract (1) upon submission of properly certified invoices or vouchers by the Contractor, and approval by the administering office, ..... [Insert the name of the office designated under agency procedures], or (2) under a letter of credit. The amount of the invoice or voucher submitted plus all advance payments previously approved shall not exceed \$..... If a letter of credit is used, the Contractor shall withdraw cash only when needed for disbursements acceptable under this contract and report cash disbursements and balances as required by the administering office. The Contractor shall apply terms similar to this clause to any advance payments to subcontractors.

(b) *Special bank account.* Until (1) the Contractor has liquidated all advance payments made under the contract and related interest charges and (2) the administering office has approved in writing the release of any funds due and payable to the Contractor, all advance payments and other payments under this contract shall

be made by check payable to the Contractor marked for deposit only in the Contractor's special bank account with the ..... [Insert the name of the bank]. None of the funds in the special bank account shall be mingled with other funds of the Contractor. Withdrawals from the special bank account may be made only by check of the Contractor countersigned by the Contracting Officer or a Government countersigning agent designated in writing by the Contracting Officer.

(c) *Use of funds.* The Contractor may withdraw funds from the special bank account only to pay for properly allocable, allowable, and reasonable costs for direct materials, direct labor, and indirect costs. Other withdrawals require approval in writing by the administering office. Determinations of whether costs are properly allocable, allowable, and reasonable shall be in accordance with generally accepted accounting principles, subject to any applicable subparts of Part 31 of the Federal Acquisition Regulation.

(d) *Repayment to the Government.* At any time, the Contractor may repay all or any part of the funds advanced by the Government. Whenever requested in writing to do so by the administering office, the Contractor shall repay to the Government any part of unliquidated advance payments considered by the administering office to exceed the Contractor's current requirements or the amount specified in paragraph (a) above. If the Contractor fails to repay the amount requested by the administering office, all or any part of the unliquidated advance payments may be withdrawn from the special bank account by check signed by only the countersigning agent and applied to reduction of the unliquidated advance payments under this contract.

(e) *Maximum payment.* When the sum of all unliquidated advance payments, unpaid interest charges, and other payments exceed ... percent of the contract price, the Government shall withhold further payments to the Contractor. On completion or termination of the contract, the Government shall deduct from the amount due to the Contractor all unliquidated advance payments and all interest charges payable. If previous payments to the Contractor exceed the amount due, the excess amount shall be paid to the Government on demand. For purposes of this paragraph, the contract price shall be considered to be the stated contract price of \$....., less any subsequent price reductions under the contract, plus (1) any price increases resulting from any terms of this contract for price redetermination or escalation, and (2) any other price increases that do not, in the aggregate, exceed \$..... [Insert an amount not higher than 10 percent of the stated contract amount inserted in this paragraph]. Any payments withheld under this paragraph shall be applied to reduce the unliquidated advance payments. If full liquidation has been made, payments under the contract shall resume.

(f) *Interest.* (1) The Contractor shall pay interest to the Government on the daily unliquidated advance payments at the daily rate specified in subparagraph (f)(3) below. Interest shall be computed at the end of each calendar month for the actual number of days

involved. For the purpose of computing the interest charge—

(i) Advance payments shall be considered as increasing the unliquidated balance as of the date of the advance payment check;

(The next page is 52-115.)

(ii) Repayments by Contractor check shall be considered as decreasing the unliquidated balance as of the date on which the check is received by the Government authority designated by the Contracting Officer; and

(iii) Liquidations by deductions from Government payments to the Contractor shall be considered as decreasing the unliquidated balance as of the date of the check for the reduced payment.

(2) Interest charges resulting from the monthly computation shall be deducted from payments, other than advance payments, due the Contractor. If the accrued interest exceeds the payment due, any excess interest shall be carried forward and deducted from subsequent payments. Interest carried forward shall not be compounded. Interest on advance payments shall cease to accrue upon satisfactory completion or termination of the contract for the convenience of the Government. The Contractor shall charge interest on advance payments to subcontractors in the manner described above and credit the interest to the Government. Interest need not be charged on advance payments to nonprofit educational or research subcontractors for experimental, developmental, or research work.

(3) If interest is required under the contract, the Contracting Officer shall determine a daily interest rate based on the higher of (i) the published prime rate of the banking institution (depository) in which the special bank account is established or (ii) the rate established by the Secretary of the Treasury under Pub. L. 92-41 (50 U.S.C. App. 1215(b)(2)). The Contracting Officer shall revise the daily interest rate during the contract period in keeping with any changes in the cited interest rates.

(4) If the full amount of interest charged under this paragraph has not been paid by deduction or otherwise upon completion or termination of this contract, the Contractor shall pay the remaining interest to the Government on demand.

(g) *Bank Agreement.* Before an advance payment is made under this contract, the Contractor shall transmit to the administering office, in the form prescribed by the administering office, an agreement in triplicate from the bank in which the special bank account is established, clearly setting forth the special character of the account and the responsibilities of the bank under the account. If possible, the Contractor shall select a bank that is a member bank of the Federal Reserve System or is an "insured" bank within the meaning the Federal Deposit Insurance Corporation Act (12 U.S.C. 1811).

(h) *Lien on Special Bank Account.* The Government shall have a lien upon any balance in the special bank account paramount to all other liens. The Government lien shall secure the repayment of any advance payments made under this contract and any related interest charges.

(i) *Lien on property under contract.* (1) All advance payments under this contract, together with interest charges, shall be secured, when made, by a lien in favor of the Government, paramount to all other liens, on the supplies or other things covered by this contract and on all material and other property acquired for or allocated to the performance of this contract, except to the extent that the Government by virtue of any other terms of this contract, or otherwise, shall have valid title to the supplies, materials, or other property as against other creditors of the Contractor.

(2) The Contractor shall identify, by marking or segregation, all property that is subject to a lien in favor of the Government by virtue of any terms of this contract in such a way as to indicate that it is subject to a lien and that it has been acquired for or allocated to performing this contract. If, for any reason, the supplies, materials, or other property are not identified by marking or segregation, the Government shall be considered to have a lien to the extent of the Government's interest under this contract on any mass of property with which the supplies, materials, or other property are commingled. The Contractor shall maintain adequate accounting control over the property on its books and records.

(3) If, at any time during the progress of the work on the contract, it becomes necessary to deliver to a third person any items or materials on which the Government has a lien, the Contractor shall notify the third person of the lien and shall obtain from the third person a receipt in duplicate acknowledging the existence of the lien. The Contractor shall provide a copy of each receipt to the Contracting Officer.

(4) If, under the termination clause, the Contracting Officer authorizes the Contractor to sell or retain termination inventory, the approval shall constitute a release of the Government's lien to the extent that—

(i) The termination inventory is sold or retained; and

(ii) The sale proceeds or retention credits are applied to reduce any outstanding advance payments.

(j) *Insurance.* The Contractor represents and warrants that it maintains with responsible insurance carriers (1) insurance on plant and equipment against fire and other hazards, to the extent that similar properties are usually insured by others operating plants and properties of similar character in the same general locality; (2) adequate insurance against liability on account of damage to persons or property; and (3) adequate insurance under all applicable workers' compensation laws. The Contractor agrees that, until work under this contract has been completed and all advance payments made under the contract have been liquidated, it will maintain this insurance; maintain adequate insurance on any materials, parts, assemblies, subassemblies, supplies, equipment, and other property ac-

quired for or allocable to this contract and subject to the Government lien under paragraph (i) of this clause; and furnish any certificates with respect to its insurance that the administering office may require.

(k) *Default.* (1) If any of the following events occurs, the Government may, by written notice to the Contractor, withhold further withdrawals from the special bank account and further payments on this contract:

(i) Termination of this contract for a fault of the Contractor.

(ii) A finding by the administering office that the Contractor has failed to—

(A) Observe any of the conditions of the advance payment terms;

(B) Comply with any material term of this contract;

(C) Make progress or maintain a financial condition adequate for performance of this contract;

(D) Limit inventory allocated to this contract to reasonable requirements; or

(E) Avoid delinquency in payment of taxes or of the costs of performing this contract in the ordinary course of business.

(iii) The appointment of a trustee, receiver, or liquidator for all or a substantial part of the Contractor's property, or the institution of proceedings by or against the Contractor for bankruptcy, reorganization, arrangement, or liquidation.

(iv) The service of any writ of attachment, levy of execution, or commencement of garnishment proceedings concerning the special bank account.

(v) The commission of an act of bankruptcy.

(2) If any of the events described in subparagraph (1) above continue for 30 days after the written notice to the Contractor, the Government may take any of the following additional actions:

(i) Withdraw by checks payable to the Treasurer of the United States, signed only by the countersigning agency, all or any part of the balance in the special bank account and apply the amounts to reduce outstanding advance payments and any other claims of the Government against the Contractor.

(ii) Charge interest, in the manner prescribed in paragraph (f) above, on outstanding advance payments during the period of any event described in subparagraph (1) above.

(iii) Demand immediate repayment by the Contractor of the unliquidated balance of advance payments.

(iv) Take possession of and, with or without advertisement, sell at public or private sale all or any part of the property on which the Government has a lien under this contract and, after deducting any expenses incident to the sale, apply the net proceeds of the sale to reduce the unliquidated balance of advance payments or other Government claims against the Contractor.

(3) The Government may take any of the actions described in subparagraphs (k)(1) and (2) of this clause it considers appropriate at its discretion and without limiting any other rights of the Government.

(l) *Prohibition against assignment.* Notwithstanding any other terms of this contract, the Contractor shall not assign this contract, any interest therein, or any claim under the contract to any party.

(m) *Information and access to records.* The Contractor shall furnish to the administering office (1) monthly or at other intervals as required, signed or certified balance sheets and profit and loss statements together with a report on the operation of the special bank account in the form prescribed by the administering office; and (2) if requested, other information concerning the operation of the Contractor's business. The Contractor shall provide the authorized Government representatives proper facilities for inspection of the Contractor's books, records, and accounts.

(n) *Other security.* The terms of this contract are considered to provide adequate security to the Government for advance payments; however, if the administering office considers the security inadequate, the Contractor shall furnish additional security satisfactory to the administering office, to the extent that the security is available.

(o) *Representations and warranties.* The Contractor represents and warrants the following:

(1) The balance sheet, the profit and loss statement, and any other supporting financial statements furnished to the administering office fairly reflect the financial condition of the Contractor at the date shown or the period covered, and there has been no subsequent materially adverse change in the financial condition of the Contractor.

(2) No litigation or proceedings are presently pending or threatened against the Contractor, except as shown in the financial statements.

(3) The Contractor has disclosed all contingent liabilities, except for liability resulting from the renegotiation of defense production contracts, in the financial statements furnished to the administering office.

(4) None of the terms in this clause conflict with the authority under which the Contractor is doing business or with the provision of any existing indenture or agreement of the Contractor.

(5) The Contractor has the power to enter into this contract and accept advance payments, and has taken all necessary action to authorize the acceptance under the terms of this contract.

(6) The assets of the Contractor are not subject to any lien or encumbrance of any character except for current taxes not delinquent, and except as shown in the financial statements furnished by the Contractor. There is no current assignment of claims under any



contract affected by these advance payment provisions.

(7) All information furnished by the Contractor to the administering office in connection with each request for advance payments is true and correct.

(8) These representations and warranties shall be continuing and shall be considered to have been repeated by the submission of each invoice for advance payments.

(p) *Covenants.* To the extent the Government considers it necessary while any advance payments made under this contract remain outstanding, the Contractor, without the prior written consent of the administering office, shall not—

(1) Mortgage, pledge, or otherwise encumber or allow to be encumbered, any of the assets of the Contractor now owned or subsequently acquired, or permit any preexisting mortgages, liens, or other encumbrances to remain on or attach to any assets of the Contractor which are allocated to performing this contract and with respect to which the Government has a lien under this contract;

(2) Sell, assign, transfer, or otherwise dispose of accounts receivable, notes, or claims for money due or to become due;

(3) Declare or pay any dividends, except dividends payable in stock of the corporation, or make any other distribution on account of any shares of its capital stock, or purchase, redeem, or otherwise acquire for value any of its stock, except as required by sinking fund or redemption arrangements reported to the administering office incident to the establishment of these advance payment provisions;

(4) Sell, convey, or lease all or a substantial part of its assets;

(5) Acquire for value the stock or other securities of any corporation, municipality, or governmental authority, except direct obligations of the United States;

(6) Make any advance or loan or incur any liability as guarantor, surety, or accommodation endorser for any party;

(7) Permit a writ of attachment or any similar process to be issued against its property without getting a release or bonding the property within 30 days after the entry of the writ of attachment or other process;

(8) Pay any remuneration in any form to its directors, officers, or key employees higher than rates provided in existing agreements of which notice has been given to the administering office; accrue excess remuneration without first obtaining an agreement subordinating it to all claims of the Government; or employ any person at a rate of compensation over \$... a year;

(9) Change substantially the management, ownership, or control of the corporation;

(10) Merge or consolidate with any other firm or corporation, change the type of business, or engage in any transaction outside the ordinary course of the Contractor's business as presently conducted;

(11) Deposit any of its funds except in a bank or trust company insured by the Federal Deposit Insurance Corporation;

(12) Create or incur indebtedness for advances, other than advances to be made under the terms of this contract, or for borrowings;

(13) Make or covenant for capital expenditures exceeding \$..... in total;

(14) Permit its net current assets, computed in accordance with generally accepted accounting principles, to become less than \$.....; or

(15) Make any payments on account of the obligations listed below, except in the manner and to the extent provided in this contract:

*[List the pertinent obligations]*

(End of clause)

(R 7-104.34 1976 OCT)

(R 1-30.414-2)

*Alternate I* (APR 1984). If the agency desires to waive the countersignature requirement because of the Contractor's financial strength, good performance record, and favorable experience concerning cost disallowances, add the following sentence, if appropriate, to paragraph (b) of the basic clause:

However, for this contract, countersignature on behalf of the Government will not be required unless it is determined necessary by the administering office.

(R 7-104.34 1976 OCT)

(R 1-30.414-2(b))

*Alternate II* (APR 1984). If used in a cost-reimbursement contract, substitute the following paragraphs (c) and (e), and subparagraphs (f)(1) and (f)(2) for paragraphs (c) and (e) and subparagraphs (f)(1) and (2) of the basic clause:

(c) *Use of funds.* The Contractor shall withdraw funds from the special bank account only to pay for allowable costs as prescribed by the ..... clause of this contract. Payment for any other types of expenses shall be approved in writing by the administering office.

(e) *Maximum payment.* When the sum of all unliquidated advance payments, unpaid interest charges, and other payments equal the total estimated cost of \$ ..... (not including fixed-fee, if any) for the work under this contract, the Government shall withhold further payments to the Contractor. Upon completion or termination of the contract, the Government shall deduct from the amount due to the Contractor all unliquidated advance payments and interest charges payable. The Contractor shall pay any deficiency to the Government upon demand. For purposes of this paragraph, the estimated cost shall be considered to be the stated estimated cost, less any subsequent reductions of the estimated

cost, plus any increases in the estimated costs that do not, in the aggregate, exceed \$..... [Insert an amount not higher than 10 percent of the stated estimated cost inserted in this paragraph.] The estimated cost shall include, without limitation, any reimbursable cost (as estimated by the Contracting Officer) incident to a termination for the convenience of the Government. Any payments withheld under this paragraph shall be applied to reduce the unliquidated advance payments. If full liquidation has been made, payments under the contract shall resume.

(f) *Interest.* (1) The Contractor shall pay interest to the Government on the daily unliquidated advance payments at the daily rate specified in subparagraph (f)(3) below. Interest shall be computed at the end of each calendar month for the actual number of days involved. For the purpose of computing the interest charge, the following shall be observed:

(i) Advance payments shall be considered as increasing the unliquidated balance as of the date of the advance payment check.

(ii) Repayments by Contractor check shall be considered as decreasing the unliquidated balance as of the date on which the check is received by the Government authority designated by the Contracting Officer.

(iii) Liquidations by deductions from payments to the Contractor shall be considered as decreasing the unliquidated balance as of the dates on which the Contractor presents to the Contracting Officer full and accurate data for the preparation of each voucher. Credits resulting from these deductions shall be made upon the approval of the reimbursement vouchers by the Disbursing Officer, based upon the Contracting Officer's certification of the applicable dates.

(2) Interest charges resulting from the monthly computation shall be deducted from any payments on account of the fixed-fee due to the Contractor. If the accrued interest exceeds the payment due, any excess interest shall be carried forward and deducted from subsequent payments of the contract price or fixed-fee. Interest carried forward shall not be compounded. Interest on advance payments shall cease to accrue upon (i) satisfactory completion or (ii) termination of the contract for the convenience of the Government. The Contractor shall charge interest on advance payments to subcontractors in the manner described above and credit the interest to the Government. Interest need not be charged on advance payments to nonprofit educational or research subcontractors for experimental, developmental, or research work.

(R 7-104.34 1976 OCT)

(R 1-30.414-2(c), (c), and (f))

*Alternate III* (APR 1984). If the agency considers a more rapid liquidation appropriate, add the following

sentence as the first sentence of paragraph (e) of the basic clause with the appropriate percentage specified:

To liquidate the principal amount of any advance payment made to the Contractor, there shall be deductions of .....percent from all payments made by the Government under the contracts involved.

(R 7-104.34 1976 OCT)

(R 1-30.414-2(e))

*Alternate IV* (APR 1984). If the agency provides advance payments under the contract at no interest to the prime contractor, add the following sentences as the beginning sentences of paragraph (f) of the clause:

No interest shall be charged to the prime Contractor for advance payments except for interest charged during a period of default. The terms of this paragraph concerning interest charges for advance payments shall not apply to the prime Contractor.

(R 7-104.34 1976 OCT)

(R 1-30.414-2(n)(3))

#### 52.232-13 Notice of Progress Payments.

As prescribed in 32.502-3(a), insert the following provision in invitations for bids and requests for proposals that include a Progress Payments clause:

##### NOTICE OF PROGRESS PAYMENTS (APR 1984)

The need for customary progress payments conforming to the regulations in Subpart 32.5 of the Federal Acquisition Regulation (FAR) will not be considered as a handicap or adverse factor in the award of the contract. The Progress Payments clause included in this solicitation will be included in any resulting contract, modified or altered if necessary in accordance with subsection 52.232-16 and its Alternate I of the FAR. Even though the clause is included in the contract, the clause shall be inoperative during any time the contractor's accounting system and controls are determined by the Government to be inadequate for segregation and accumulation of contract costs.

(End of provision)

(R 7-2003.64 APR 1974)

(R 1-30.504-4(a))

#### 52.232-14 Notice of Availability of Progress Payments Exclusively for Small Business Concerns.

As prescribed in 32.502-3(b)(2), insert the following provision in invitations for bids if it is anticipated that (a) both small business concerns and others may submit bids in response to the same invitation and (b) only the small business bidders would need progress payments:

##### NOTICE OF AVAILABILITY OF PROGRESS PAYMENTS EXCLUSIVELY FOR SMALL BUSINESS CONCERNS (APR 1984)

The Progress Payments clause will be available only to small business concerns. Any bid conditioned upon inclusion of a progress payment clause in the resulting contract will be rejected as nonresponsive if the bidder is not a small business concern.

(End of provision)

regularly sold to the general public in the normal course of business by the Contractor, the price to be paid for such material, notwithstanding (b)(1) above, shall be on the basis of an established catalog or list price, in effect when the material is furnished, less all applicable discounts to the Government; *provided*, that in no event shall such price be in excess of the Contractor's sales price to its most favored customer for the same item in like quantity, or the current market price, whichever is lower.

(AV 7-90.6 1972 MAY)

*Alternate II (JAN 1986)*. If a labor-hour contract is contemplated, and if no specific reimbursement for materials furnished is intended, the Contracting Officer may add the following paragraph (h) to the basic clause:

(h) The terms of this clause that govern reimbursement for materials furnished are considered to have been deleted.

**52.232-8 Discounts for Prompt Payment.**

As prescribed in 32.111(c)(1), insert the following clause:  
**DISCOUNTS FOR PROMPT PAYMENT (JUL 1985)**

(a) Discounts for prompt payment will not be considered in the evaluation of offers. However, any offered discount will form a part of the award, and will be taken if payment is made within the discount period indicated in the offer by the offeror. As an alternative to offering a prompt payment discount in conjunction with the offer, offerors awarded contracts may include prompt payment discounts on individual invoices.

(b) In connection with any discount offered for prompt payment, time shall be computed from (1) the date of completion of performance of the services or delivery of the supplies to the carrier if acceptance is at point of origin, or date of delivery at destination or port of embarkation if delivery and acceptance are at either of these points, or (2) the date a proper invoice or voucher is received in the office specified by the Government, if the latter is later than date of performance or delivery. For the purpose of computing the discount earned, payment shall be considered to have been made on the date which appears on the payment check or the date on which a wire transfer was made.

(End of clause)

**52.232-9 Limitation on Withholding of Payments.**

As prescribed in 32.111(c)(2), insert a clause substantially as follows, appropriately modified with respect to payment due dates in accordance with agency regulations, in solicitations and contracts when a supply contract, service contract, time-and-materials contract, labor-hour contract, or research and development contract is contemplated that includes two or more terms authorizing the temporary withholding of amounts otherwise payable to the contractor for supplies delivered or services performed:

**LIMITATION ON WITHHOLDING OF PAYMENTS  
(APR 1984)**

If more than one clause or Schedule term of this contract authorizes the temporary withholding of amounts otherwise payable to the Contractor for supplies delivered or services performed, the total of the amounts withheld at any one time shall not exceed the greatest amount that may be withheld under any one clause or Schedule term at that time; *provided*, that this limitation shall not apply to—

(a) Withholdings pursuant to any clause relating to wages or hours of employees;

(b) Withholdings not specifically provided for by this contract;

(c) The recovery of overpayments; and

(d) Any other withholding for which the Contracting Officer determines that this limitation is inappropriate.

(End of clause)

(R 7-104.21 1958 SEP)

(R 7-403.12 1959 FEB)

**52.232-10 Payments under Fixed-Price Architect-Engineer Contracts.**

As prescribed in 32.111(d)(1), insert the following clause:  
**PAYMENTS UNDER FIXED-PRICE ARCHITECT-ENGINEER CONTRACTS (AUG 1987)**

(a) Estimates shall be made monthly of the amount and value of the work and services performed by the Contractor under this contract which meet the standards of quality established under this contract.

(b) Upon approval of the estimate by the Contracting Officer, payment upon properly executed vouchers shall be made to the Contractor, as soon as practicable, of 90 percent of the approved amount, less all previous payments; *provided*, that payment may be made in full during any months in which the Contracting Officer determines that performance has been satisfactory. Also, whenever the Contracting Officer determines that the work is substantially complete and that the amount retained is in excess of the amount adequate for the protection of the Government, the Contracting Officer may release the excess amount to the Contractor.

(c) Upon satisfactory completion by the Contractor and acceptance by the Contracting Officer of the work done by the Contractor under the "Statement of Architect-Engineer Services", the Contractor will be paid the unpaid balance of any money due for work under the statement, including retained percentages relating to this portion of the work. If the Government exercises the option under the Option for Supervision and Inspection Services clause, progress payments as provided for in (a) and (b) above will be made for this portion of the con-

(R 7-2003.63 APR 74)

(R 1-30.504-4(c))

**52.232-15 Progress Payments Not Included.**

As prescribed in 32.502-3(c), insert the following provision in invitations for bids if the solicitation will not contain one of the provisions prescribed in 32.502-3(a) and (b): **PROGRESS PAYMENTS NOT INCLUDED (APR 1984)**

A progress payments clause is not included in this solicitation, and will not be added to the resulting contract at the time of award. Bids conditioned upon inclusion of a progress payment clause in the resulting contract will be rejected as nonresponsive.

(End of provision)

(R E-504.5 JULY 1976)

(R 1-30.504-6)

**52.232-16 Progress Payments.**

(a) As prescribed in 32.502-4(a), insert the following clause in solicitations and fixed-price contracts under which the Government will provide progress payments based on costs. A different customary rate for other than small business concerns may be substituted in accordance with 32.501-1 for the progress payment and liquidation rate indicated.

(b) If an unusual progress payment rate is approved for the prime contractor (see 32.501-2), the rate approved shall be substituted for the customary rate in paragraph (a)(1).

(c) If the liquidation rate is changed from the customary progress payment rate (see 32.503-8 and 32.503-9), the new rate shall be substituted for the rate in paragraphs (a)(4), (a)(5), and (b).

(d) If advance and progress payments are authorized in the same contract, the words "less any unliquidated advance payments" may be deleted from paragraph (a)(4) of this clause.

(e) If an unusual progress payment rate is approved for a subcontract (see 32.504(b) and 32.501-2), subparagraph (j)(4) shall be modified to specify the new rate, the name of the subcontractor, and that the new rate shall be used for that subcontractor in lieu of the customary rate.

**PROGRESS PAYMENTS (AUG 1987)**

Progress payments shall be made to the Contractor when requested as work progresses, but not more frequently than monthly in amounts approved by the Contracting Officer, under the following conditions:

(a) *Computation of amounts.* (1) Unless the Contractor requests a smaller amount, each progress payment shall be computed as (i) 80 percent of the Contractor's cumulative total costs under this contract, as shown by records maintained by the Contractor for the purpose of obtaining pay-

ment under Government contracts, plus (ii) progress payments to subcontractors (see paragraph (j) below), all less the sum of all previous progress payments made by the Government under this contract. Cost of money that would be allowable under 31.205-10 of the Federal Acquisition Regulation shall be deemed an incurred cost for progress payment purposes.

(2) The following conditions apply to the timing of including costs in progress payment requests:

(i) The costs of supplies and services purchased by the Contractor directly for this contract may be included only after payment by cash, check, or other form of actual payment.

(ii) Costs for the following may be included when incurred, even if before payment, when the Contractor is not delinquent in payment of the costs of contract performance in the ordinary course of business:

(A) Materials issued from the Contractor's stores inventory and placed in the production process for use on this contract.

(B) Direct labor, direct travel, and other direct in-house costs.

(C) Properly allocable and allowable indirect costs.

(iii) Accrued costs of Contractor contributions under employee pension, profit sharing, and stock ownership plans shall be excluded until actually paid unless—

(A) The Contractor's practice is to contribute to the plans quarterly or more frequently; and

(B) The contribution does not remain unpaid 30 days after the end of the applicable quarter or shorter payment period (any contributions remaining unpaid shall be excluded from the Contractor's total costs for progress payments until paid).

(iv) If the contract is subject to the special transition method authorized in Cost Accounting Standard (CAS) 410, Allocation of Business Unit General and Administrative Expense to Final Cost Objective, General and Administrative expenses (G&A) shall not be included in progress payment requests until the suspense account prescribed in CAS 410 is less than—

(A) Five million dollars; or

(B) The value of the work-in-process inventories under contracts entered into after the suspense account was established (only a pro rata share of the G&A allocable to the excess of the inventory over the suspense account value is includable in progress payment requests under this contract).

(3) The Contractor shall not include the following in total costs for progress payment purposes in subparagraph (a)(1)(i) above:

(i) Costs that are not reasonable, allocable to this contract, and consistent with sound and generally accepted accounting principles and practices.

(ii) Costs incurred by subcontractors or suppliers.

(iii) Costs ordinarily capitalized and subject to depreciation or amortization except for the properly depreciated or amortized portion of such costs.

(iv) Payments made or amounts payable to subcontractors or suppliers, except for—

(A) Completed work, including partial deliveries, to which the Contractor has acquired title; and

(B) Work under cost-reimbursement or time-and-material subcontracts to which the Contractor has acquired title.

(4) The amount of unliquidated progress payments may exceed neither (i) the progress payments made against incomplete work (including allowable unliquidated progress payments to subcontractors) nor (ii) the value, for progress payment purposes, of the incomplete work. Incomplete work shall be considered to be the supplies and services required by this contract, for which delivery and invoicing by the Contractor and acceptance by the Government are incomplete.

(5) The total amount of progress payments shall not exceed 80 percent of the total contract price.

(6) If a progress payment or the unliquidated progress payments exceed the amounts permitted by subparagraphs (a)(4) or (a)(5) above, the Contractor shall repay the amount of such excess to the Government on demand.

(b) *Liquidation.* Except as provided in the Termination for Convenience of the Government clause, all progress payments shall be liquidated by deducting from any payment under this contract, other than advance or progress payments, the unliquidated progress payments, or 80 percent of the amount invoiced, whichever is less. The Contractor shall repay to the Government any amounts required by a retroactive price reduction, after computing liquidations and payments on past invoices at the reduced prices and adjusting the unliquidated progress payments accordingly. The Government reserves the right to unilaterally change from the ordinary liquidation rate to an alternate rate when deemed appropriate for proper contract financing.

(c) *Reduction or suspension.* The Contracting Officer may reduce or suspend progress payments, increase the rate of liquidation, or take a combination of these acquisitions, after finding on substantial evidence any of the following conditions:

(1) The Contractor failed to comply with any material requirement of this contract (which includes paragraphs (f) and (g) below).

(2) Performance of this contract is endangered by the Contractor's (i) failure to make progress or (ii) unsatisfactory financial condition.

(3) Inventory allocated to this contract substantially exceeds reasonable requirements.

(4) The Contractor is delinquent in payment of the costs of performing this contract in the ordinary course of business.

(5) The unliquidated progress payments exceed the fair value of the work accomplished on the undelivered portion of this contract.

(6) The Contractor is realizing less profit than that reflected in the establishment of any alternate liquidation rate in paragraph (b) above, and that rate is less than the progress payment rate stated in subparagraph (a)(1) above.

(d) *Title.* (1) Title to the property described in this paragraph (d) shall vest in the Government. Vestiture shall be immediately upon the date of this contract, for property acquired or produced before that date. Otherwise, vestiture shall occur when the property is or should have been allocable or properly chargeable to this contract.

(2) "Property," as used in this clause, includes all of the below-described items acquired or produced by the Contractor that are or should be allocable or properly chargeable to this contract under sound and generally accepted accounting principles and practices.

(i) Parts, materials, inventories, and work in process;

(ii) Special tooling and special test equipment to which the Government is to acquire title under any other clause of this contract;

(iii) Nondurable (i.e., noncapital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment, and other similar manufacturing aids, title to which would not be obtained as special tooling under subparagraph (ii) above; and

(iv) Drawings and technical data, to the extent the Contractor or subcontractors are required to deliver them to the Government by other clauses of this contract.

(3) Although title to property is in the Government under this clause, other applicable clauses of this contract; e.g., the termination or special tooling clauses, shall determine the handling and disposition of the property.

(4) The Contractor may sell any scrap resulting from production under this contract without requesting the Contracting Officer's approval, but the proceeds shall be credited against the costs of performance.

(5) To acquire for its own use or dispose of property to which title is vested in the Government under this clause, the Contractor must obtain the Contracting Officer's advance approval of the action and the terms. The Contractor shall (i) exclude the allocable costs of the property from the costs of contract performance, and (ii) repay to the Government any amount of unliquidated progress payments

allocable to the property. Repayment may be by cash or credit memorandum.

(6) When the Contractor completes all of the obligations under this contract, including liquidation of all progress payments, title shall vest in the Contractor for all property (or the proceeds thereof) not—

(i) Delivered to, and accepted by, the Government under this contract; or

(ii) Incorporated in supplies delivered to, and accepted by, the Government under this contract and to which title is vested in the Government under this clause.

(7) The terms of this contract concerning liability for Government-furnished property shall not apply to property to which the Government acquired title solely under this clause.

(e) *Risk of loss.* Before delivery to and acceptance by the Government, the Contractor shall bear the risk of loss for property, the title to which vests in the Government under this clause, except to the extent the Government expressly assumes the risk. The Contractor shall repay the Government an amount equal to the unliquidated progress payments that are based on costs allocable to property that is damaged, lost, stolen, or destroyed.

(f) *Control of costs and property.* The Contractor shall maintain an accounting system and controls adequate for the proper administration of this clause.

(g) *Reports and access to records.* The Contractor shall promptly furnish reports, certificates, financial statements, and other pertinent information reasonably requested by the Contracting Officer for the administration of this clause. Also, the Contractor shall give the Government reasonable opportunity to examine and verify the Contractor's books, records, and accounts.

(h) *Special terms regarding default.* If this contract is terminated under the Default clause, (i) the Contractor shall, on demand, repay to the Government the amount of unliquidated progress payments and (ii) title shall vest in the Contractor, on full liquidation of progress payments, for all property for which the Government elects not to require delivery under the Default clause. The Government shall be liable for no payment except as provided by the Default clause.

(i) *Reservations of rights.* (1) No payment or vesting of title under this clause shall (i) excuse the Contractor from performance of obligations under this contract or (ii) constitute a waiver of any of the rights or remedies of the parties under the contract.

(2) The Government's rights and remedies under this clause (i) shall not be exclusive but rather shall be in addition to any other rights and remedies provided by law or this contract and (ii) shall not be affected by delayed, partial, or omitted exercise of any right, remedy, power, or privilege, nor shall such exercise or any single exercise preclude or impair any further exercise under this

clause or the exercise of any other right, power, or privilege of the Government.

(j) *Progress payments to subcontractors.* The amounts mentioned in (a)(1)(ii) above shall be all progress payments to subcontractors or divisions, if the following conditions are met:

(1) The amounts included are limited to (i) the unliquidated remainder of progress payments made plus (ii) for small business concerns any unpaid subcontractor requests for progress payments that the Contractor has approved for current payment in the ordinary course of business.

(2) The subcontract or interdivisional order is expected to involve a minimum of approximately 6 months between the beginning of work and the first delivery, or, if the subcontractor is a small business concern, 4 months.

(3) The terms of the subcontract or interdivisional order concerning progress payments—

(i) Are substantially similar to the terms of the clause at 52.232-16, Progress Payments, for any subcontractor that is a large business concern, or that clause with its *Alternate 1* for any subcontractor that is a small business concern;

(ii) Are at least as favorable to the Government as the terms of this clause;

(iii) Are not more favorable to the subcontractor or division than the terms of this clause are to the Contractor;

(iv) Are in conformance with the requirements of paragraph 32.504(e) of the Federal Acquisition Regulation; and

(v) Subordinate all subcontractor rights concerning property to which the Government has title under the subcontract to the Government's right to require delivery of the property to the Government if (A) the Contractor defaults or (B) the subcontractor becomes bankrupt or insolvent.

(4) The progress payment rate in the subcontract is the customary rate used by the Contracting Agency, depending on whether the subcontractor is or is not a small business concern.

(5) The parties agree concerning any proceeds received by the Government for property to which title has vested in the Government under the subcontract terms, that the proceeds shall be applied to reducing any unliquidated progress payments by the Government to the Contractor under this contract.

(6) If no unliquidated progress payments to the Contractor remain, but there are unliquidated progress payments that the Contractor has made to any subcontractor, the Contractor shall be subrogated to all the rights the Government obtained through the terms required by this clause to be in any subcontract, as if all such rights had transferred to the Contractor.

(7) The Contractor shall pay the subcontractor's progress payment request under subdivision (j)(1)(ii) above, within a reasonable time after receiving the Government progress payment covering those amounts.

(8) To facilitate small business participation in subcontracting under this contract, the Contractor agrees to provide progress payments to small business concerns, in conformity with the standards for customary progress payments stated in Subpart 32.5 of the Federal Acquisition Regulation. The Contractor further agrees that the need for such progress payments shall not be considered as a handicap or adverse factor in the award of subcontracts.

(k) *Limitations on Unfinalized Contract Actions.* Notwithstanding any other progress payment provisions in this contract, progress payments may not exceed 80 percent of costs incurred on work accomplished under unfinalized contract actions. A "contract action" is any action resulting in a contract, as defined in Subpart 2.1, including contract modifications for additional supplies or services, but not including contract modifications that are within the scope and under the terms of the contract, such as contract modifications issued pursuant to the Changes clause, or funding and other administrative changes. This limitation shall apply to the costs incurred, as computed in accordance with paragraph (a) of this clause, and shall remain in effect until the contract action is finalized. Costs incurred which are subject to this limitation shall be segregated on Contractor progress payment requests and invoices from those costs eligible for higher progress payment rates. For purposes of progress payment liquidation, as described in paragraph (b) of this clause, progress payments for unfinalized contract actions shall be liquidated at 80 percent of the amount invoiced for work performed under the unfinalized contract action as long as the contract action remains unfinalized. The amount of unliquidated progress payments for unfinalized contract actions shall not exceed 80 percent of the maximum liability of the Government under the unfinalized contract action or such lower limit specified elsewhere in the contract. Separate limits may be specified for separate actions.

(End of clause)

*Alternate I (AUG 1987).* If the contract is with a small business concern, change each mention of the progress payment and liquidation rates excepting paragraph (k) to the customary rate of 85 percent for small business concerns (see 32.501-1), delete subparagraphs (a)(1) and (a)(2) from the basic clause, and substitute the following subparagraphs (a)(1) and (a)(2):

(a) *Computation of amounts.* (1) Unless the Contractor requests a smaller amount, each progress payment shall be computed as (i) 85 percent of the Contractor's total costs incurred under this contract whether or not actually paid, plus (ii) progress payments to subcontractors (see paragraph (j) below), all less the sum of all previous progress payments

made by the Government under this contract. Cost of money that would be allowable under 31.205-10 of the Federal Acquisition Regulation shall be deemed an incurred cost for progress payment purposes.

(2) Accrued costs of Contractor contributions under employee pension plans shall be excluded until actually paid unless—

(i) The Contractor's practice is to make contributions to the retirement fund quarterly or more frequently; and

(ii) The contribution does not remain unpaid 30 days after the end of the applicable quarter or shorter payment period (any contribution remaining unpaid shall be excluded from the Contractor's total costs for progress payments until paid).

*Alternate II (AUG 1987).* If the contract is a letter contract, add paragraphs (l) and (m). The amount specified in paragraph (m) shall not exceed 80 percent applied to the maximum liability of the Government under the letter contract. Separate limits may be specified for separate parts of the work.

(l) Progress payments made under this letter contract shall, unless previously liquidated under paragraph (b) of this clause, be liquidated under the following procedures:

(1) If this letter contract is superseded by a definitive contract, unliquidated progress payments made under this letter contract shall be liquidated by deducting the amount from the first progress or other payments made under the definitive contract.

(2) If this letter contract is not superseded by a definitive contract calling for the furnishing of all or part of the articles or services covered under the letter contract, unliquidated progress payments made under the letter contract shall be liquidated by deduction from the amount payable under the Termination clause.

(3) If this letter contract is partly terminated and partly superseded by a contract, the Government shall allocate the unliquidated progress payments to the terminated and unliquidated portions as the Government deems equitable, and shall liquidate each portion under the relevant procedure in subparagraphs (l)(1) and (l)(2) of this clause.

(4) If the method of liquidating progress payments provided in this clause does not result in full liquidation, the Contractor shall immediately pay the unliquidated balance to the Government on demand.

(m) The amount of unliquidated progress payments shall not exceed ..... (specify dollar amount).

**52.232-17 Interest.**

As prescribed in 32.617(a), insert the following clause in solicitations and contracts unless it is contemplated that the contract will be in one or more of the categories specified in 32.617(a)(1) through 32.617(a)(7). As prescribed in 32.617(b), the following clause may be inserted in solicitations and contracts when it is contemplated that the con-

tract will be in any of the categories specified in 32.617(a)(1) through 32.617(a)(7):

**INTEREST (APR 1984)**

(a) Notwithstanding any other clause of this contract, all amounts that become payable by the Contractor to the Government under this contract (net of any applicable tax credit under the Internal Revenue Code (26 U.S.C. 1481)) shall bear simple interest from the date due until paid unless paid within 30 days of becoming due. The interest rate shall

be the interest rate established by the Secretary of the Treasury as provided in Section 12 of the Contract Disputes Act of 1978 (Public Law 95-563), which is applicable to the period in which the amount becomes due, as provided in paragraph (b) of this clause, and then at the rate applicable for each six-month period as fixed by the Secretary until the amount is paid.

(b) Amounts shall be due at the earliest of the following dates:

- (1) The date fixed under this contract.



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SUBPART 32.1--GENERAL

32.070 See DAR Council Letter

32.102 Description of Contract Financing Methods.

(e)(2) Progress payments based on percentage or state of completion will be confined to contracts for construction, shipbuilding and ship conversion, alteration or repair.

See DAR Council Letter

32.108 Financial Consultation. The contract financing offices are: the Chief of Contract Financing, Office of the Comptroller of the Army; the Executive Assistant Comptroller for Banking, Cash Management, Contract Financing and Compensation Systems, Assistant Comptroller of the Navy for Financial Management; the Chief of Banking and Contract Financing, Directorate of Accounting, Air Force Accounting and Finance Center; and the Comptroller, Defense Logistics Agency. For other Departments, the contracting financing office will be within the Office of the Agency Comptroller.

32.111 Contract Clauses.

(a), (b), (c) and (d) See DAC 76-42, Item I, for authorized modifications with respect to payment due dates.

(70) The contracting officer shall insert the clause at 52.232-7000, Invoices, in solicitations and contracts for supplies and services when a fixed price contract is contemplated.

See DAR Council Letter

32.170 Responsibilities.

32.170-1 Organization. The financing function should be separated from the procurement function, but close cooperation should be preserved at all times. For progress payments, contract financing officers will ordinarily participate in the development of appropriate regulations and standard contract provisions designed to avoid undue risk to the Government, and in specific cases involving policy questions or unusual financing arrangements.

32.170-2 Resolution of Disagreements. If a disagreement arises between the financing office and the procuring activity on financing provisions, the matter will be referred to and resolved in the higher echelons of the authority responsible for both financing and procurement functions.

32.170-3 Responsibility, Administration, Contract Finance Committee. The Assistant Secretary of Defense (Acquisition and Logistics) has the responsibility for insuring uniform administration of financing. Only policy issues or important procedural problems shall be referred to the Office of the Assistant Secretary of Defense (Acquisition and Logistics). Usual financing operations shall be the responsibility of the Departments.

(a) Responsibility for financing in each Department shall be in the Under or Assistant Secretary, or other designated official, responsible for the comptroller function, with the focal point for such activities at Departmental headquarters. Contract financing offices may be established at the operational level determined by the Departments.

(b) There shall be a Contract Finance Committee composed of a representative of the Assistant Secretary of Defense (Acquisition and Logistics) as chairman, a representative of the Assistant Secretary of Defense (Comptroller), and two representatives of each Military Department and DLA (one representing procurement and one representing the contract finance office). The Committee shall meet upon call by the Chairman or when requested by a member. The Committee shall advise and assist the Assistant Secretary of Defense (Acquisition and Logistics) in assuring proper and uniform application of policies, procedures and forms. The Committee may recommend to the Secretary of Defense through the Assistant Secretary of Defense (Acquisition and Logistics) further policy directives on financing matters. The Committee shall be responsible for the formulation, revision and promulgation of uniform contract financing regulations.

**32.171 Deviations.** Actions in the exercise of the judgment and discretion allowed by these regulations are not deviations. Actions contrary to or inconsistent with these regulations constitute deviations. Deviations will be permitted only in exceptional circumstances, after the proposed deviation has been presented to the Contract Finance Committee and a recommendation obtained, and the approval of the Assistant Secretary of Defense (Acquisition and Logistics) or his designated representative has been given. This procedure will also be followed for amendments to these regulations.

**32.172 Financial Responsibility of Contractors.** Procuring activities must give due regard to the financial capabilities of potential suppliers. Financial difficulties encountered by contractors and subcontractors may disrupt production schedules; cause wastage of manpower and materials; and if connected with guaranteed loans, advance payments or progress payments, result in monetary loss to the Government. If financial crises occur in the course of a contractor's production, the need for continued production may make guaranteed loans or advance payments imperative for continued production, even though monetary losses may be likely.

**32.173 Financial Information and Analysis.**

(a) The necessity for financial information and analysis of the financial capability of contractors vary with the circumstances of particular cases. Judgment must be used in accumulating and evaluating data. Financial analysis would serve little useful purpose when providing customary progress payments:

(1) for contractors who are known from experience to be fairly relied upon to perform their contracts satisfactorily;

(2) for contractors who are in a satisfactory financial condition and operating profitably, where the items involved are regularly produced by the contractor and the contract amounts are within the normal sales volume of the contractor. In such cases, the financial evaluation may consist of scrutiny of the contractor's balance sheets and operating statements. In doubtful cases, the financial analysis would have to be as detailed as necessary to fit the circumstances.

(b) Obtaining and analyzing data on a contractor's financial capability is of particular importance when:

(1) the contractor is a new supplier,

(2) the contractor has not supplied the item (or a similar item) within the preceding twelve months,

(3) the contractor is a newly organized concern,

(4) the contractor is on a list requiring pre-award clearances or special clearance prior to award,

(5) the contractor is on any current list indicating current or post contract defaults or delinquencies,

(6) the contractor is known to be involved in performance difficulties as a supplier or subcontractor for private customers on Government or commercial work,

(7) the contractor is listed on the Consolidated List of Contractors Indebted to the Government (Hold-Up List), or,

(8) there are any facts or circumstances which support reasonable doubts as to the contractor's financial capability to perform.

**32.174 Appropriate Information.** The kinds of information and data that may be appropriate in particular cases are outlined below. Only those items which are appropriate to a particular case are required. The purpose of obtaining this data is to gain a full understanding of the propriety and reasonable necessity for contract financing, for evaluation of a contractor's ability to perform contracts without loss to the Government, and for informed judgment related to terms, conditions and protective provisions that may be appropriate for the protection of the Government.

(a) Balance sheet and income statement for the most recent fiscal year prepared and certified by an independent public accountant (including his comments, if any), and, if available, similar financial data for the two previous years; latest available interim balance sheet and income statement of the current fiscal year; a separate statement of amounts of defense and commercial sales. If audited reports are not available, then corresponding statements should be submitted, certified by an authorized officer, partner, or individual proprietor as truly and fully setting forth the financial condition and operating results of the applicant; if a proprietorship, partnership or joint venture, personal financial statements of proprietor, partners, or members of joint venture and description of individual liabilities of partners or members of joint venture on contracts of partnership or joint venture;

(b) Summary history of contractor and its principal management personnel, indicating particularly any past insolvencies of the contractor or a predecessor or of the officers, partners, or proprietors; also a description of its products or services;

(c) Statement of all affiliates of the contractor, showing financial interests of the contractor in affiliates and of affiliates in the contractor, and also mutual officers, directors and major stockholders or owners, and disclosing character and amount of business transactions with affiliates or with officers, directors, major stockholders or owners of the contractor or its affiliates; also, if a corporation, list of major stockholders, and shares held;

(d) Statement of compensation payable to each officer, partner, proprietor, and principal executive, and to each key employee receiving comparable compensation, including bonus, commission, and profit-sharing arrangements, together with similar data for the past two years; also past and projected dividends, unless obtained with (a) above;

(e) Schedule of principal contracts and orders on hand, showing defense orders and civilian orders separately, and showing face amounts, unfinished amounts, and unliquidated advance or progress payments, and also indicating bids outstanding and contemplated and explanation concerning contracts under negotiation;

(f) Cash forecast, showing estimated disbursements and receipts for the period or periods involved (see 32.174-1 and 32.174-2);

(g) Estimated income statements and estimated balance sheets (see 32.174-3);

(h) Comparison of past financial results with estimates previously furnished by the contractor;

(i) Credit agency ratings of the contractor, and, when significant, credit agency ratings of principal subcontractors and of principal business customers (defense and commercial) of the contractor;

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(j) Existing and contemplated credit or financing arrangements, names of parties and relationship, if any, to contractor, amounts available or to be available, periods of availability, and required or contemplated payments, including (1) loans and credits, (2) advances and progress payments, (3) projected equity capital increases, (4) deferred trade credit, if any, (5) creditor subordinations or standbys, and (6) mortgages, liens, pledges, assignments, conditional sales, lease/purchases, hypothecations, and other encumbrances or security arrangements, both existing and contemplated;

(k) Status of all tax accounts, particularly Federal income, excise, and withholding taxes, and social security taxes or contributions (including verification with Internal Revenue Service, when appropriate) with special attention to the matter of Federal tax delinquencies (which are covered by the lien and right of distraint and levy provided by Sections 6321 and 6331 of the Internal Revenue Code);

(l) Appropriate information, explanation and schedules to indicate (1) leases, deferred purchased arrangements, and patent or royalty arrangements, outlining terms and showing relationship, if any, of other parties to the contractor, (2) insurance maintained and to be maintained, (3) contemplated capital expenditures, debt reduction or retirement, and acquisitions of capital stock, (4) delinquencies on contracts, subcontracts or purchase orders, and status thereof, (5) pending or anticipated liability for contract price refunds, or for renegotiation, or for other Government claims, (6) anticipated losses on contracts, (7) contingent liabilities, including those on endorsements, guarantees, warranties, surety bonds, and material litigation pending or threatened, (8) aging and collectibility of accounts and notes receivable, status of disputed receivables, identification of any amounts included in receivables but not currently due and payable, (9) obsolescence of inventory and method of valuing inventory, (10) aging of accounts and notes payable, identifying major creditors and interest rates and other charges, if any, and status of significant disputed items, (11) adequacy of reserves for depreciation, (12) analysis of surplus;

(m) Significant ratios such as (1) inventory to annual sales, (2) inventory to current assets, (3) liquid assets to current assets, (4) liquid assets to current liabilities, (5) current assets to current liabilities, and (6) net worth to debt;

(n) Comments and opinion of audit agency concerning contractor's accounting system and controls, and available audit agency analysis of important elements of financial statements or projections;

(o) Other facts that may be appropriate for the purposes stated at the beginning of this 32.174.

**32.174-1 Cash Flow Forecast and Estimated Financial Statements.** In doubtful cases, an estimated cash budget (Cash Flow Forecast) and related estimated income statements and estimated balance sheets prepared by the contractor, will be very useful for the purpose of arriving at an informed judgement as to the cash requirements (both for the contract and for the contractor's other activities), cash receipts for the contract period, and cash or credit needed to supply any excess or projected expenditures over projected receipts. When considered useful or necessary, such estimates should be requested from the prospective contractor, analyzed by financial personnel, and discussed to the extent necessary or appropriate with the prospective contractor. Many contractors will have such projects readily available, perhaps not including estimated balance sheets. The failure of the contractor to have prepared such estimates, or resistance to their preparation, or difficulties and delays in preparation, or poor quality of the projections, or the use of unreasonable or unrealistic assumptions in their preparation, may well constitute warning signals that the company's planning has been insufficient and that significant financial troubles may be encountered during the contemplated period of contract performance.

**32.174-2 Realistic Assumptions.** Cash forecasts can, of course, be no more reliable and representative of probable financial developments than the assumptions on which these forecasts are based. Each cash forecast and related projection should disclose the important underlying assumptions. Most important of these assumptions are the--

- (1) estimated amounts and timing of purchases of materials, parts, components, subassemblies, services, and payments therefor;
- (2) estimated amounts and timing of purchases of machinery and equipment, other production or test facilities, other fixed assets, and purchases or production of special tooling, and payments therefore;
- (3) schedule of fixed cash charges, such as debt installments, interest, rentals and taxes;
- (4) projected manufacturing and production schedules;
- (5) projected shipments, or delivery acceptances;
- (6) estimated amounts and timing of billings to customers (including progress payments), and customer payments;
- (7) estimated amounts and timing of cash receipts from lenders or other credit sources, and liquidation of loans; and
- (8) estimated amounts and timing of cash receipts from other sources.

The assumptions underlying cash forecasts should be checked for reasonableness and realism--with the contractor, Government personnel responsible in the areas of engineering, production scheduling, cost and price analysis, and with others (including prospective supply, subcontract, and loan or credit sources)--as may be prudent in the circumstances of the case.

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**32.174-3 Estimated Income Statements and Balance Sheets.** The cash budget or cash forecast does not show anticipated profit or loss, and is limited to the forecast of movements within a company's cash account. The concurrent submission of an estimated income statement covering the same period serves to tie in the anticipated cash transactions with the estimated sales and expense activity, and culminates in the estimated balance sheet position. The estimated income statement also can serve as a guide for evaluating the company's projections with respect to sales volume, cost of goods sold, gross profit and net profit in relation to the known results of past performance.

**32.175 Interpretations.** It is important that these regulations and contract clauses be applied fairly and uniformly for all contractors. When a serious question of interpretation or application of these regulations arises, an advance opinion should be obtained from the procurement policy office at the headquarters of the Department primarily interested. If the circumstances do not reasonably permit requesting an advance opinion, report of an interpretation made should be made to the appropriate Departmental headquarters procurement policy office. That office should obtain the views of interested offices of the other Departments, including the contract financing offices (32.108). When questions submitted are considered to be of importance in the general interest of uniformity and of fair and effective administration of these regulations, appropriate revision of these regulations will be considered. Changes and additions to these regulations will be developed by the Contract Finance Committee (see 32.170-3(b) and 32.171).

**PART 32--CONTRACT FINANCING**  
**SUBPART 32.3--LOAN GUARANTEES FOR DEFENSE PRODUCTION**

**32.302 Authority.**

(a) The Department of the Army, the Department of the Navy, the Department of the Air Force, and the Defense Logistics Agency, among others, are designated as "guaranteeing agencies" within the Department of Defense.

**32.304 Procedures.****32.304-1 Application for Guarantee.**

(a) Guaranteed loans will be used primarily for working capital purposes and not for facilities expansion. Guarantees are not precluded where a relatively small portion of the loan might be used for facilities expansion of a minor or incidental nature, provided that the contractor's financial condition is such that the facilities expansion will not impair repayment of the guaranteed loan.

**32.304-2 Certificate of Eligibility.**

(a) Contracting officers are expected to immediately take appropriate steps for the determination of eligibility. Their findings and report, including certificate of eligibility where appropriate, should be submitted to the contract financing office within the guaranteeing agency.

(c) The Department that has the preponderance of interest on the basis of the dollar amount of unfilled and unpaid balances (without regard to the existence of progress payments and without regard to the issuance or nonissuance of certificates of eligibility on particular contracts) on contracts and subcontracts will be the guaranteeing agency. Contracts with advance payments will be included only if the guaranteed loan will liquidate the advance payment. Service procurement contracts are deemed those of the purchasing department. If the application is approved and a guarantee agreement is executed, the guaranteeing agency will bear all losses and expenses and receive all revenues under the guarantee. In exceptional cases, one Department may act for others through a sharing arrangement. If preponderance of interest should shift to another Department during the guaranteed loan period, actions on requests for increases in amount or extension of maturity will ordinarily be taken by the Department with the current preponderance of interest. However, the new guarantee should simply replace the former guarantee so as not to disturb or impair any security for the existing loan. The existing loan agreement and collateral security instruments should be appropriately revised. The contract financing office of the Department which authorized the existing guaranteed loan will transfer

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the file to the contract financing office of the Department with the current preponderance of interest. If the loan is in distress with foreseeable losses, and the purpose of the request is for the purpose of orderly liquidation of the loan to reduce the amount of the loss, the Department which guaranteed the loan will take action.

**32.304-70 Guaranteed Loans for an Extended Period of Time.** It is not the policy of the Department of Defense to continue furnishing assistance in the form of guaranteed loans over an extended period of time unless it is reasonably necessary to obtain required products.

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**PART 32--CONTRACT FINANCING  
SUBPART 32.4--ADVANCE PAYMENTS**

**32.404 Exclusions.**

(a)(9) In accordance with 10 U.S.C. 503, FAR Subpart 32.4 does not apply to advance payments for advertising for military recruitment in high school and college publications not to exceed \$500 under any single contract.

**32.409 Contracting Officer Action.**

**32.409-1 Recommendation for Approval.** The departmental contract financing office (see 32.108) shall prepare the documents required by FAR 32.409-1(e)&(f). This is necessary to assure uniform application of this subpart as required by FAR 32.402(e)(1).

**32.410 Findings, Determination, and Authorization.**

(a) Modifications to incorporate special facts and circumstances are permitted.

(b) In cases where the procedure for advance payments without a special bank account is to be used in accordance with 32.470, insert the following paragraph instead of paragraph (a)(4) of the Findings, Determination, and Authorization for Advance Payments at FAR 32.410.

"(4) The proposed advance payment clause contains appropriate provisions for the protection of the Government, as security for advance payments. These include provisions that the outstanding advance payments will be liquidated from cost reimbursements as they become due the contractor. Such security is deemed to be adequate."

**32.412 Contract Clause.**

(70) The contracting office shall insert the clause at 52.232-7001, Advance Payments Pool, in any contract that will be subject to the terms of an advance payment pool agreement with a nonprofit educational or research and development institution. Normally this will include all cost reimbursement type contracts with the particular institution.

(71) The contracting office shall insert the clause at 52.232-7002, Disposition of Payment, in contracts when the payments under the contract are to be made by a disbursing office other than the disbursing office designated in the advance payment pool agreement.

**32.470 Procedure for Advance Payments to Nonprofit Educational and Research and Development Institutions Without a Special Bank Account.**

In view of the nonprofit position of educational and certain research institutions and the Government objective of strengthening

the research capabilities of these institutions, interest-free advance payments in reasonable amounts may be authorized, when prudent and practical, to finance experimental, research and development contracts. The advance payments may be periodically made directly to the institutions without the use of either a special bank account or letter of credit under the procedure described below:

(a) The contracting officer shall advise the departmental contract financing office upon the award of any cost-type contract to an institution with an advance payment pool arrangement (see 32.471).

(b) The agreement set forth at 32.472 will be used. These arrangements will allow advance payments directly to the contractor to meet its contractual cash needs for the shortest practical periods of time to cover contract performance. The contractor shall periodically determine its cash requirements for contract(s) performance and submit requests for advance payments, in an acceptable format with supporting information as prescribed by the administering office, to the designated approving official who shall determine the necessity for the advance payment. If the approving official concurs with the amount of advance payment requested by the contractor, the request will be promptly approved and forwarded to the designated disbursing office for payment. In the event that the approving official determines that the amount of advance payments requested for the specified period is in excess of the needs, the request will be approved and forwarded to the disbursing office for payment of only the amount needed. The approving official shall act promptly, in accordance with the contract or pool agreement terms and departmental procedures, to resolve any disagreement on the unapproved portion of the request.

(c) The contractor shall submit cost reimbursement vouchers on a monthly basis for the contract(s) being financed by advance payments to the disbursing office designated in the contract. The proceeds from the payments that would otherwise be due the contractor shall be applied in liquidation of the outstanding advance payments. If the proceeds exceed the outstanding advance payments, the remaining balance shall be paid to the contractor.

(d) The advance payments shall be requested, approved, and paid based on estimates. There may be a variance between the contractor's estimated and actual cash requirements for each period. These variances represent over-or-under financing by the Government and could become significant. Consequently, these variances must be identified and taken into consideration with each new request for an advance payment. This is a joint responsibility of the contractor and the approving official.

#### **32.471 Pooled Advance Payments.**

An advance payment pool arrangement is an instrument for conveniently financing the performance of more than one contract, held by a single contractor. The agreement is separate from the contracts

financed under it. It is especially convenient for the financing of cost-type contracts with nonprofit educational or research institutions for experimental, or research and development work, when several contracts or a series of contracts require financing by advance payments. When advance payments are appropriate, pooled advance payments may also be used to finance performance of other types of contracts held by a single contractor. They may be established without regard to the number of appropriations involved, and regardless of the fact that contracts affected may be those of more than one DoD purchasing office, DoD procuring activity, or Military Department. If more convenient or otherwise preferable, there also may be more than one advance payment pool agreement in force at the same time with a single contractor, designed separately to finance contracts of the Military Departments respectively concerned, or of one or more DoD procuring activities respectively. Advance payment pool agreements may be established under the statutes mentioned in FAR 32.401 and will be in accordance with the procedure that follows for arrangements with nonprofit institutions. Advance payment pool arrangements with other than nonprofit organizations shall be in accordance with the specific directions of the departmental contract financing office.

#### **32.471-1 Distinction Between Pool Contracts and Designated Pool Contracts.**

An advance payment pool agreement may cover a broad area of a contractor's financial needs rather than piecemeal segments related to separate contracts. A pool agreement is based upon the contractor's financing requirements for a group of DoD contracts to be performed at the same time. The monetary requirements for the group of contracts are considered in fixing the maximum dollar amount for the advance payment pool agreement. Advances are normally not made on each separate contract, but can be made on and charged against one or more contracts, so as to supply the monetary requirements of smaller contracts included in the advance payment pool. A contract to which the advance payments are charged is called a "designated pool contract." All other contracts financed by the pool agreement are called "pool contracts."

#### **32.471-2 Advance Payment Pool Agreement - Special Features.**

The principal features distinguishing an advance payment pool agreement from an advance payment provision affecting only a single contract are:

- (a) The advance payment pool agreement specifies one or more designated pool contracts, and provides for substitution from time to time of new or different contracts as the designated pool contract(s);

(c) The advance payment pool agreement defines the contracts included as pool contracts, and provides for inclusion of them as they are awarded;

(d) All payments under the pool contracts and designated pool contracts are made into a special bank account, except where the procedure for advance payments without a special bank account is to be used in accordance with 32.409-3 and 32.470. Where a special bank account is not used, payments otherwise due the contractor are applied in liquidation of the outstanding advance payments; and

(e) The appropriate provisions of the advance payment clause are made applicable to all pool contracts, including the designated pool contracts.

#### **32.471-3 Liquidation - Designated Pool Contracts - Administering Office.**

It is imperative for each advance payment pool that effective arrangements be made to ensure that the advances outstanding do not exceed the amount authorized in the advance payment pool agreement and that timely liquidation is accomplished. For each pool agreement, there shall be a single administering office, and to the extent possible, there should be a single disbursing office for all of the contracts in the pool, especially those contracts which are designated pool contracts.

#### **32.471-4 Advance Payment Pool - Understandings.**

Advance payment pools including contracts of more than one Military Department require approval from the contract financing office of each department concerned. The following guidance is provided:

(a) Requests to establish an advance payment pool agreement may be initiated by the contractor, the contracting officer, chief of a procuring activity, or at Departmental headquarters.

(b) When the advance payment pool includes contracts of more than one Military Department, the authorizing Department should be the one having a preponderant interest in the contractor's unfinished contracts. The Military Department with the preponderant interest is the Department with the largest dollar value of the contractor's unfinished contracts. Possible exceptions to the preponderance principle are cases in which it would be more convenient to use a relatively large long-term contract of a nonpreponderant Department as the designated pool contract, or where it is reasonably expected that preponderance will shift during the term of the advance payment pool agreement.

(c) Situations may occur in which the remaining payments available on pool contracts are not sufficient to liquidate the outstanding advance. These circumstances will not affect the normal practice of offsetting mutual debits and credits. If there is only one open designated pool contract, the entire advance payment loss should

fall on that contract. If there is more than one open designated pool contract on which advance payments remain outstanding after adjustment for debits and credits under each separate contract, the advance payment loss (insofar as contracts of two or more Military Departments are involved) will fall on all of those designated pool contracts, in proportion to the contract prices of the designated pool contracts.

(d) Normally, records will not be maintained to show separately the amount of advance payments invested in each one of the separate contracts. The keeping of such records is unnecessary, and would not be consistent with the purposes of advance payment pools.

### 32.472 Agreement for Advance Payments Without Special Bank Account.

An agreement with a nonprofit educational or research and development institution for pooled advance payments without a special bank account is constructed by making the following changes to the Advance Payments clause at 52.232-12.

(a) Change the clause title to "Advance Payment Pool Agreement Without Special Bank Account."

(b) Throughout the clause text: Change all occurrences of the word "contract" to "agreement."

(c) Add the following preamble immediately below the title:

"This agreement is entered into this \_\_\_\_ day of \_\_\_\_\_, 19\_\_ between the United States of America (the government), represented by \_\_\_\_\_, and

(insert institution name and appropriate identification information) (hereinafter referred to as the "contractor")."

(d) In paragraph "(a)(2)," in the blank space left for the amount, insert the following:

". . . the amount stated in the Designations and Determinations paragraph hereof or the aggregate of the total unpaid designated pool contracts' prices, whichever is less."

(e) Delete paragraph (b) and insert the following:

"(b) Amount of Advance Payments.

(1) The Contractor shall determine the estimated amount of advance payment(s) necessary to meet the requirements of paragraph (c) herein entitled "Use of Funds" to cover performance of the pool contract(s). This determination shall be pursuant to written instructions provided by the Administering Office (see Designations and Determinations paragraph herein) relative to the (i) shortest practical period for which advance payments will be provided, (ii) format and frequency of requests for advance payments, and (iii) data required in support of each request. The estimate shall be adjusted for the amount by which actual cash expenditures for prior period performance of the pool contract(s) exceeded or was less than the advance payments provided for such performance. The Contractor .

shall submit its estimate and supporting data in a request for advance payment(s) to the Approving Official designated in writing by the Administering Office for advance payments. The request should be submitted sufficiently early to permit review, approval, and disbursement of the required advance payment(s) by the time the funds are actually needed by the Contractor.

(2) The Approving Official will review the Contractor's advance payment requirements to determine the reasonableness thereof, and if concurrence is given, the request will be approved and the Disbursing Office designated (see Designations and Determinations paragraph herein) will be notified by the Approving Official to make payment. If the Approving Official determines that the advance payment requested by the Contractor is in excess of cash requirements for performance of the pool contracts during the specified period of time, the Approving Official will approve an amount based on such determination and notify the Disbursing Office of the reduced amount. Upon any such reduction, the Approving Official will immediately notify the Administering Office for this advance payment pool agreement in writing, with a copy to the Contractor, of the amount requested, the amount approved, and the reasons for reduction. The Administering Office will determine whether additional funds will be advanced to the Contractor.

(3) Upon notification of the approved request, the Disbursing Office will draw a Treasury check payable to the Contractor for the amount authorized by the Approving Official and mail such check to the Contractor in time to be received on or about the date the funds are required for contract performance."

(f) Delete paragraph (c) and insert the following:

"(c) Use of Funds. Advance payments hereunder are to be used by the Contractor solely for the purpose of making payments for direct materials, direct labor, and administrative and overhead expenses allowable in accordance with the provisions of the pool contracts, or for the purpose of reimbursing the Contractor for such payments. Any interpretation required as to the proper use of funds shall be made in writing by the Administering Office."

(g) Delete the last sentence of paragraph (d).

(h) Delete paragraph (e) and insert the following:

"(e) Liquidation. The contractor will submit monthly cost reimbursement vouchers in accordance with the payment provisions of the pool contracts. The Government shall withhold payments of such vouchers due the Contractor and apply the amounts withheld against the Contractor's obligation to repay advance payments made hereunder and interest charges thereon until such advance payments and interest charges shall have been fully liquidated. Upon completion or termination of the advance payment pool agreement, the balance of liquidated advance payments shall be deducted from any amount otherwise due or which may become due to the Contractor from the Government, and any deficiency shall be paid by the Contractor to the Government upon demand."

(i) Add the following to the last sentence of paragraph (f)(2):  
". . . except as provided in the Liquidation and Default paragraphs herein."

(j) Add the following sentence at the end of paragraph (f)(2):  
"If interest is required, the interest will be calculated in accordance with paragraph (f) herein."

(k) Delete from paragraph (f)(3):  
". . . the higher of (i) the published prime rate of the banking institution (depository) in which the special bank account is established or (ii) . . ."

(l) Delete paragraphs (g) and (h).

(m) Change paragraph letters (i) through (p) to (g) through (n).

(n) Delete old paragraph (m) and insert the following:

"(k) Information and Access to Records. The Contractor shall furnish to the administering office (1) monthly or at other intervals as required, signed or certified balance sheets and profit and loss statements together; and (2) if requested, other information concerning the operation of the Contractor's business. The Contractor shall provide the authorized Government representatives proper facilities for inspection of the Contractor's books, records, and accounts."

(o) Add the following new paragraphs:

"(o) Designations and Determinations:

(1) Amount. The amount of advance payments at any time outstanding shall not exceed \$ \_\_\_\_\_ or the aggregate of the total undisbursed obligation of the designated pool contract, whichever is less.

(2) Administering Office. The office administering advance payments: \_\_\_\_\_

(3) Disbursing Office. The office making advance payments under this Agreement: \_\_\_\_\_

(4) Approving Office. The approving office shall be \_\_\_\_\_"

(p) Limiting Date. Advance payments made hereunder are to finance all pool contracts subject to this Agreement, including amendments issued thereunder which result in increasing the contract price, that are executed on or before \_\_\_\_\_ (insert a date, normally not more than two years in the future)."

(p) Add the following at the conclusion of the agreement:

"Signatures and official titles:

For the Contractor:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_ (name)  
\_\_\_\_\_ (title)  
\_\_\_\_\_ (date)

For the United States:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_ (name)  
\_\_\_\_\_ (title)  
\_\_\_\_\_ (date)"

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**PART 32--CONTRACT FINANCING  
SUBPART 32.5--PROGRESS PAYMENTS BASED ON COSTS**

**32.501 General.****32.501-1 Customary Progress Payment Rates.**

(a) The customary progress payment rate applicable to Foreign Military Sales requirements is 95% for other than small businesses, and 100% for small businesses. The customary progress payment rate for flexible progress payments is the rate determined by use of the CASH II computer program in accordance with the requirements of 32.502-1(71). Except for contracts which contain both U.S. and FMS requirements, no more than one progress payment rate or liquidation rate is applicable to a contract at any point in time.

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**32.501-2 Unusual Progress Payments.**

(a) Contracting officers shall not modify contracts to authorize unliquidated unusual progress payments in excess of \$25,000,000 without the prior written consent of the Office of The Assistant Secretary of Defense (Acquisition and Logistics). All other unusual progress payment provisions shall be coordinated by the departmental contract financing office, with the Department of Defense Contract Finance Committee.

**32.501-3 Contract Price.**

(b) For purposes of making progress payments, the contract price may exceed the funds obligated under the contract if the contract contains an appropriate limitation of funds clause. In such cases, the progress payments shall be limited to the lesser of the applicable percentage of the contract price, or 100% of the funds obligated.

**32.502 Preaward Matters.****32.502-1 Use of Customary Progress Payments.****(70) Customary FMS Progress Payments.**

(1) FMS progress payments shall be applicable to Department of Defense acquisitions on behalf of foreign governments or international organizations pursuant to Section 22 of the Arms Export Control Act (FMS requirements).

(2) FMS progress payments are not applicable to:

- (i) Acquisitions for replenishment of U.S. Government inventories or stocks, and
- (ii) Acquisitions made under DoD cooperative logistic support arrangements.

**(71) Customary Flexible Progress Payments.**

(1) Paying progress payments assists in financing a contractor's performance and reduces the contractor's investment in its work in

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process inventory. The actual investment held by a contractor in work in process inventory is influenced by a number of factors in addition to progress payments, such as delivery schedules, cash management practices, and Government payment practices. Progress payment amounts that are determined by using uniform, standard progress payment rates (i.e., 90% or 95%) are insensitive to these other factors influencing investment and, as a consequence, result in investments by contractors in work in process inventory that vary among contractors and across contracts; on the other hand, flexible progress payment rates (expressed as a percentage that will be applied to costs to determine the amount payable as a progress payment in the same manner as uniform, standard progress payment rates) are designed to tailor more closely the progress payment rate to the cash needs for financing performance of a particular contractor for a given contract.

(2) For flexible progress payments, cash needs are measured and projected in relation to investment underlying the work in process inventory over the life of the contract. Total investment is measured by a weighted average of total costs paid by the contractor to complete performance of the contract, and the contractor's investment is the weighted average of the amount not paid by the Government. The Department of Defense (DoD), as a matter of policy, has concluded that a contractor should retain at least a 5% investment in work in process inventory over the life of the contract. Accordingly, the DoD will make progress payments at a rate (expressed as a whole number) that is the highest rate which yields a corresponding investment by the contractor in work in process inventory of not less than 5%. This progress payment rate is to be determined by the DoD Cash Flow Computer Model. In no event will the progress payment rate be greater than 100%, or less than the uniform, standard progress payment rate that would have been applied to the contract absent flexible progress payments.

(3) Contracting officers shall use a flexible progress payment rate in lieu of the uniform standard rates if:

(1) The contractor requests the use of flexible progress payments rates,

(ii) The contractor agrees to the requirements of this section, and

(iii) The criteria in paragraph (5) below are met.

(4) The flexible progress payment rate shall be determined through application of the DoD Cash Flow Computer Model, available to contracting officers on the COPPER IMPACT computer time sharing network under the computer file name "CASH II." The model takes into account key cash flow factors, such as contract cost profile, delivery schedules, subcontractor progress payments, liquidation rates, and payment/reimbursement cycles. Operating instructions and cash flow data requirements are retrievable within the model in a conversational

mode. Contractors may obtain copies of the DoD Cash Flow Computer Model User's Guide from the Defense Technical Information Center, Building 5, Cameron Station, Alexandria, VA 22314. Contracting officers shall not grant contractor access to Government leased COPPER IMPACT time sharing computer network.

(5) Contractors who submit certified cost or pricing data, as defined in FAR 15.804-2, for negotiated fixed-price contracts in excess of \$1 million may request flexible progress payments. Formally advertised contracts are not eligible for flexible progress payments. Flexible progress payments are not available for contracts awarded and performed entirely outside of the United States, its possessions and territories.

(6) Contractors will furnish to the contracting officer cash flow data in the form and context specified by the DoD Cash Flow Computer Model. These data include: actual and projected incurred cost broken down by element of cost and by month for the duration of the contract, float times for each element of cost, progress payment receipts and delivery payment receipts and associated contract prices and profit percentage. Contracting officers will verify the cash flow data in accordance with normal procedures used to verify contractor cost and pricing data. Administrative contracting officers are encouraged to establish advance agreements at contractor locations for float and payment lag which are common to several contracts. Such agreements should be established when administratively practical.

(7) A redetermination of the flexible progress payment rate shall be made upon the request of the Government or contractor if measurement of the contractor's cumulative investment in work in process inventory using actual and projected cash flow data indicates an investment level above 7% or below 3%. The cash flow computer model is designed to generate a progress payment rate that yields a target investment of 5%, based on a weighted average. Accordingly, there should normally be no need to request actual and projected contract cash flow data unless delivery schedules are revised, Government progress payment lag times are substantially changed from those used in the establishment of the progress payment rate, or substantial new work (e.g., option) is added to the contract.

(8) As noted in FAR 32.504, the standards for progress payments to subcontractors ought to be the same as those applicable to prime contractors. Accordingly, subcontractors who request a flexible progress payment rate, meet the criteria in paragraph (5) above and agree to the requirements of this section are to receive a flexible progress payment rate. The subcontract flexible progress payment rate will be determined by the prime contractor without regard to the progress payment rate in the prime contract. The DoD Cash Flow Computer Model and associated procedures will be used by the prime contractor and a reasonable review of the cash flow data provided by the subcontractor will be made.

(9) When flexible progress payments are contemplated for use on a definitive contract superseding a letter contract or an unpriced BOA order, the applicable standard progress payment clause at FAR 52.232-16 shall be used until definitization.

**32.502-2 Contract Finance Office Clearance.** Deviation from the Progress Payment clause, policy and procedures prescribed in FAR Part 32 and this Supplement shall be authorized only by the Office of The Assistant Secretary of Defense (Acquisition and Logistics) in accordance with 32.171.

**32.502-4 Contract Clauses.**

(70) The contracting officer shall insert the clause at 52.232-7003, Progress Payments for Foreign Military Sales Acquisitions, in any contract that provides for progress payments and contains FMS requirements.

(71) The contracting officer shall insert the clause at 52.232-7004, Flexible Progress Payments, when a flexible progress payment rate is used in the contract.

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**32.503 Postaward Matters.**

**32.503-1 Contractor Requests.** Subject to the specific requirements of agency procedures, contractor requests for progress payments may be submitted by computer generated equivalents of the Standard Form 1443.

**32.503-6 Suspension or Reduction of Payments.**

(g) Loss Contracts.

(70) Loss Ratio Adjustment Procedures. The following procedures shall be followed whenever the adjustments required by FAR 32.503-6(f) and (g) are made;

(i) Except as provided in paragraph (ii) below, the loss ratio adjustment shall be calculated by the contracting officer using the procedures in FAR 32.503-6(g) by preparation of a supplementary analysis to the contractor's request for progress payments;

(ii) The Contractor may be requested to prepare the supplementary analysis as an attachment to the progress payment request, when the contracting officer determines, after a review, that the contractor's methods of estimating the Costs to Complete are reliable, accurate, and not susceptible to improper influences, prejudicial to the Government's interests; and

(iii) In order to maintain an audit trail, and permit verification of calculations, the loss ratio adjustment shall not be made by alteration or replacement of the data on the contractor's original request for progress payment (SF 1443 or computer generated equivalent).

**PART 32--CONTRACT FINANCING  
SUBPART 32.6--CONTRACT DEBTS**

**32.600 Scope.** This subpart provides additional guidance for the collection of contract debts, the charging of interest thereon, the deferral of payments, the compromise and termination of claims, and the reporting of contractor bankruptcies.

**32.601 Definition.** Unless otherwise indicated in this subpart, the contract financing office within each military department and DLA is the "responsible official" for purposes of FAR Subpart 32.6.

**32.605 Responsibilities and Cooperation among Government Officials.**

(b) A disbursing officer has primary responsibility for determining the amount and collection of contract debt whenever overpayments or erroneous payments have been made. The disbursing officer also has such primary responsibility when the amounts due and dates for payment are fixed by the terms of the contract itself, and copy of such contract has been furnished to the disbursing officer with notice to collect as amounts become due. Disbursing officers are those officials designated to make payments under a contract or to receive payments of amounts due under a contract, including finance and accounting officers at installations where integrated accounting is in effect.

**32.606 Debt Determination and Collection.**

(c)(9)(vii) Upon transfer of a case to the contract financing office, the debt record maintained by a contracting officer shall be closed by appropriate reference to the date of transfer. When a disbursing officer is primarily responsible for collection, the record of the debt shall be maintained until payment or advice of collection is received. In all cases transferred to a contract financing office, that office shall establish and maintain an accounts receivable record showing all pertinent information relating to the debt, including an indebtedness and payment record reflecting current status, to be closed upon collection or compromise, or referral of the case to the General Accounting Office or to the Department of Justice.

(d) In the absence of a deferment agreement made by the contract financing office, a report of indebtedness will be made to the General Accounting Office upon failure to effect collection within a reasonable period, generally not to exceed 180 days from the date the debt is established.

(e) Before a debt is placed on the Hold-Up List (see 32.173), or before distribution of a new listing, the office undertaking to effect collection may sometimes request other offices having dealings with the contractor on other contracts, whether contracting officers or disbursing officers, to withhold payments on contracts, for application on the debt. Government personnel are expected to cooperate and assist in the fulfillment of such requests, giving due

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regard, however, to the effect of abrupt cessation of payments on the operations of the contractor, performance of the contracts, and the interest of the United States in such contracts. In the making of these requests to other offices, and in complying with such requests, care will be taken at all times to avoid overcollection or duplicate collection. Each check to liquidate indebtedness pursuant to such requests will be drawn payable to "(contractor's name (or office designated for contract administration))," and transmitted to the disbursing officer on the contract under which the indebtedness arose, and will be accompanied by a statement sufficient to identify the indebtedness to which it is to be applied. Appropriate notice of the deduction will be given to the contractor concerned, by the agency making the deduction.

### **32.610 Demand for Payment of Contract Debt.**

(a) Demands for payment of contract debts resulting from other than a termination for default shall be made by the office which first determines an amount due, whether it be the Contract Administration Office, the Contracting Office, the Disbursing Office, or the selling office/agency, and will be handled in accordance with the regulations of the department or agency to which that office is assigned. A copy of the demand shall be provided to the payment office cited in the contract and designated to receive payment. Demands for payment of contract debts resulting from a termination for default, e.g., excess costs, unliquidated progress payments, and liquidated damages, shall be made by the Procuring Contracting Officer and shall direct the debtor to make payment to an office of the Procuring Department. If this action will result in the payment being made to a payment office other than the one cited in the contract, the assigned ACO will issue a contract modification designating the new payment office.

### **32.613 Deferment of Collection.**

(70) Deferment requests will be forwarded as soon as possible to the contract financing office of the Department concerned. Such requests shall be supported by adequate identifying and explanatory information, including relevant memoranda and correspondence, accounting data, amounts and dates of any collections, name and location of disbursing office and, if applicable, the assignee, date of filing of appeal or of action with the Claims Court, information on hand concerning financial condition of the contractor, and recommendations for action on the deferment request. Incident to its review and action of a deferment or installment proposal, the contract financing office may request additional information, as well as other assistance needed from the transmitting office. Such requested information and assistance will be furnished promptly so that final action on the proposed deferment or installment may be taken by the contract financing office without unnecessary delay. Whenever deemed appropriate by the contract financing office, it may deal directly with the contractor concerning collection or deferment of the debt.

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(71) When the contract financing office enters into a deferral agreement or a compromise, it will furnish copies to the appropriate contracting officer and disbursing officer when deemed necessary.

(72) When the contract financing office denies a deferral request, or does not reach agreement with a contractor on a deferment, it will give timely notice to the appropriate contracting officer when deemed necessary.

### **32.614 Interest.**

#### **32.614-1 Interest Charges.**

(c) The interest rates established by the Secretary of the Treasury will be published in the Federal Register every 6 months. The current rate may also be obtained from the Departmental contract financing office representative.

**32.616 Compromise Actions.** Department of Defense authority under the cited statute and joint regulations has been delegated to the Departments. Within each Department, for those debts covered by this subpart authority to act in conformity to the cited statute and joint regulations has been delegated to the contract financing office.

#### **32.617 Contract Clause.**

(a)(7) The following further exceptions have been established:

(i) contracts for instructions of military personnel or ROTC personnel at civilian schools, colleges, and universities;

(ii) basic agreements with telephone companies, under which communications services and facilities will be ordered, and purchases under such agreements; and

(iii) transportation contracts with common carriers for common carrier services, e.g., common carrier transportation services procured by transportation requests, transportation warrants, bills of lading, and similar transportation forms.

(70) Contractors and contracts mentioned in FAR 32.617(a)(2) through (5), and other contractors in exceptional circumstances, may be exempted from the administrative interest charges required by this subpart when so agreed by the DoD Contract Finance Committee, with the approval of the Assistant Secretary of Defense (Acquisition and Logistics) or his representative.

#### **32.670 Transfer of Responsibility for Debt Collection.**

(a) Transfer of the debt case will be made to the contract financing office upon the expiration of 45 days without full collection after the date of initial demand, whether or not postponement has been requested. Debt cases under contracts terminated for default shall be transferred to the contract financing office of the Procuring Department. Debt cases transferred to the . . .

contract financing office of the Procuring Department under contracts terminated for default shall not include that portion of a debt related to actions where a disbursing officer has primary responsibility. All debt cases where the disbursing officer has primary responsibility shall be transferred to the contract financing office of the disbursing office's department. Other types of debt cases shall be transferred to the contract financing office or other office of the Department which first determines an amount to be due in accordance with the regulations of that Department.

(b) The transfers required above will not be made for amounts less than \$600.00. However, it is incumbent on contracting officers and disbursing officers to effect collection whenever and by such means as are practicable.

(c) The contract financing office of each military department shall take appropriate actions to effect collection of debts referred to it. This includes administration of deferment agreements; causing debts to be listed on the consolidated list of contractors indebted to the United States, commonly known as the "Hold-Up List;" to remove names from the "Hold-Up List;" to determine administrative uncollectibility; and to refer debts to the General Accounting Office or the Department of Justice as appropriate. Within each Department, no arrangement for installment or deferral of payments may be made without the approval of the contract financing office. Acting in conformity to the standards stated in this subpart, those offices may approve or deny deferment proposals transmitted to them or made directly to them by contractors, or approve such proposals on prescribed conditions.

(d) Responsibility for assuring effective administration in accordance with this subpart shall be in the Assistant Secretary of Defense (Acquisition and Logistics). Responsibility for effective administration under this subpart in each Department shall be in the Under or Assistant Secretary, or other designated official, responsible for the comptroller function. The DoD Contract Finance Committee shall advise and assist the Assistant Secretary of Defense (Acquisition and Logistics) in assuring proper application of policies and the development of procedures hereunder, and in the formulation of such further instructions on this subject as may appear desirable. That Committee is responsible for this section and will develop and promulgate herein supplemental instructions on this subject.

**32.671 Bankruptcy Reporting.** For those debts covered by this subpart, claims in bankruptcy, insolvency, or in proceedings for reorganization or rearrangement will be furnished to the Department of Justice. These claims are (a) those which have been transferred to a contract financing office; (b) those on their way to a contract financing office at inception of bankruptcy or insolvency proceedings;



(c) those pending and not forwarded to a contract financing office at inception of bankruptcy or insolvency proceedings; and (d) those which are the consequence of bankruptcy or insolvency proceedings.

Information on a bankruptcy, insolvency, reorganization or rearrangement will be provided as soon as possible by the office of origin of a debt to that office within a Department designated to receive such information. Proof of claim, with pertinent supporting data and documentation shall be furnished to the Department of Justice by the contract financing office or by such other office as may be designated within a Department. All claims arising under the same contract will be filed by the procuring department which awarded the contract. Information, reports, and proof of claim under this paragraph are not expected on debts of less than \$600.

**DOD FAR SUPPLEMENT**

**PART 32--CONTRACT FINANCING  
SUBPART 32.7--CONTRACT FUNDING**

**32.705 Contract Clauses.**

**32.705-2 Clauses for Limitation of Cost or Funds.**

(a) When a contract is of the installment type, the clause at FAR 52.232-20, Limitation of Costs, may be appropriately modified.

(c) When a contract is of the installment type, the clause at FAR 52.232-22, Limitation of Funds, may be appropriately modified.

**PART 32--CONTRACT FINANCING  
SUBPART 32.8--ASSIGNMENT OF CLAIMS**

**32.803 Policies.**

(b) Only DOD contracts for personal services may prohibit the assignment of claims (see FAR 32.806(b) for appropriate clause).

(d) For purposes of DOD contracts, a national emergency is deemed to exist (see 50 U.S.C. 1651(a)(4) and (5)). Nevertheless, when Departments determine it is in the Government's interest, they may exclude the no set-off commitment (Alt. I) in accordance with Departmental procedures.

(e) The assignee shall forward to the administrative contracting officer, disbursing officer, and surety, if any, the notice and instrument of assignment in the number of copies indicated below:

(1) To the administrative contracting officer - a true copy of the instrument of assignment and an original and three copies of the notice of assignment. The administrative contracting officer shall acknowledge receipt by signing and dating all copies of the notice of assignment and shall--

(i) file the true copy of the instrument of assignment and the original of the notice in the contract file;

(ii) forward two copies of the notice to the disbursing officer designated in the contract to make payment;

(iii) return a copy of the notice to the assignee; and

(iv) advise the procuring contracting officer that the assignment has been made.

(2) To the surety or sureties, if any - a true copy of the instrument of assignment and an original and three copies of the notice of assignment. The surety shall return three acknowledged copies of the notice to the assignee who shall forward two copies to the disbursing officer designated in the contract.

(3) To the disbursing officer designated in the contract to make payment - a true copy of the instrument of assignment and an original and one copy of the notice of assignment. The disbursing officer shall acknowledge and return to the assignee the copy of the notice and shall file the true copy of the instrument and original notice.

**32.806 Contract Clauses.**

(a)(2) When the clause at FAR 52.232-23 is used, the contracting officer shall also insert Alternate I, unless excluded under FAR 32.803(d).

with the Determinations, Findings and Authorization for advance payments dated \_\_\_\_\_. Payments made pursuant to this clause shall be governed by the terms and conditions of the Advance Payment Pool Agreement, as it may be amended from time to time, between the United States of America and \_\_\_\_\_ (insert the name fo the contractor), which agreement is hereby incorporated by reference with the same force and effect as though fully set forth herein.

(End of clause)

**52.232-7002 Disposition of Payments.** As prescribed at 32.412(71), insert the following clause:

**DISPOSITION OF PAYMENTS (APR 1984)**

Payment will be by a dual payee Treasury check drawn payable to the contractor or the \_\_\_\_\_ (insert name of the disbursing office designated in the advance payment pool agreement) and forwarded to the \_\_\_\_\_ (insert name of the disbursing office designated in the advance payment pool agreement) for appropriate disposition.

(End of clause)

**52.232-7003 Progress Payments for Foreign Military Sales Acquisitions.** As prescribed at 32.502-4(70), insert the following clause:

**PROGRESS PAYMENTS FOR FOREIGN MILITARY SALES ACQUISITIONS (APR 1984)**

If this contract includes FMS requirements, the contractor shall submit progress payment requests in accordance with the following:

- (a) The contractor shall submit a separate progress payment request for each separate progress payment rate in this contract.
- (b) The contractor shall submit a supporting schedule showing the amount of each request distributed to each country's requirements in the contract. This schedule shall also show the contract line items and total prices thereof applicable to each separate progress payment rate.

(c) Each progress payment request shall:

- (1) Identify the contract requirements to which it applies, (i.e., FMS or U.S.).
- (2) Be calculated on the basis of the prices, costs (including estimated costs to complete), subcontractor progress payments, and progress payment liquidations of the contract requirements to which it applies. The contractor in preparing these requests shall distribute costs among contract line items and countries in a manner acceptable to the Administrative Contracting Officer.

(End of clause)

**DOD FAR SUPPLEMENT**

52.232-7004 Flexible Progress Payments. As prescribed at 32.502-4(71), insert the following clause:

**FLEXIBLE PROGRESS PAYMENTS (APR 1984)**

This contract is subject to flexible progress payment procedures. The progress payment rate of this contract is \_\_%, and this percentage applies in lieu of the uniform, standard progress payment rate and liquidation rate of the "Progress Payments" clause. The progress payment rate of this contract was determined by the DoD Cash Flow Computer Model, (dated \_\_\_\_\_), using five percent (5%) as the targeted rate for the Contractor's investment (as a weighted average of costs) in its work in process inventory over the life of the contract. If actual and projected cash flow data generated during performance of this contract reveal that the progress payment rate will result in an investment in work in process inventory by the Contractor in excess of seven percent (7%), or less than three percent (3%), the progress payment rate shall be redetermined by using the DoD Cash Flow Computer Model. Unless it contained an error, the version of the DoD Cash Flow Computer Model that was used initially in this contract will be used for any redetermination permitted by this clause. In no event will the progress payment rate be less than the uniform, standard progress payment rate that would have applied to this contract absent flexible progress payment procedures, and in no event will the progress payment rate be greater than one hundred percent (100%).

(End of clause)

52.232-7005  
52.232-7006  
52.232-7007

See  
DAR  
COUNCIL  
Letter

DOD FAR SUPPLEMENT

NOTES

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## Chapter C

### Cost Accounting Standards

1. Over the past decade Cost Accounting Standards (CAS) have become an important and controversial part of the acquisition process. The standards have had a major impact on the way defense contractors' estimate and account for costs on contracts. Contract administration office personnel need a basic understanding of the historical development, basic requirements, and structure of the standards.

2. The administration of CAS is primarily an ACO function. It is the ACO who must deem adequate the contractor's disclosure statement, monitor consistent application of CAS, and determine price adjustments for CAS changes and noncompliances.

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<u>Title</u>	<u>Page</u>	<u>Assignment</u>
1. CAS status	C-2	Read
2. List of Cost Accounting Standards	C-3	Read
3. CAS coverage rules	C-4 thru C-5	Read
4. Coverage rules class exercise	C-6	Review
5. CAS Program Requirement	C-7 thru C-11 (30.202-8)	Read
6. CAS Rules and Regulation	C-11(30.301) thru C-15 (30.302-4)	Review
7. CAS Rules and Regulation	C-15 (30.303) thru C-17 (30.307)	Read
8. CAS Administration	C-18 thru C-20	Read
9. CAS Contract Clauses	C-21 thru C-26	Review
10. DFAR 30.4	C-27	Read
11. Summary of each Cost Accounting Standard	C-28 thru C-47	INFO/REF

SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Cost Accounting Standards

TIME: 3.5 Hrs

OBJECTIVES: Understand the requirements and administration of the cost accounting standards.

SAMPLES OF BEHAVIOR:

- a. Comprehend the purpose and objectives of financial and cost accounting and the intent of the Cost Accounting Standards.
- b. Comprehend the history and current status of the Cost Accounting Standards.
- c. Know the types of contracts and contractors for which the cost accounting standards are applicable.
- c. Comprehend the intent of current and proposed standards.
- d. Understand the requirement and procedure for determining the adequacy and compliance of the Disclosure Statements.
- e. Understand the requirements and procedures for making price adjustments required by new standards, voluntary changes and non-compliance.

INSTRUCTIONAL METHODS: Lecture/Discussion  
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS: ACA Textbook

REQUIRED STUDENT PREPARATION: As defined in Chapter "C" of the ACA textbook.



### **Cost Accounting Standards (CAS) Status**

The CAS Board was created by Congress in 1970 to promulgate cost accounting standards to be followed by defense contractors and subcontractors under government contracts. The CAS Board published 19 standards but then ceased to function in September 1980 when Congress did not appropriate funds for Board operations. Subsequent legislative attempts by Congress to transfer the Board's authority to existing organizations were not successful. Consequently, no organization had the ability to grant waivers or to interpret and modify the standards.

In October 1983, the DoD General Counsel requested the Department of Justice's legal opinion on DoD authority to assume the CAS Board function. The Department of Justice responded in November 1983 that in its opinion DoD was "legally free to adopt, reject or grant exemptions to the CAS." Based on this legal opinion, DoD determined that the CAS have the status of regulations and should be included in the Federal Acquisition Regulation (FAR) to be administered and modified as appropriate through normal FAR rule-making procedures.

Subsequently, the CAS Policy Group (CASPG) was established under the DAR Council for the purpose of handling the newly acquired DoD CAS regulatory responsibilities. The CASPG is chaired by the Air Force and staffed by members of the services, DLA, NASA, DCAA, OASD(C), OASD(A&L), and GSA. The Policy Group is currently processing the CAS and the CAS Board rules and regulations through the FAR regulatory process with formal incorporation into the FAR after staffing and approval by the Civilian Agency Acquisition Council. In addition, the Group has prioritized a list of potential changes to the CAS and expects to have the most needed changes prepared by the time the standards are incorporated into the FAR. (HQ USAF/RDC-FAR, David Relly, AV 227-9441)

# COST ACCOUNTING STANDARDS

## CONCEPTS & PRINCIPLES

- 401 CONSISTENCY IN ESTIMATING, ACCUMULATING, AND REPORTING COSTS
- 402 CONSISTENCY IN ALLOCATING COSTS INCURRED FOR THE SAME PURPOSE
- 405 ACCOUNTING FOR UNALLOWABLES
- 406 COST ACCOUNTING PERIOD

## ALLOCATION OF COSTS TO CONTRACTS

- 403 ALLOCATION OF HOME OFFICE EXPENSE
- 407 USE OF STANDARD COST SYSTEMS
- 410 ALLOCATION OF BUSINESS UNIT G & A
- 414 COST OF MONEY
- 418 ALLOCATION OF DIRECT & INDIRECT COST

## IDENTIFICATION &

### ASSIGNMENT OF COSTS

- 404 CAPITALIZATION OF TANGIBLE ASSETS
- 409 DEPRECIATION OF TANGIBLE ASSETS
- 408 ACCOUNTING FOR PAID ABSENCE
- 412 COMPOSITION AND MEASUREMENT OF PENSION COSTS
- 413 ADJUSTMENT AND ALLOCATION OF PENSION COSTS
- 415 ACCOUNTING FOR DEFERRED COMPENSATION
- 416 ACCOUNTING FOR INSURANCE COSTS
- 411 ACCOUNTING FOR ACQUISITION COSTS OF MATERIALS
- 417 COST OF MONEY AS AN ELEMENT OF FACILITIES CAPITAL
- 420 ACCOUNTING FOR IR&D/B&P

## COVERAGE RULES

- Business units that have not received a negotiated prime contract or subcontract in excess of \$500,000 are exempt from complying with CAS.
- Once a business unit receives a negotiated national defense contract/subcontract in excess of \$500,000, that contract and all future negotiated contracts/subcontracts in excess of \$100,000 awarded prior to completion of the \$500,000 contract, or any of the covered \$100,000 contracts, must include one of the two CAS clauses providing for either "full" or "modified" coverage.
  - Assuming that the requirement for initial coverage, as described above, has been met, national defense and nondefense contracts/subcontracts over \$100,000 are eligible for "modified" coverage if the business unit's total national defense CAS covered awards in the preceding cost accounting period are less than \$10 million and less than 10 percent of the business unit's total sales. A contractor who is eligible to use "modified" coverage must elect to do so; otherwise "full" coverage will apply.
  - Negotiated defense and nondefense contracts /subcontracts over \$100,000 are subject to "full" coverage if the business unit has already met the initial coverage requirement (award of the covered defense contract in excess of \$500,000) and total national defense CAS covered awards in the preceding cost accounting period are more than 10 percent of the business unit's total sales or \$10 million or more.
- Business units with a single national defense award of \$10 million or more are subject to "full" coverage.

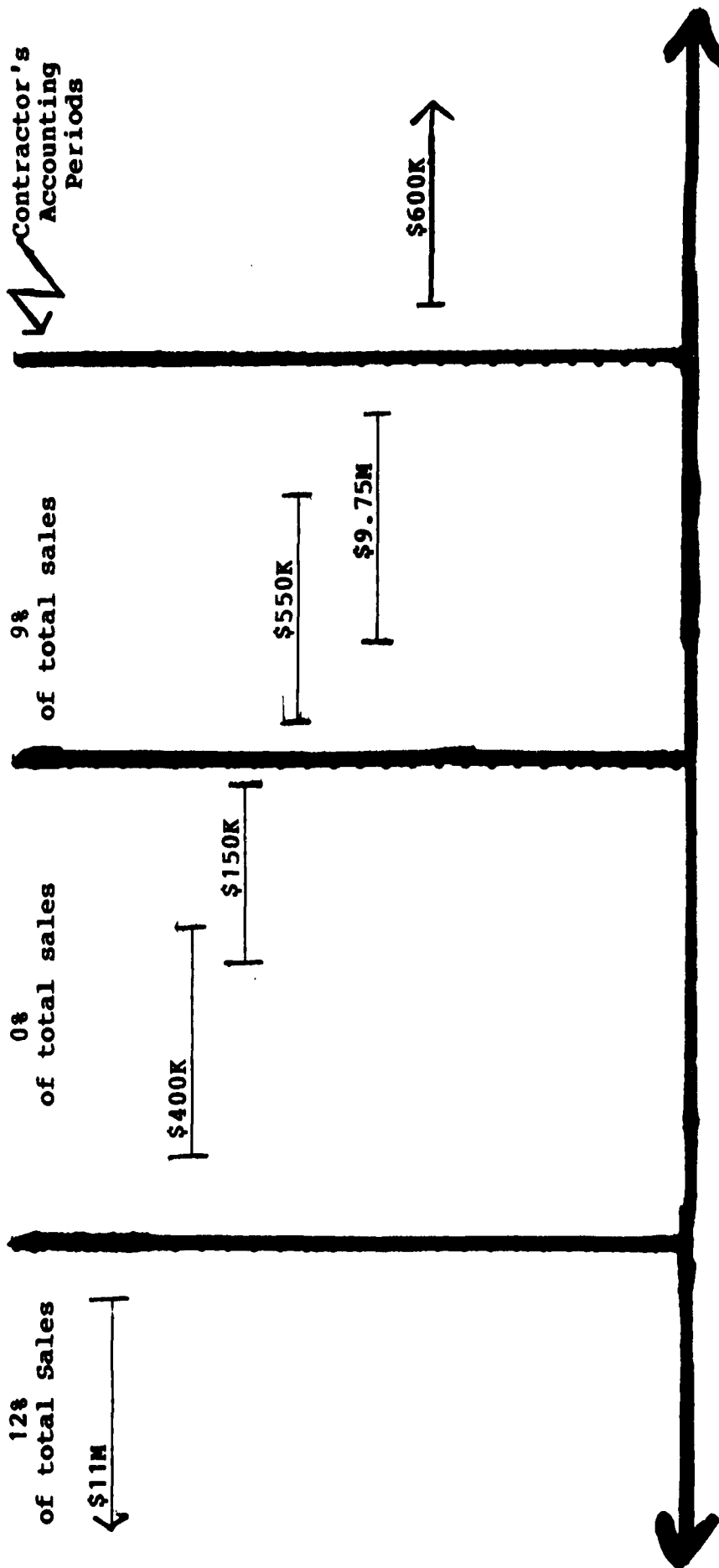
## DISCLOSURE STATEMENT RULES

- Any company which, together with its segments, received net awards of negotiated defense prime contracts and subcontracts subject to CAS totaling more than \$10 million in the preceding cost accounting period must submit a Disclosure Statement before award of its first CAS - covered contract.

However, if the first CAS - covered contract is received within 90 days of the start of the accounting period, the contractor is not required to file until the end of 90 days.

- Any business unit that is selected to receive a CAS-covered national defense contract or subcontract of \$10 million or more shall submit a Disclosure Statement before award.

CAS COVERAGE



1. Which contract is covered by CAS?
2. If CAS covered, indicate full or modified
3. Indicate when contractor is required to submit a disclosure statement.

**PART 30**  
**COST ACCOUNTING STANDARDS**

**30.000 Scope of part.**

This part describes policies and procedures for applying the Cost Accounting Standards to negotiated national defense contracts and subcontracts. This part also prescribes policies and procedures for applying those standards to certain nondefense contracts. This part does not apply to sealed bid contracts or to any contract with a small business concern (see 30.201-1(b) for these and other exemptions).

**SUBPART 30.1—GENERAL**

**30.101 Cost Accounting Standards.**

(a) Pub. L. 91-379 (50 U.S.C. App. 2168) requires certain national defense contractors and subcontractors to comply with Cost Accounting Standards (CAS) and to disclose in writing and follow consistently their cost accounting practices.

(b) The obligation to comply with the CAS is extended to certain nondefense contracts as a matter of policy. This decision has resulted in differences in application between national defense and nondefense contracts and these differences are noted in the appropriate sections throughout this part.

**SUBPART 30.2—CAS PROGRAM REQUIREMENTS**

**30.201 Contract requirements.**

**30.201-1 CAS applicability.**

(a) This subsection describes the rules for determining whether a proposed contract or subcontract is exempt from CAS. (See Subpart 30.4.) Negotiated contracts not exempt in accordance with 30.201-1(b) shall be subject to CAS. A CAS-covered contract may be subject to either full or modified coverage. The rules for determining whether full or modified coverage applies are in 30.201-2.

(b) The following categories of contracts and subcontracts are exempt from all CAS requirements:

- (1) Sealed bid contracts.
- (2) Negotiated contracts and subcontracts not in excess of \$100,000.
- (3) Contracts and subcontracts with small businesses.
- (4) Contracts and subcontracts with foreign governments or their agents or instrumentalities or, insofar as

the requirements of CAS other than 30.401 and 30.402 are concerned, any contract or subcontract awarded to a foreign concern.

(5) Contracts and subcontracts in which the price is set by law or regulation.

(6) Contracts and subcontracts when the price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public (see 15.804-3(c)). A prospective contractor requesting exemption from CAS on this basis must provide supporting justification in accordance with 15.804-3(e). When the contracting officer determines that the justification is adequate, this exemption from CAS shall be used even though the award is made on the basis of adequate price competition.

(7) Contracts and subcontracts of \$500,000 or less if the business unit is not currently performing any national defense CAS-covered contracts.

(8) Nondefense contracts awarded based on adequate price competition (see 15.804-3(b)).

(9) Nondefense contracts and subcontracts awarded to business units that are not currently performing any CAS-covered national defense contracts.

(10) Contracts and subcontracts with educational institutions other than those to be performed by Federally Funded Research and Development Centers (FFRDC's) operated by such institutions.

(11) Contracts awarded to labor surplus area concerns pursuant to a labor surplus area set-aside (see Part 20).

(12) Contracts and subcontracts awarded to a United Kingdom contractor for performance substantially in the United Kingdom, provided that the contractor has filed with the United Kingdom Ministry of Defense, for retention by the Ministry, a completed Disclosure Statement (Form No. CASB-DS-1) which shall adequately describe its cost accounting practices. Whenever that contractor is already required to follow U.K. Government Accounting Conventions, the disclosed practices shall be in accord with the requirements of those conventions. (See 30.201-4(d).

(13) Subcontracts under the NATO PHM Ship program to be performed outside the United States by a foreign concern.

(14) Contracts and subcontracts to be executed and performed entirely outside the United States, its territories, and possessions.

(15) Firm-fixed-price contracts and subcontracts awarded without submission of any cost data; *provided*, that the failure to submit such data is not attributable to a waiver of the requirement for certified cost or pricing data.

**30.201-2 Types of CAS coverage.**

(a) *Full coverage.* Full coverage requires that the business unit comply with all of the CAS in effect on the date of the contract award and with any CAS that become applicable because of later award of a national defense CAS-covered contract. However, the award of a new nondefense CAS-covered contract shall not trigger application of new CAS having effective dates later than the award date of the last national defense CAS-covered contract. Full coverage applies to contractor business units that—

- (1) Receive a single national defense CAS-covered contract award of \$10 million or more;
- (2) Received \$10 million or more in national defense CAS-covered contract awards during its preceding cost accounting period; or
- (3) Received less than \$10 million in national defense CAS-covered contract awards during its preceding cost accounting period but such awards were 10 percent or more of total sales.

(b) *Modified coverage.* (1) Modified CAS coverage requires only that the contractor comply with Standard 401, Consistency in Estimating, Accumulating, and Reporting Costs, and Standard 402, Consistency in Allocating costs Incurred for the Same Purpose. Modified, rather than full, CAS coverage may be applied to a covered contract of less than \$10 million awarded to a business unit that received less than \$10 million in national defense CAS-covered contracts in the immediately preceding cost accounting period if the sum of such awards was less than 10 percent of the business unit's total sales during that period. For the purpose of determining whether the sum of covered contract awards equals 10 percent of the business unit's total sales, an order received by the one segment from another segment shall be treated in the same way that a subcontract award to the receiving segment would be treated. In measuring sales for a year, a transfer by one segment to another shall be deemed to be a sale by the transferor.

(2) If any one contract is awarded with modified CAS coverage, all CAS-covered contracts awarded to that business unit during that cost accounting period must also have modified coverage with the following exception: if the business unit receives a single national defense contract award of \$10 million or more, that contract must be subject to full CAS coverage. Thereafter, any covered contract awarded in the same cost accounting period must also be subject to full CAS coverage.

(3) A contract awarded with modified CAS coverage shall remain subject to such coverage throughout its life regardless of changes in the business unit's CAS status during subsequent cost accounting periods.

(c) *Nondefense contracts.* Nondefense contracts subject to CAS shall have the same type of CAS coverage as the most recently awarded national defense contract currently being performed by the same business unit.

(d) *Subcontracts.* Subcontract awards subject to CAS re-

quire the same type of CAS coverage as would prime contracts awarded to the same business unit.

(e) *Foreign concerns.* Contracts with foreign concerns subject to CAS shall only be subject to modified coverage.

**30.201-3 Solicitation provisions.**

(a) *Cost Accounting Standards Notices and Certification (National Defense).* The contracting officer shall insert the provision at 52.230-1, Cost Accounting Standards Notices and Certification (National Defense), in solicitations for proposed national defense contracts subject to CAS as specified in 30.201. The provision allows offerors to—

- (1) Certify their Disclosure Statement status;
- (2) Claim exemption from CAS if they are not currently performing any CAS-covered contracts and the proposal will result in an award of \$500,000 or less;
- (3) Claim exemption from full CAS coverage and elect modified CAS coverage when appropriate; and
- (4) Certify whether award of the contemplated contract would require a change to existing cost accounting practices.

(b) *Cost Accounting Standards Notices and Certification (Nondefense).* The contracting officer shall insert the provision at 52.230-2, Cost Accounting Standards Notices and Certification (Nondefense), in solicitations for proposed nondefense contracts that do not meet the criteria for CAS exemption in 30.201-1. The provision allows offerors to claim exemption from CAS if they are not currently performing any CAS-covered national defense contracts or to certify what type of CAS coverage applies to them.

**30.201-4 Contract clauses.**

(a) *Cost Accounting Standards.* (1) The contracting officer shall insert the clause at 52.230-3, Cost Accounting Standards, in negotiated contracts, unless the contract is exempted (see 30.201-1), the contract is subject to modified coverage (see 30.201-2), or the clause prescribed in paragraph (d) of this subsection is used.

(2) The clause at 52.230-3 requires the contractor to disclose actual cost accounting practices (applicable to national defense contracts only) and to follow these practices consistently.

(b) *Administration of Cost Accounting Standards.* (1) The contracting officer shall insert the clause at 52.230-4, Administration of Cost Accounting Standards, in contracts containing either the clause prescribed in paragraph (a) of this subsection, or the clause prescribed in paragraph (c) of this subsection.

(2) The clause at 52.230-3, Cost Accounting Standards, specifies rules for administering CAS requirements and procedures to be followed in cases of failure to comply.

(c) *Disclosure and Consistency of Cost Accounting Practices.* (1) The contracting officer shall insert the clause at 52.230-5, Disclosure and Consistency of Cost Accounting Practices, in negotiated contracts when the contract amount is over \$100,000, but less than \$10 million, and the offeror certifies it is eligible for and elects to use modified CAS coverage (see 30.201-2, unless the clause prescribed in paragraph (d) of this subsection is used).

(2) The clause at 52.230-5 requires the contractor to comply with CAS 401 and 402, to disclose (if it meets certain requirements) actual cost accounting practices, and to follow consistently disclosed and established cost accounting practices.

(d) *Consistency in Cost Accounting Practices.* The contracting officer shall insert the clause at 52.230-6, Consistency in Cost Accounting Practices, in negotiated defense contracts that are exempt from CAS requirements solely on the basis of the fact that the contract is to be awarded to a United Kingdom contractor and is to be performed substantially in the United Kingdom (see 30.201-1(b)(12)).

#### 30.201-5 Waiver.

(a) In some instances, contractors or subcontractors may refuse to accept all or part of the requirements of the CAS clauses (52.230-3, Cost Accounting Standards and 52.230-5, Disclosure and Consistency of Cost Accounting Practices). If the contracting officer determines that it is impractical to obtain the materials, supplies, or services from any other source, the contracting officer shall prepare a request for waiver describing the proposed contract or subcontract and containing—

(1) An unequivocal statement that the proposed contractor or subcontractor refuses to accept a contract containing all or a specified part of a CAS clause and the specific reason for that refusal;

(2) A statement as to whether the proposed contractor or subcontractor has accepted any prime contract or subcontract containing a CAS clause;

(3) The amount of the proposed award and the sum of all awards by the agency requesting the waiver to the proposed contractor or subcontractor in each of the preceding 3 years;

(4) A statement that no other source is available to satisfy the agency's needs on a timely basis;

(5) A statement of alternative methods considered for fulfilling the need and the agency's reasons for rejecting them;

(6) A statement of steps being taken by the agency to establish other sources of supply for future contracts for the products or services for which a waiver is being requested; and

(7) Any other information that may be useful in evaluating the request.

(b) (1) For national defense contracts of the DOD, waivers shall be controlled and approved by the Deputy Assistant Secretary of Defense (Procurement) and shall be processed for review by the Defense Acquisition Regulatory (DAR) Council in accordance with agency procedures.

(2) For national defense contracts of the National Aeronautics and Space Administration (NASA), waivers shall be controlled and approved by the Assistant Administrator for Procurement after consultation with the Deputy Assistant Secretary of Defense (Procurement). Requests for waiver shall be processed in accordance with agency regulations.

(c) For nondefense contracts, and defense contracts of agencies other than DOD or NASA, the agency head or designee may waive CAS requirements. Agencies shall ensure consistent treatment of—

(1) Waivers within the agency; and

(2) Contractors performing under both defense and nondefense contracts.

(d) For purchases of substantially the same product from the same contractor for which a waiver was previously granted, approval authority is redelegated in the Department of Defense to the Secretaries of the Military Departments and the Director, Defense Logistics Agency.

#### 30.202 Disclosure requirements.

##### 30.202-1 General requirements.

(a) A Disclosure Statement is a written description of a contractor's cost accounting practices and procedures. The submission of a new or revised Disclosure Statement is not required for any nondefense contract or from any small business concern. However, if a Disclosure Statement has been submitted in connection with a CAS-covered defense contract, the contractor must also comply with such disclosed practices under nondefense CAS-covered contracts (see subparagraph (a)(1) of the clause at 52.230-3, Cost Accounting Standards).

(b) Completed Disclosure Statements are required in the following circumstances:

(1) Any business unit that is selected to receive a CAS-covered negotiated national defense contract or subcontract of \$10 million or more shall submit a Disclosure Statement before award.

(2) Any company which, together with its segments, received net awards of negotiated national defense prime contracts and subcontracts subject to CAS totaling more than \$10 million in its most recent cost accounting period must submit a Disclosure Statement before award of its first CAS-covered contract in the immediately following cost accounting period. However, if the first CAS-covered contract is received within 90 days of the start of the cost accounting period, the contractor is not required to file until the end of 90 days.



(c) When a Disclosure Statement is required, a separate Disclosure Statement must be submitted for each segment whose costs included in the total price of any CAS-covered contract or subcontract exceed \$100,000, unless the contract or subcontract is of the type or value exempted by 30.201-1. If the cost accounting practices are identical for more than one segment, then only one Disclosure Statement, clearly identifying each such segment, need be submitted. A Disclosure Statement will also be required for each corporate or group office whose costs of any amount are allocated to one or more segments performing CAS-covered contracts.

(d) Each corporate or other home office that allocates costs to one or more disclosing segments performing CAS-covered contracts must submit a Part VIII of the Disclosure Statement.

(e) Foreign contractors and subcontractors who are required to submit a Disclosure Statement may, in lieu of filing a Form No. CASB-DS-1, make disclosure by using a disclosure form prescribed by an agency of its Government, provided that the official designated to approve waivers in 30.201-5 determines that the information disclosed by that means will satisfy requirements of Subpart 30.2. The use of alternative forms has been approved for the contractors of the following countries:

- (1) Canada.
- (2) Federal Republic of Germany.

#### 30.202-2 Impracticality of submission.

The agency head may determine that it is impractical to secure the Disclosure Statement, although submission is required, and authorize contract award without obtaining the Statement. This authority may not be delegated.

#### 30.202-3 Amendments and revisions.

(a) Contractors and subcontractors are responsible for maintaining accurate Disclosure Statements and complying with disclosed practices. Amendments and revisions to Disclosure Statements may be submitted at any time and may be proposed by either the contractor or the Government. Resubmission of complete, updated, Disclosure Statements is discouraged except when extensive changes require it to assist the review process.

(b) Should the obligation to maintain the Disclosure Statement cease because the contractor no longer meets the financial thresholds, the contractor shall still be required to follow the disclosed practices for those contracts awarded during a period in which the contractor was obligated to submit a Disclosure Statement.

#### 30.202-4 Privileged and confidential information.

If the offeror or contractor notifies the contracting officer that the Disclosure Statement contains trade secrets and

commercial or financial information, which is privileged and confidential, the Disclosure Statement shall be protected and shall not be released outside the Government.

#### 30.202-5 Filing Disclosure Statements.

(a) Disclosure must be on Form Number CASB-DS-1. Forms may be obtained from the cognizant administrative contracting officer (ACO).

(b) Offerors are required to file Disclosure Statements as follows:

- (1) Original and one copy with the cognizant ACO; and
- (2) One copy with the cognizant contract auditor.

(c) Amendments and revisions shall be submitted to the currently cognizant ACO and auditor.

#### 30.202-6 Responsibilities.

(a) The contracting officer is responsible for determining when a proposed contract may require CAS coverage and for including the appropriate notice in the solicitation. The contracting officer must then ensure that the offeror has made the required solicitation certifications and that required Disclosure Statements are submitted.

(b) The contracting officer shall not award a CAS-covered contract until the ACO has made a written determination that a required Disclosure Statement is adequate unless, in order to protect the Government's interest, the contracting officer waives the requirement for an adequacy determination before award. In this event, a determination of adequacy shall be required as soon as possible after the award.

(c) The cognizant auditor is responsible for conducting reviews of Disclosure Statements for adequacy and compliance.

(d) The cognizant ACO is responsible for determinations of adequacy and compliance of the Disclosure Statement.

#### 30.202-7 Determinations.

(a) *Adequacy determination.* The contract auditor shall conduct an initial review of a Disclosure Statement to ascertain whether it is current, accurate, and complete and shall report the results to the cognizant ACO, who shall determine whether or not it adequately describes the offeror's cost accounting practices. If the ACO identifies any areas of inadequacy, the ACO shall request a revised Disclosure Statement. If the Disclosure Statement is adequate, the ACO shall notify the offeror in writing, with copies to the auditor and contracting officer. The notice of adequacy shall state that a disclosed practice shall not, by virtue of such disclosure, be considered an approved practice for pricing proposals or accumulating and reporting contract performance cost data. Generally, the ACO shall furnish the contractor notification of adequacy or inadequacy within 30 days after the Disclosure Statement has been received by the ACO.

(b) *Compliance determination.* After the notification of adequacy, the auditor shall conduct a detailed compliance review to determine whether or not the disclosed practices comply with Part 31 and the CAS and shall advise the ACO of the results. The ACO shall take action regarding non-compliance with CAS under FAR 30.602-2. The ACO may require a revised Disclosure Statement and adjustment of the prime contract price or cost allowance. Noncompliance with Part 31 shall be processed separately, in accordance with normal administrative practices.

#### 30.202-8 Subcontractor Disclosure Statements.

(a) The contractor or higher tier subcontractor is responsible for administering the CAS requirements contained in subcontracts.

(b) If the subcontractor has previously furnished a Disclosure Statement to an ACO, the subcontractor may satisfy the submission requirement by identifying to the contractor or higher tier subcontractor the ACO to whom it was submitted.

(c)(1) If the subcontractor considers the Disclosure Statement (or other similar information) privileged or confidential, the subcontractor may submit it directly to the ACO and auditor cognizant of the subcontractor, notifying the contractor or higher tier subcontractor. A preaward determination of adequacy is not required in such cases. Instead, the ACO cognizant of the subcontractor shall (i) notify the auditor that the adequacy review will be performed during the postaward compliance review and, upon completion, (ii) notify the subcontractor, the contractor or higher tier subcontractor, and the cognizant ACO's of the findings.

(2) Even though a Disclosure Statement is not required, a subcontractor may (i) claim that CAS-related reviews by contractors or higher tier subcontractors would reveal proprietary data or jeopardize the subcontractor's competitive position and (ii) request that the Government perform the required reviews.

(d) When the Government requires determinations of adequacy or inadequacy, the ACO cognizant of the subcontractor shall make such recommendation to the ACO cognizant of the prime contractor or next higher tier subcontractor. ACO's cognizant of higher tier subcontractors or prime contractors shall not reverse the determination of the ACO cognizant of the subcontractor.

(e) Postaward submission of the subcontractor's Disclosure Statement must be approved by the ACO having cognizance of the prime contractor. Before authorizing postaward submission, the ACO shall coordinate with the ACO cognizant of the subcontractor to ensure that this action will not have an adverse impact on other contracts and subcontracts subject to the CAS requirements, and with the contracting officer to obtain the information needed to make the required written determination.

(f) Any determination that it is impractical to secure a subcontractor's Disclosure Statement must be made in accordance with 30.202-2.

### SUBPART 30.3—CAS RULES AND REGULATIONS

#### 30.301 Definitions.

The definitions set forth in section 31.001 also apply to this part.

"Actual cost," as used in this part, means an amount determined on the basis of cost incurred as distinguished from forecasted cost. Actual cost includes standard cost properly adjusted for applicable variance.

"Asset accountability unit," as used in this part, means a tangible capital asset which is a component of plant and equipment that is capitalized when acquired or whose replacement is capitalized when the unit is removed, transferred, sold, abandoned, demolished, or otherwise disposed of.

"Assignment of cost to cost accounting periods." (See 30.302-1(b).)

"Bid and proposal (B&P) cost," as used in this part, means the cost incurred in preparing, submitting, or supporting any bid or proposal which effort is neither sponsored by a grant, nor required in the performance of a contract.

"CAS-covered contract," as used in this part, means any negotiated contract or subcontract in which a CAS clause is required to be included.

"Category of material," as used in this part, means a particular kind of goods, comprised of identical or interchangeable units, acquired or produced by a contractor, which are intended to be sold, or consumed or used in the performance of either direct or indirect functions.

"Change to a cost accounting practice." (See 30.302-2.)

"Cost accounting practice." (See 30.302-1.)

"Cost objective," as used in this part, means a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

"Currently performing," as used in this part, means that a contractor has been awarded a contract, but has not yet received notification of final acceptance of all supplies, services, and data deliverable under the contract (including options).

"Defense contractor," as used in this part, means any person who enters into a contract with the United States for the production of material or the performance of services for the national defense.

"Defense subcontractor," as used in this part, means any person other than the United States who contracts, at any tier, to perform any part of a defense contractor's contract.

"Direct cost," as used in this part, means any cost which is identified specifically with a particular final cost objective. Direct costs are not limited to items which 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.

"Disclosure statement," as used in this part, means the Disclosure Statement required by 30.202-1.

"Entitlement," as used in this part, means an employee's right whether conditional or unconditional to receive a determinable amount of compensated personnel absence, or pay in lieu thereof.

"Established catalog or market price of commercial items sold in substantial quantities to the general public" is as defined in 15.804-3(c).

"Funded pension cost," as used in this part, means the portion of pension costs for a current or prior cost accounting period that has been paid to a funding agency or, under a pay-as-you-go plan to plan participants or beneficiaries.

"Funding agency," as used in this part, means an organization or individual which provides facilities to receive and accumulate assets to be used either for the payment of benefits under a pension plan, or for the purchase of such benefits.

"Indirect cost," as used in this part, 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.

"Indirect cost pool," as used in this part, means a grouping of incurred costs identified with two or more objectives but not identified specifically with any final cost objective.

"Material inventory record," as used in this part, means any record used for the accumulation of actual or standard costs of a category of material recorded as an asset for subsequent cost allocation to one or more cost objectives.

"Measurement of cost." (See 30.302-1(a).)

"Multiemployer pension plan," as used in this part, means a plan to which more than one employer contributes and which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer.

"Negotiated subcontract," as used in this part, means any subcontract except a firm fixed-priced subcontract made by a contractor or subcontractor after receiving offers from at least two persons not associated with each other or with such contractor or subcontractor, providing (a) the solicitation to all competitors is identical, (b) price is the only consideration in selecting the subcontractor from among the competitors solicited, and (c) the lowest offer received in compliance with the solicitation from among those solicited is accepted.

"Net awards," as used in this part, means the total obligated value of negotiated national defense prime contract and subcontract awards received during the reporting period minus cancellations, terminations, and other related credit transactions.

"Operating revenue," as used in this part, means amounts accrued or charged to customers, clients, and tenants, for the sale of products manufactured or purchased for resale, for services, and for rental of property held primarily for leasing to others. It includes both reimbursable costs and fees under cost-type contracts and percentage-of-completion sales accruals, except it includes only the fee for management contracts under which the contractor acts essentially as an agent of the Government in the erection or operation of Government-owned facilities. It excludes incidental interest, dividends, royalty, and rental income and proceeds from the sale of assets used in the business.

"Production unit," as used in this part, means a grouping of activities which either uses homogeneous inputs of direct material and direct labor or yields homogeneous outputs such that costs or statistics related to these homogeneous inputs or outputs are appropriate as bases for allocating variances.

"Repairs and maintenance," as used in this part, means the total endeavor to obtain the expected service during the life of tangible capital assets. Maintenance is the regularly recurring activity of keeping assets in normal or expected operating condition. Repair is the activity of putting them back into normal or expected operating condition.

"Reporting costs," as used in this part, is the provision of cost information to others. The reporting of costs involves selecting relevant cost data and presenting it in an intelligible manner for use by the recipient.

"Small business," as used in this part, means any concern, firm, person, corporation, partnership, cooperative, or other business enterprise which, under 15 U.S.C. 637(b)(6) and the rules and regulations of the Small Business Administration in Part 121 of Title 13 of the Code of Federal Regulations, is determined to be a small business concern for the purpose of Government contracting.

### 30.302 Definitions, explanations, and illustrations of the terms, "cost accounting practice" and "change to a cost accounting practice."

#### 30.302-1 Cost accounting practice.

"Cost accounting practice," as used in this part, means any disclosed or established accounting method or technique which is used for allocation of cost to cost objectives, assignment of cost to cost accounting periods, or measurement of cost.

(a) "Allocation of cost to cost objectives," as used in this part, includes both direct and indirect allocation of cost. Examples of cost accounting practices involving allocation of cost to cost objectives are the accounting methods or techniques used to accumulate cost, to determine whether a cost is to be directly or indirectly allocated to determine the composition of cost pools, and to determine the selection and composition of the appropriate allocation base.

“Assignment of cost to cost accounting periods,” as used in this part, refers to a method or technique used in determining the amount of cost to be assigned to individual cost accounting periods. Examples of cost accounting practices which involve the assignment of cost to cost accounting periods are requirements for the use of specified accrual basis accounting or cash basis accounting for a cost element.

(c) “Measurement of cost,” as used in this part, encompasses accounting methods and techniques used in defining the components of cost, determining the basis for cost measurement, and establishing criteria for use of alternative cost measurement techniques. The determination of the amount paid or a change in the amount paid for a unit of goods and services is not a cost accounting practice. Examples of cost accounting practices which involve measurement of costs are—

- (1) The use of either historical cost, market value, or present value;
- (2) The use of standard cost or actual cost; or
- (3) The designation of those items of cost which must be included or excluded from tangible capital assets or pension cost.

**30.302-2 Change to a cost accounting practice.**

“Change to a cost accounting practice,” as used in this part, means any alteration in a cost accounting practice, as defined in 30.302-1, whether or not such practices are covered by a Disclosure Statement, except for the following:

- (a) The initial adoption of a cost accounting practice for the first time a cost is incurred, or a function is created, is not a change in cost accounting practice. The partial or total elimination of a cost or the cost of a function is not a change in cost accounting practice. As used here, function is an activity or group of activities that is identifiable in scope and has a purpose or end to be accomplished.
- (b) The revision of a cost accounting practice for a cost which previously had been immaterial is not a change in cost accounting practice.

**30.302-3 Illustrations of changes which meet the definition of “change to a cost accounting practice.”**

(a) The method or technique used for measuring costs has been changed.

<i>Description</i>	<i>Accounting treatment</i>
(1) Contractor changes its actuarial cost method for computing pension costs.	(1)(i) <i>Before change:</i> The contractor computed pension costs using the aggregate cost method. (ii) <i>After change:</i> The contractor computes pension cost using the unit credit method.

<i>Description</i>	<i>Accounting treatment</i>
(2) Contractor uses standard costs to account for its direct labor. Labor cost at standard was computed by multiplying labor-time standard by actual labor rates. The contractor changes the computation by multiplying labor-time standard by labor-rate standard.	(2)(i) <i>Before change:</i> Contractor’s direct labor cost was measured with only one component set at standard. (ii) <i>After change:</i> Contractor’s direct labor cost is measured with both the time and rate components set at standard.

(b) The method or technique used for assignment of cost to cost accounting periods has been changed.

<i>Description</i>	<i>Accounting treatment</i>
(1) Contractor changes his established criteria for capitalizing certain classes of tangible capital assets whose acquisition costs totaled \$1 million per cost accounting period.	(1)(i) <i>Before change:</i> Items having acquisition costs of between \$200 and \$400 per unit were capitalized and depreciated over a number of cost accounting periods. (ii) <i>After change:</i> The contractor charges the value of assets costing between \$200 and \$400 per unit to an indirect expense pool which is allocated to the cost objectives of the cost accounting period in which the cost was incurred.
(2) Contractor changes his methods for computing depreciation for a class of assets.	(2)(i) <i>Before change:</i> The contractor assigned depreciation costs to cost accounting periods using an accelerated method. (ii) <i>After change:</i> The contractor assigns depreciation costs to cost accounting periods using the straight line method.
(3) Contractor changes his general method of determining asset lives for classes of assets acquired prior to the effective date of CAS 409.	(3)(i) <i>Before change:</i> The contractor identified the cost accounting periods to which the cost of tangible capital assets would be assigned using guideline class lives provided in IRS Rev. Pro. 72-10.

*Description*

*Accounting treatment*

(ii) *After change:* The contractor changes the method by which he identifies the cost accounting periods to which the costs of tangible assets will be assigned. He now uses the expected actual lives based on past usage.

(c) The method or technique used for allocating costs has been changed.

*Description*

*Accounting treatment*

(1) Contractor changes his method of allocating G&A expenses under the requirements of Cost Accounting Standard 410.

(1)(i) *Before change:* The contractor operating under Cost Accounting Standard 410 has been allocating his general and administrative expense pool to final cost objectives on a total cost input base in compliance with the standard. The contractor's business changes substantially such that there are significant new projects which have only insignificant quantities of material.  
 (ii) *After change:* After the addition of the new work, an evaluation of the changed circumstances reveals that the continued use of a total cost input base would result in a significant distortion in the allocation of the G&A expense pool in relation to the benefits received. To remain in compliance with Standard 410, the contractor alters his G&A allocation base from a total cost input base to a value added base.

(2) The contractor changes the accounting for hardware common to all projects.

(2)(i) *Before change:* The contractor allocated the cost of purchased or requisitioned hardware directly to projects.

*Description*

*Accounting treatment*

(ii) *After change:* The contractor charges the cost of purchased or requisitioned hardware to an indirect expense pool which is allocated to projects using an appropriate allocation base.

(3) The contractor merges operating segments A and B which use different cost accounting practices in accounting for manufacturing overhead costs.

(3)(i) *Before change:* In segment A, the costs of the manufacturing overhead pool have been allocated to final cost objectives using a direct labor hours base; in segment B, the costs of the manufacturing overhead pool have been allocated to final cost objectives using a direct labor dollars base.

(ii) *After change:* As a result of the merger of operations, the combined segment decides to allocate the cost of the manufacturing overhead pool to all final cost objectives, using a direct labor dollars base. Thus, for those final cost objectives referred to in segment A, the cost of the manufacturing overhead pool will be allocated to the final cost objectives of segment A using a direct labor dollars base instead of a direct labor hours base.

**30.302-4 Illustrations of changes which do not meet the definition of "Change to a cost accounting practice."**

*Description*

*Accounting treatment*

(a) Changes in the interest rate levels in the national economy have invalidated the prior actuarial assumption with respect to anticipated investment earnings. The pension plan administrators adopted an increased (decreased) interest rate actuarial assumption.

(a) Adopting the increase (decrease) in the interest rate actuarial assumption is not a change in cost accounting practice.

<i>Description</i>	<i>Accounting treatment</i>	<i>Description</i>	<i>Accounting treatment</i>
The company allocated the resulting pension costs to all final cost objectives.		years the process resulted in an estimated future life of 10 years for this class of assets. This year a technological change leads to a prediction of a useful life of 7 years for the assets acquired this year for the class of assets.	is not a change in cost accounting practice.
(b) The basic benefit amount for a company's pension plan is increased from \$8 to \$10 per year of credited service. The change increases the dollar amount of pension cost allocated to all final cost objectives.	(b) The increase in the amount of the benefits is not a change in cost accounting practice.	(g) The marketing department of a segment has reported directly to the general manager of the segment. The costs of the marketing department have been combined as part of the segment's G&A expense pool. The company reorganizes and requires the marketing department to report directly to a vice president at corporate headquarters.	(g) After the organization change in the company's reporting structure, the parties agree that the appropriate recognition of the beneficial or causal relationship between the costs of the marketing department and the segment is to continue to combine these costs as part of the segment's G&A expense pool. Thus, the organizational change has not resulted in a change in cost accounting practice.
(c) A contractor who has never paid pensions establishes for the first time a pension plan. Pension costs for the first year amounted to \$3.5 million.	(c) The initial adoption of an accounting practice for the first time incurrence of a cost is not a change in cost accounting practice.	<b>30.303 Effect of filing Disclosure Statement.</b>	(a) A disclosure of a cost accounting practice by a contractor does not determine the allowability of particular items of cost. Irrespective of the practices disclosed by a contractor, the question of whether or not, or the extent to which, a specific element of cost is allowed under a contract remains for consideration in each specific instance. Contractors are cautioned that the determination of the allowability of cost items will remain a responsibility of the contracting officers pursuant to the provisions of the applicable procurement regulations.
(d) A contractor maintained a Deferred Incentive Compensation Plan. After several years' experience, the plan was determined not to be attaining its objective, so it was terminated, and no future entitlements were paid.	(d) There was a termination of the Deferred Incentive Compensation Plan. Elimination of a cost is not a change in cost accounting practice.	(b) The individual Disclosure Statement may be used in audits of contracts or in negotiation of prices leading to contracts. The authority of the audit agencies and the contracting officers is in no way abrogated by the material presented by the contractor in his Disclosure Statement. Contractors are cautioned that their disclosures must be complete and accurate; the practices disclosed may have a significant impact on ways in which contractors will be required to comply with Cost Accounting Standards.	<b>30.304 Concurrent full and modified coverage.</b>
(e) A contractor eliminates a segment that was operated for the purpose of doing research for development of products related to nuclear energy.	(e) The projects and expenses related to nuclear energy projects have been terminated. No transfer of these projects and no further work in this area is planned. This is an elimination of cost and not a change in cost accounting practice.	Contracts subject to full coverage may be performed during a period in which a previously awarded contract	30-9
(f) For a particular class of assets for which technological changes have rarely affected asset lives, a contractor starts with a 5-year average of historical lives to estimate future lives. He then considers technological changes and likely use. For the past several	(f) The change in estimate (not in method) is not a change in cost accounting practice. The contractor has not changed the method or technique used to determine the estimate. The methodology applied has indicated a change in the estimated life, and this	C-15	

subject to modified coverage is being performed. Compliance with full coverage may compel the use of cost accounting practices that are not required under modified coverage. Under these circumstances the cost accounting practices applicable to contracts subject to modified coverage need not be changed. Any resulting differences in practices between contracts subject to full coverage and those subject to modified coverage shall not constitute a violation of 30.401 and 30.402. This principle also applies to contracts subject to modified coverage being performed during a period in which a previously awarded contract subject to full coverage is being performed.

### 30.305 Materiality.

In determining whether amounts of cost are material or immaterial, the following criteria shall be considered where appropriate; no one criterion is necessarily determinative:

(a) *The absolute dollar amount involved.* The larger the dollar amount, the more likely that it will be material.

(b) *The amount of contract cost compared with the amount under consideration.* The larger the proportion of the amount under consideration to contract cost, the more likely it is to be material.

(c) *The relationship between a cost item and a cost objective.* Direct cost items, especially if the amounts are themselves part of a base for allocation of indirect costs, will normally have more impact than the same amount of indirect costs.

(d) *The impact on Government funding.* Changes in accounting treatment will have more impact if they influence the distribution of costs between Government and non-Government cost objectives than if all cost objectives have Government financial support.

(e) *The cumulative impact of individually immaterial items.* It is appropriate to consider whether such impacts (1) tend to offset one another, or (2) tend to be in the same direction and hence to accumulate into a material amount.

(f) *The cost of administrative processing of the price adjustment modification shall be considered.* If the cost to process exceeds the amount to be recovered, it is less likely the amount will be material.

### 30.306 Interpretations.

In determining amounts of increased costs in the clauses at 52.230-3, Cost Accounting Standards, and 52.230-5, Disclosure and Consistency of Cost Accounting Practices, the following considerations apply:

(a) Increased costs shall be deemed to have resulted whenever the cost paid by the Government results from a change in a contractor's cost accounting practices or from failure to comply with applicable Cost Accounting Standards, and such cost is higher than it would have been had the practices not been changed or applicable Cost Accounting Standards complied with.

(b) If the contractor under any fixed-price contract, including a firm fixed-price contract, fails during contract performance to follow its cost accounting practices or to comply with applicable Cost Accounting Standards, increased costs are measured by the difference between the contract price agreed to and the contract price that would have been agreed to had the contractor proposed in accordance with the cost accounting practices used during contract performance. The determination of the contract price that would have been agreed to will be left to the contracting parties and will depend on the circumstances of each case.

(c) The Government policy underlying this interpretation is that the United States not pay increased costs, including a profit enlarged beyond that in the contemplation of the parties to the contract when the contract costs, price, or profit is negotiated, by reason of a contractor's failure to use applicable Cost Accounting Standards, or to follow consistently its cost accounting practices. In making price adjustments under the Cost Accounting Standard clause at 52.230-3 in fixed price or cost reimbursement incentive contracts, or contracts providing for prospective or retroactive price redetermination, the Federal agency shall apply this requirement appropriately in the circumstances.

(d) The contractor and the contracting officer may enter into an agreement as contemplated by subdivision (a)(4)(ii) of the Cost Accounting Standards clause at 52.230-3, covering a change in practice proposed by the Government or the contractor for all of the contractor's contracts for which the contracting officer is responsible, provided that the agreement does not permit any increase in the cost paid by the Government. Such agreement may be made final and binding, notwithstanding the fact that experience may subsequently establish that the actual impact of the change differed from that agreed to.

(e) An adjustment to the contract price or of cost allowances pursuant to the Cost Accounting Standards clause at 52.230-3 may not be required when a change in cost accounting practices or a failure to follow Standards or cost accounting practices is estimated to result in increased costs being paid under a particular contract by the United States. This circumstance may arise when a contractor is performing two or more covered contracts, and the change or failure affects all such contracts. The change or failure may increase the cost paid under one or more of the contracts, while decreasing the cost paid under one or more of the contracts. In such case, the Government will not require price adjustment for any increased costs paid by the United States, so long as the cost decreases under one or more contracts are at least equal to the increased cost under the other affected contracts, provided that the contractor and the affected contracting officers agree on the method by which the price adjustments are to be made for all affected contracts. In this situation, the contracting agencies would, of course, require an adjustment of the contract price or cost allowances, as appropriate, to the extent that the increases

under certain contracts were not offset by the decreases under the remaining contracts.

**30.307 Cost Accounting Standards Preambles.**

Following Part 30, an Appendix containing the nonregulatory preambles to the Cost Accounting Standards and preambles to related Rules and Regulations is provided in the looseleaf edition only. The preambles are not regulatory, but are intended to explain why the Standards and related Rules and Regulations were written, and to provide rationale for positions taken relative to issues raised in the public comments. The preambles are printed in chronological order to provide an administrative history. As revisions are made to Part 30, preambles will be published under the FAR system. Part I, Preambles to the Cost Accounting Standards, and Part II, Preambles to the Related Rules and Regulations published by the Cost Accounting Standards Board, were originally published in Title 4 of the Code of Federal Regulations. Part III is reserved for preambles to be published under the FAR system.

**SUBPART 30.4-COST ACCOUNTING STANDARDS**

**30.400 General.**

This subpart contains the Cost Accounting Standards (CAS). The requirements for use of these Standards are contained in Subpart 30.2. Normal FAR numbering conventions are modified in Subpart 30.4 to maintain the original CAS numbering and referencing scheme. For example, CAS 401 now reads 30.401.

**30.401 Cost accounting standard—consistency in estimating, accumulating and reporting costs.**

**30.401-10 Reserved.**

**30.401-20 Purpose.**

The purpose of this Cost Accounting Standard is to ensure that each contractor's practices used in estimating costs for a proposal are consistent with cost accounting practices used by him in accumulating and reporting costs. Consistency in the application of cost accounting practices is necessary to enhance the likelihood that comparable transactions are treated alike. With respect to individual contracts, the consistent application of cost accounting practices will facilitate the preparation of reliable cost estimates used in pricing a proposal and their comparison with the costs of performance of the resulting contract. Such comparisons provide one important basis for financial control over costs during contract performance and aid in establishing accountability for

costs in the manner agreed to by both parties at the time of contracting. The comparisons also provide an improved basis for evaluating estimating capabilities.

**30.401-30 Reserved.**

**30.401-40 Fundamental requirement.**

(a) A contractor's practices used in estimating costs in pricing a proposal shall be consistent with his cost accounting practices used in accumulating and reporting costs.

(b) A contractor's cost accounting practices used in accumulating and reporting actual costs for a contract shall be consistent with his practices used in estimating costs in pricing the related proposal.

(c) The grouping of homogeneous costs in estimates prepared for proposal purposes shall not per se be deemed an inconsistent application of cost accounting practices under paragraphs (a) and (b) of this section when such costs are accumulated and reported in greater detail on an actual cost basis during contract performance.

**30.401-50 Techniques for application.**

(a) The standard allows grouping of homogeneous costs in order to cover those cases where it is not practicable to estimate contract costs by individual cost element or function. However, costs estimated for proposal purposes shall be presented in such a manner and in such detail that any significant cost can be compared with the actual cost accumulated and reported therefor. In any event the cost accounting practices used in estimating costs in pricing a proposal and in accumulating and reporting costs on the resulting contract shall be consistent with respect to:

(1) The classification of elements or functions of cost as direct or indirect; (2) the indirect cost pools to which each element or function of cost is charged or proposed to be charged; and (3) the methods of allocating indirect costs to the contract.

(b) Adherence to the requirement of 30.401-40(a) of this standard shall be determined as of the date of award of the contract, unless the contractor has submitted cost or pricing data pursuant to Pub. L. 87-653, in which case adherence to the requirement of 30.401-40(a) shall be determined as of the date of final agreement on price, as shown on the signed certificate of current cost or pricing data. Notwithstanding 30.401-40(b), changes in established cost accounting practices during contract performance may be made in accordance with FAR Part 30.

**30.401-60 Illustrations.**

(a) The following examples are illustrative of applications of cost accounting practices which are deemed to be consistent.



**SUBPART 30.5—RESERVED.****SUBPART 30.6—CAS ADMINISTRATION.****30.601 Responsibility.**

(a) The cognizant ACO shall perform CAS administration for all contracts in a business unit notwithstanding retention of other administration functions by the contracting officer.

(b) Within 30 days of the award of any new contract or subcontract subject to CAS, the contracting officer, contractor, or subcontractor making the award shall request the cognizant ACO to perform administration for CAS matters (see Subpart 42.2).

**30.602 Changes to disclosed or established cost accounting practices.**

Adjustments to contracts for CAS noncompliance, new standards, or voluntary changes are required only if the amounts involved are material. The ACO has the right to forego action to adjust contracts if the amount involved is not considered material; however, in the case of non-compliance issues, the ACO shall inform the contractor that (a) the Government reserves the right to make appropriate contract adjustments if, in the future, the ACO determines that the cost impact has become material and (b) the contractor is not excused from the obligation to comply with the applicable Standard or rules and regulations involved. In determining materiality, the ACO shall use the criteria in 30.305.

**30.602-1 Equitable adjustment for new or modified standards.**

(a) The clause at 52.230-1, Cost Accounting Standards Notices and Certification (National Defense), requires offerors to state whether or not the award of the contemplated contract would require a change to established cost accounting practices affecting existing contracts and subcontracts. The contracting officer shall ensure that the contractor's response to the notice is made known to the cognizant ACO.

(b) Contracts and subcontracts containing the clause at 52.230-3, Cost Accounting Standards, may require equitable adjustments to comply with new or modified CAS. Such adjustments are limited to contracts and subcontracts awarded before the effective date of each new or modified standard. A new or modified standard becomes applicable prospectively to these contracts and subcontracts when a new national defense contract or subcontract containing the clause at 52.230-3, Cost Accounting Standards, is awarded on or after the effective date of the new standard.

(c) Contracting officers shall encourage contractors to submit to the cognizant ACO any change in accounting practice in anticipation of complying with a new or modified standard as soon as practical after the new or modified standard has been incorporated into the FAR.

(d) Upon receipt of information from the contractor indicating that an accounting change is required to comply with a new or modified standard, the cognizant ACO shall review the proposed change concurrently for adequacy and compliance. If the review indicates that the change is both adequate and in compliance (see 30.202-7), the contractor shall be notified and requested to submit a cost impact proposal in sufficient detail to determine the impact on each CAS-covered contract and subcontract. The proposal shall identify each additional standard and all contracts and subcontracts containing the CAS clause and having an award date before the effective date of that standard. The proposal shall be in sufficient detail to permit evaluation, determination, and negotiation of the cost impact upon each affected contract and subcontract containing the clause at 52.230-3, Cost Accounting Standards, and shall be in the form and manner specified by the cognizant contracting officer.

(e) The cognizant ACO shall promptly analyze the proposal with the assistance of the auditor, determine the impact, and negotiate the contract price adjustments on behalf of all Government agencies. The ACO shall invite contracting offices to participate in negotiations of adjustments when the price of any of their contracts may be increased or decreased by \$10,000 or more. At the conclusion of negotiations, the ACO shall—

(1) Execute supplemental agreements to contracts of the ACO's own agency (and, if additional funds are required, request them from the appropriate contracting officer);

(2) Prepare a negotiation memorandum and send copies to cognizant auditors and contracting officers of other agencies having prime contracts affected by the negotiation (those agencies shall execute supplemental agreements in the amounts negotiated); and

(3) Furnish copies of the memorandum indicating the effect on costs to the ACO of the next higher tier subcontractor or prime contractor, as appropriate, if a subcontract is to be adjusted. This memorandum shall be the basis for negotiation between the subcontractor and the next higher tier subcontractor or prime contractor and for execution of a supplemental agreement to the subcontract.

(f) If the contractor does not submit a proposal in the form and time specified (see paragraph (b) of the clause at 52.230-4, Administration of Cost Accounting Standards, or if the parties fail to agree concerning the cost impact, the cognizant ACO, with the assistance of the auditor, shall estimate the cost impact on contracts and subcontracts containing the clause at 52.230-3, Cost Accounting Standards. The ACO shall request the contractor to agree to the cost or price adjustment. The ACO may withhold an amount not to exceed 10 percent of each subsequent payment request related to the contractor's CAS-covered prime contracts, which contain the appropriate withholding provisions, until the proposal has been furnished by the contractor. The

contractor shall also be advised that in the event no agreement on the cost or price adjustment is reached within 20 days, action may be taken in accordance with the clause at 52.233-1, Disputes. If the ACO issues a unilateral determination under the Disputes clause, the ACO shall consider appropriate action to protect the Government's interests under Subpart 32.6.

### 30.602-2 Noncompliance with CAS requirements.

(a) Within 15 days of the receipt of a report of alleged noncompliance from the auditor, the cognizant ACO shall make an initial finding of compliance or noncompliance and advise the auditor.

(b) If an initial finding of noncompliance is made, the ACO shall immediately notify the contractor in writing of the exact nature of the noncompliance and allow 30 days within which to agree or to submit reasons why the existing practices are considered to be in compliance.

(c) If the contractor agrees with the initial finding of noncompliance—

(1) The contractor shall be required to correct the noncompliance and submit a complete description of any accounting change and the general dollar magnitude of the change on all CAS-covered contracts and subcontracts;

(2) The cognizant ACO shall review the accounting change for adequacy and compliance concurrently (if the change is both adequate and in compliance, the ACO shall notify the contractor and request a cost impact proposal);

(3) The cost impact proposal must identify all contracts and subcontracts containing the clause at 52.230-3, Cost Accounting Standards, or the clause at 52.230-5, Disclosure and Consistency of Cost Accounting Practices, and shall be in sufficient detail to permit evaluation and negotiation of the cost impact on each separate CAS-covered contract and subcontract from the date of failure to comply until the noncompliance is corrected; and

(4) The ACO shall then follow the procedures in 30.602-1(e).

(d) If the contractor disagrees with the initial noncompliance finding, the cognizant ACO shall review the reasons why the contractor considers the existing practices to be in compliance and make a determination of compliance or noncompliance.

(1) If the ACO makes a determination of compliance, the ACO shall notify the contractor and send a copy to the auditor.

(2) If the ACO makes a determination of noncompliance, or if the contractor fails to furnish the cost impact proposal, the ACO, with the assistance of the auditor, shall determine the cost impact of the noncompliance on contracts and subcontracts containing CAS clauses. The ACO may withhold an amount not to exceed 10 percent of each subsequent payment request related to the contractor's CAS-covered prime contracts, which contain the appropriate provisions, until the proposal has been furnished by the contractor.

(3) If the ACO determines that the noncompliance results in material increased costs to the Government, the ACO shall notify the contractor and request agreement as to the cost or price adjustment, together with any applicable interest. The contractor shall also be advised that in the event no agreement on the cost or price adjustment is reached within 20 days, action may be taken in accordance with the clause at 52.233-1, Disputes. If the ACO issues a unilateral determination under the Disputes clause, the ACO shall consider appropriate action to protect the Government's interests under Subpart 32.6.

(4) If the ACO's estimate indicates there is no material increase in costs as a result of the noncompliance and the contractor refuses to take corrective action, the ACO shall notify the contractor in writing that the contractor is in noncompliance, that corrective action should be taken, and that if such noncompliance subsequently results in materially increased costs to the Government, the provisions of the clause at 52.230-3, Cost Accounting Standards, and/or the clause at 52.230-5, Disclosure and Consistency of Cost Accounting Practices, will be enforced.

### 30.602-3 Voluntary changes.

(a) The contract price may be adjusted for voluntary changes to a contractor's Disclosure Statement or cost accounting practices. The contractor must first notify the cognizant ACO by submission, not less than 60 days (or such other date as may be mutually agreed to) before proposed implementation, of a description of the accounting change and the general dollar magnitude of the change (including the sum of all increases and the sum of all decreases) for all CAS-covered contracts and subcontracts.

(b) The cognizant ACO shall review the accounting change concurrently for adequacy and compliance (see 30.202-7). If the change meets both tests, the ACO shall so notify the contractor and request that the contractor submit a cost impact proposal identifying all contracts and subcontracts containing the clause at 52.230-3, Cost Accounting Standards, and the clause at 52.230-5, Disclosure and Consistency of Cost Accounting Practices. The cost impact proposal shall be in sufficient detail to allow evaluation and negotiation of the cost impact upon each affected CAS-covered contract and subcontract.

(c) With the assistance of the auditor, the ACO shall promptly analyze the cost impact proposal to determine whether or not the proposed change will result in increased costs being paid by the Government. The ACO shall consider all of the contractor's affected CAS-covered contracts and subcontracts, but any cost changes to higher-tier subcontracts or contracts of other contractors over and above the cost of the subcontract adjustment shall not be considered. Increased costs resulting from a voluntary change may be allowed only if the ACO determines that the change is desirable and not detrimental to the Government. The ACO shall then follow the procedures in 30.602-1(e).

(d) If the contractor fails to submit a cost impact proposal in the form and time specified or if the parties fail to agree concerning the cost impact, the cognizant ACO, with the assistance of the auditor, shall estimate the cost impact on contracts and subcontracts containing a CAS clause and shall then request the contractor to agree to the cost or price adjustment. The ACO may withhold an amount not to exceed 10 percent of each subsequent payment request related to the contractor's CAS-covered prime contracts, which contain the appropriate withholding provisions, until the proposal has been furnished by the contractor. The contractor shall also be advised that, in the event no agreement on the cost or price adjustment is reached within 20 days, action may be taken in accordance with the clause

at 52.233-1, Disputes. If the ACO issues a unilateral determination under the Disputes clause, the ACO shall consider appropriate action to protect the Government's interests under Subpart 32.6.

**30.603 Subcontract administration.**

When a negotiated CAS price adjustment or a determination of noncompliance is required at the subcontract level, the ACO cognizant of the subcontractor shall make the determination and advise the ACO cognizant of the prime contractor or next higher tier subcontractor of his decision. ACO's cognizant of higher tier subcontractors or prime contractors shall not reverse the determination of the ACO cognizant of the subcontractor.

~~52.229-9 Taxes—Cost-Reimbursement Contracts with Foreign Governments.~~

~~As prescribed in 29.402-2(b), insert the following clause in solicitations and contracts when a cost-reimbursement contract with a foreign government is contemplated:~~

~~TAXES—COST-REIMBURSEMENT CONTRACTS WITH FOREIGN GOVERNMENTS (APR 1984)~~

~~Any tax or duty from which the United States Government is exempt by agreement with the Government of ..... [insert name of the foreign government], or from which any subcontractor under this contract is exempt under the laws of ..... [insert name of country], shall not constitute an allowable cost under this contract.~~

~~(End of clause)~~

~~(AV 7-204.24(b) 1960 JUL)~~

52.230-1 Cost Accounting Standards Notices and Certification (National Defense).

As prescribed in 30.201-3, insert the following provision:  
COST ACCOUNTING STANDARDS NOTICES AND CERTIFICATION (NATIONAL DEFENSE) (SEP 1987)

Note: This notice does not apply to small businesses or foreign governments.

This notice is in four parts, identified by Roman numerals I through IV.

Offerors shall examine each part and provide the requested information in order to determine Cost Accounting Standards (CAS) requirements applicable to any resultant contract.

I. DISCLOSURE STATEMENT—COST ACCOUNTING PRACTICES AND CERTIFICATION

(a) Any contract in excess of \$100,000 resulting from this solicitation, except contracts in which the price negotiated is based on (1) established catalog or market prices of commercial items sold in substantial quantities to the general public, or (2) prices set by law or regulation, will be subject to the requirements of Federal Acquisition Regulation (FAR) Subparts 30.3 and 30.4, except for those contracts which are exempt as specified in FAR 30.201-1.

(b) Any offeror submitting a proposal which, if accepted, will result in a contract subject to the requirements of FAR Subparts 30.3 and 30.4 must, as a condition of contracting, submit a Disclosure Statement as required by FAR 30.202. The Disclosure Statement must be submitted as a part of the offeror's proposal under this solicitation unless the offeror has already submitted a Disclosure Statement disclosing the practices used in connection with the pricing of this proposal. If an applicable Disclosure Statement has already been submitted, the offeror may satisfy the requirement for submission by providing the information requested in paragraph (c) of Part I of this provision.

CAUTION: A practice disclosed in a Disclosure Statement shall not, by virtue of such disclosure, be deemed to be a proper, approved, or agreed-to practice for pricing proposals or accumulating and reporting contract performance cost data.

(c) Check the appropriate box below:

- (1) Certificate of Concurrent Submission of Disclosure Statement.

The offeror hereby certifies that, as a part of the offer, copies of the Disclosure Statement have been submitted as follows: (i) original and one copy to the cognizant Administrative Contracting Officer (ACO), and (ii) one copy to the cognizant contract auditor.

(Disclosure must be on Form No. CASB DS-1. Forms may be obtained from the cognizant ACO.)

Date of Disclosure Statement: .....

Name and Address of Cognizant ACO where filed: .....

The offeror further certifies that practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the Disclosure Statement.

- (2) Certificate of Previously Submitted Disclosure Statement.

The offeror hereby certifies that Disclosure Statement was filed as follows:

Date of Disclosure Statement: .....

Name and Address of Cognizant ACO where filed: .....

The offeror further certifies that the practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the applicable disclosure statement.

- (3) Certificate of Monetary Exemption.

The offeror hereby certifies that the offeror, together with all divisions, subsidiaries, and affiliates under common control, did not receive net awards of negotiated national defense prime contracts and subcontracts subject to CAS totaling more than \$10 million in the cost accounting period immediately preceding the period in which this proposal was submitted. The offeror further certifies that if such status changes before an award resulting from this proposal, the offeror will advise the Contracting Officer immediately.

- (4) Certificate of Interim Exemption.

The offeror hereby certifies that (i) the offeror first exceeded the monetary exemption for disclosure, as defined in (3) above, in the cost accounting period immediately preceding the period in which this offer was submitted and (ii) in accordance with FAR 30.202-1, the offeror is not yet required to submit a Disclosure Statement. The offeror further certifies that if an award resulting from this proposal has not been made within 90 days after the end of that period, the offeror will immediately submit a revised certificate to the Contracting Officer, in the form specified under subparagraphs (c)(1) or (c)(2) of Part I of this provision, as appropriate, to verify submission of a completed Disclosure Statement.

CAUTION: Offerors currently required to disclose because they were awarded a CAS-covered national defense prime contract or subcontract of \$10 million or more in the current cost accounting period may not claim this exemption (4). Further, the exemption applies only in connection

with proposals submitted before expiration of the 90-day period following the cost accounting period in which the monetary exemption was exceeded.

**II. COST ACCOUNTING STANDARDS—EXEMPTION FOR CONTRACTS OF \$500,000 OR LESS**

If this proposal is expected to result in the award of a contract of \$500,000 or less, the offeror shall indicate whether the exemption below is claimed. Failure to check the box below shall mean that the resultant contract is subject to CAS requirements or that the offeror elects to comply with such requirements.

The offeror hereby claims an exemption from the CAS requirements under the provisions of Federal Acquisition Regulation (FAR) 30.201-1(b)(7) and certifies that notification of final acceptance of all deliverable items has been received on all prime contracts or subcontracts containing the Cost Accounting Standards clause or the Disclosure and Consistency of Cost Accounting Practices clause. The offeror further certifies that the Contracting Officer will be immediately notified in writing when an award of any other contract or subcontract containing Cost Accounting Standards clauses is received by the offeror subsequent to this certificate but before the date of any award resulting from this proposal.

**III. COST ACCOUNTING STANDARDS—ELIGIBILITY FOR MODIFIED CONTRACT COVERAGE**

If the offeror is eligible to use the modified provisions of Federal Acquisition Regulation (FAR) 30.201-2(b) and elects to do so, the offeror shall indicate by checking the box below. Checking the box below shall mean that the resultant contract is subject to the Disclosure and Consistency of Cost Accounting Practices clause in lieu of the Cost Accounting Standards clause.

The offeror hereby claims an exemption from the Cost Accounting Standards clause under the provisions of FAR 30.201-2(b) and certifies that the offeror is eligible for use of the Disclosure and Consistency of Cost Accounting Practices clause because (i) during the cost accounting period immediately preceding the period in which this proposal was submitted, the offeror received less than \$10 million in awards of CAS-covered national defense prime contracts and subcontracts, and (ii) the sum of such awards equaled less than 10 percent of total sales during that cost accounting period. The offeror further certifies that if such status changes before an award resulting from this proposal, the offeror will advise the Contracting Officer immediately.

**CAUTION:** An offeror may not claim the above eligibility for modified contract coverage if this proposal is expected to result in the award of a national defense contract of \$10 million or more or if, during its current cost accounting period, the offeror has been awarded a single CAS-covered national defense prime contract or subcontract of \$10 million or more.

**IV. ADDITIONAL COST ACCOUNTING STANDARDS APPLICABLE TO EXISTING CONTRACTS**

The offeror shall indicate below whether award of the contemplated contract would, in accordance with subparagraph (a)(3) of the Cost Accounting Standards clause, require a change in established cost accounting practices affecting existing contracts and subcontracts.

YES  NO

Note: If the offeror has checked "yes" above and is awarded the contemplated contract, the offeror will be required to comply with the requirements of subparagraph (a)(1) and paragraphs (b) and (c) of the Administration of Cost Accounting Standards clause.

(End of provision)

**52.230-2 Cost Accounting Standards Notices and Certification (Nondefense).**

As prescribed in 30.201-3(b), insert the following provision:

**COST ACCOUNTING STANDARDS NOTICES AND CERTIFICATION (NONDEFENSE) (SEP 1987)**

Note: This notice does not apply to small businesses or foreign governments.

(a) Any contract over \$100,000 resulting from this solicitation shall be subject to Cost Accounting Standards (CAS) if it is awarded to a business unit that is currently performing a national defense CAS-covered contract or subcontract, except when—

- (1) The award is based on adequate price competition;
- (2) The price is set by law or regulation;
- (3) The price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public; or
- (4) One of the exemptions in Federal Acquisition Regulation (FAR) 30.201-1(b) applies.

(b) Contracts not exempted from CAS shall be subject to full or modified coverage as follows:

(1) If the business unit receiving the award is currently performing a national defense contract or subcontract subject to full CAS coverage FAR 30.201-2(a), this contract will have full CAS coverage and will contain the clauses from the FAR entitled Cost Accounting Standards, 52.230-3 and Administration of Cost Accounting Standards, 52.230-4.

(2) If the business unit receiving the award is currently performing a national defense contract or subcontract subject to modified CAS coverage FAR 30.201-2(b), this contract will have modified coverage and will contain the clauses entitled Disclosure and Consistency of Cost Accounting Practices, 52.230-5 and Administration of Cost Accounting Standards, 52.230-4.

**A. Certificate of CAS Applicability**  
The offeror hereby certifies that—

The offeror is not performing any CAS-covered national defense contract or subcontract. The offeror further certifies that it will immediately notify the Contracting Officer in writing if it is awarded any national defense CAS-covered contract or subcontract subsequent to the date of this certificate but before the date of the award of a contract resulting from this solicitation. (If this statement applies, no further certification is required.)

The offeror is currently performing a negotiated national defense contract or subcontract that contains the Cost Accounting Standards clause at FAR 52.230-3.

The offeror is currently performing a negotiated national defense contract or subcontract that contains the Disclosure and Consistency of Cost Accounting Practices clause at FAR 52.230-5.

**B. Additional Certification—CAS Applicable Offerors**

The offeror subject to Cost Accounting Standards further certifies that practices used in estimating costs in pricing this proposal are consistent with the practices disclosed in the Disclosure Statement where it has been submitted as required by FAR 30.202-1 through 30.202-5.

**C. Data Required—CAS Covered Offerors**

The offeror certifying that it is currently performing a national defense contract containing either CAS clause (see A above) is required to furnish the name, address (including agency or department component), and telephone number of the cognizant Contracting Officer administering the offeror's CAS-covered contracts.

Name of Contracting Officer: .....  
 Address: .....  
 Telephone Number: .....

(End of provision)

**52.230-3 Cost Accounting Standards.**

As prescribed in 30.201-4(a), insert the following clause:  
**COST ACCOUNTING STANDARDS (SEP 1987)**

(a) Unless the contract is exempt under FAR 30.201-1 and 30.201-2, the provisions of Federal Acquisition Regulation (FAR) Subpart 30.3 are incorporated herein by reference and the Contractor in connection with this contract, shall—

(1) (National Defense Contracts Only) By submission of a Disclosure Statement, disclose in writing the Contractor's cost accounting practices as required by FAR 30.202-1 through 30.202-5. The practices disclosed for this contract shall be the same as the practices currently disclosed and applied on all other contracts and subcontracts being performed by the Contractor and which contain a Cost Accounting Standards (CAS) clause. If the Contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets and commercial or financial information which is privileged and confidential, the Disclosure Statement shall be protected and shall not be released outside of the Government.

(2) Follow consistently the Contractor's cost accounting practices in accumulating and reporting contract performance cost data concerning this contract. If any change in cost accounting practices is made for the purposes of any contract or subcontract subject to CAS requirements, the change must be applied prospectively to this contract and the Disclosure Statement must be amended accordingly. If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) of this clause, as appropriate.

(3) Comply with all CAS, including any modifications and interpretations indicated thereto contained in FAR Subpart 30.4, in effect on the date of award of this contract or, if the Contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the Contractor's signed certificate of current cost or pricing data. The Contractor shall also comply with any CAS (or modifications to CAS) which hereafter become applicable to a contract or subcontract of the Contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract.

(4)(i) Agree to an equitable adjustment as provided in the Changes clause of this contract if the contract cost is affected by a change which, pursuant to subparagraph (a)(3) of this clause, the Contractor is required to make to the Contractor's established cost accounting practices.

(ii) Negotiate with the Contracting Officer to determine the terms and conditions under which a change may be made to a cost accounting practice, other than a change made under other provisions of subparagraph (a)(4) of this clause; provided that no agreement may be made under this provision that will increase costs paid by the United States.

(iii) When the parties agree to a change to a cost accounting practice, other than a change under subdivision (a)(4)(i) of this clause, negotiate an equitable adjustment as provided in the Changes clause of this contract.

(5) Agree to an adjustment of the contract price or cost allowance, as appropriate, if the Contractor or a subcontractor fails to comply with an applicable Cost Accounting Standard, or to follow any cost accounting practice consistently and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States, together with interest thereon computed at the rate determined by the Secretary of the Treasury pursuant to Pub. L. 92-41, 85 Stat. 97, from the time the payment by the United States was made to the time the adjustment is effected.

(b) If the parties fail to agree whether the Contractor or a subcontractor has complied with an applicable CAS in FAR Subpart 30.4 or a CAS rule or regulation in FAR

Subpart 30.3 and as to any cost adjustment demanded by the United States, such failure to agree shall be a dispute concerning a question of fact within the meaning of the Disputes clause of this contract.

(c) The Contractor shall permit any authorized representatives of the Government to examine and make copies of any documents, papers, or records relating to compliance with the requirements of this clause.

(d) The Contractor shall include in all negotiated subcontracts which the Contractor enters into, the substance of this clause, except paragraph (b), and shall require such inclusion in all other subcontracts, of any tier, including the obligation to comply with all CAS in effect on the subcontract's award date or if the subcontractor has submitted cost or pricing data, on the date of final agreement on price as shown on the subcontractor's signed Certificate of Current Cost or Pricing Data. This requirement shall apply only to negotiated subcontracts in excess of \$100,000 where the price negotiated is not based on—

(1) Established catalog or market prices of commercial items sold in substantial quantities to the general public; or

(2) Prices set by law or regulation, and except that the requirement shall not apply to negotiated subcontracts otherwise exempt from the requirement to include a CAS clause as specified in FAR 30.201-1.

Note (1): New or modified CAS shall be applicable to both national defense and nondefense CAS-covered contracts upon award of a new national defense CAS-covered contract containing the new or modified Standard. The award of a new nondefense CAS-covered contract shall not trigger application of new CAS or modification to CAS.

Note (2): Subcontractors shall be required to submit their Disclosure Statements to the Contractor. However, if a subcontractor has previously submitted its Disclosure Statement to a Government Administrative Contracting Officer (ACO), it may satisfy that requirement by certifying to the Contractor the date of the Statement and the address of the ACO.

Note (3): In any case where a subcontractor determines that the Disclosure Statement information is privileged and confidential and declines to provide it to the Contractor or higher tier subcontractor, the Contractor may authorize direct submission of that subcontractor's Disclosure Statement to the same Government offices to which the Contractor was required to make submission of its Disclosure Statement. Such authorization shall in no way relieve the Contractor of liability as provided in subparagraph (a)(5) of this clause. In view of the foregoing and since the contract may be subject to adjustment under this clause by reason of any failure to comply with rules, regulations, and Standards as specified in FAR Subparts 30.3 and 30.4 in connection with covered subcontracts, it is expected that the Contractor may wish to include a clause in each such subcontract requiring the subcontractor to appropriately indemnify the Contractor. However, the inclusion of such a

clause and the terms thereof are matters for negotiation and agreement between the Contractor and the subcontractor, provided that they do not conflict with the duties of the Contractor under its contract with the Government. It is also expected that any subcontractor subject to such indemnification will generally require substantially similar indemnification to be submitted by its subcontractors.

Note (4): If the subcontractor is a business unit which, pursuant to FAR 30.201-2(b) is entitled to elect modified contract coverage and to follow 30.401 and 30.402, the clause at 52.230-5, "Disclosure Consistency of Cost Accounting Practices," of the Federal Acquisition Regulation shall be inserted in lieu of this clause.

Note (5): The terms defined in FAR 30.301 and 31.001 shall have the same meanings herein. As there defined "negotiated subcontract" means any subcontract except a firm-fixed-price subcontract made by a Contractor or subcontractor after receiving offers from at least two persons not associated with each other or with such Contractor or subcontractor, providing (1) the solicitation to all competitors is identical, (2) price is the only consideration in selecting the subcontractor from among the competitors solicited, and (3) the lowest offer received in compliance with the solicitation from among those solicited is accepted.

(End of clause)

#### 52.230-4 Administration of Cost Accounting Standards.

As prescribed in 30.201-4(b)(1), insert the following clause:

##### ADMINISTRATION OF COST ACCOUNTING STANDARDS (SEP 1987)

For the purpose of administering the Cost Accounting Standards (CAS) requirements under this contract, the Contractor shall take the steps outlined in paragraphs (a) through (f) of this clause:

(a) Submit to the cognizant Contracting Officer a description of any accounting change, the potential impact of the change on contracts containing a CAS clause, and if not obviously immaterial, a general dollar magnitude cost impact analysis of the change which displays the potential shift of costs between CAS-covered contracts by contract type (i.e., firm-fixed-price, incentive, cost-plus-fixed-fee, etc.) and other contractor business activity. As related to CAS-covered contracts, the analysis should display the potential impact of funds of the various Agencies/Departments (i.e., Department of Energy, National Aeronautics and Space Administration, Army, Navy, Air Force, other Department of Defense, other Government) as follows:

(1) For any change in cost accounting practices required to comply with a new CAS in accordance with subparagraph (a)(3) and subdivision (a)(4)(i) of the CAS clause, within 60 days (or such other date as may be mutually agreed to) after award of a contract requiring this change.

(2) For any change in cost accounting practices proposed in accordance with subdivision (a)(4)(ii) or (a)(4)(iii) of the CAS clause or with subparagraph (a)(3) of the Disclosure and Consistency of Cost Accounting Practices clause, not less than 60 days (or such other date as may be mutually agreed to) before the effective date of the proposed change.

(3) For any failure to comply with an applicable CAS or to follow a disclosed practice as contemplated by subparagraph (a)(5) of the CAS clause or by subparagraph (a)(4) of the Disclosure and Consistency of Cost Accounting Practices clause, within 60 days (or such other date as may be mutually agreed to) after the date of agreement of noncompliance by the Contractor.

(b) Submit a cost impact proposal in the form and manner specified by the cognizant Contracting Officer within 60 days (or such other date as may be mutually agreed to) after the date of determination of the adequacy and compliance of a change submitted pursuant to paragraph (a) of this clause. If the cost impact proposal is not submitted within the specified time, or any extension granted by the cognizant Contracting Officer, an amount not to exceed 10 percent of each payment made after that date may be withheld until such time as a proposal has been provided in the form and manner specified by the cognizant Contracting Officer.

(c) Agree to appropriate contract and subcontract amendments to reflect adjustments established in accordance with subparagraphs (a)(4) and (a)(5) of the CAS clause or with subparagraphs (a)(3) or (a)(4) of the CAS Disclosure and Consistency of Cost Accounting Practices clause.

(d) For all subcontracts subject either to the CAS clause or to the Disclosure and Consistency of Cost Accounting Practices clause—

(1) so state in the body of the subcontract, in the letter of award, or in both (self-deleting clauses shall not be used); and (2) include the substance of this clause in all negotiated subcontracts. In addition, within 30 days after award of the subcontract, submit the following information to the Contractor's cognizant contract administration office for transmittal to the contract administration office cognizant of the subcontractor's facility:

- (i) Subcontractor's name and subcontract number.
- (ii) Dollar amount and date of award.
- (iii) Name of Contractor making the award.

(iv) Any changes the subcontractor has made or proposes to make to accounting practices that affect prime contracts or subcontracts containing the CAS clause or Disclosure and Consistency of Cost Accounting Practices clause, unless these changes have already been reported. If award of the subcontract results in making one or more CAS effective for the first time, this fact shall also be reported.

(e) Notify the Contracting Officer in writing of any adjustments required to subcontracts under this contract and

agree to an adjustment, based on them, to this contractor's price or estimated cost and fee. This notice is due within 30 days after proposed subcontract adjustments are received and shall include a proposal for adjusting the higher tier subcontract or the prime contract appropriately.

(f) For subcontracts containing the CAS clause, require the subcontractor to comply with all Standards in effect on the date of award or of final agreement on price, as shown on the subcontractor's signed Certificate of Current Cost or Pricing Data, whichever is earlier.

(End of clause)

**52.230-5 Disclosure and Consistency of Cost Accounting Practices.**

As prescribed in 30.201-4(c)(1), insert the following clause:

**DISCLOSURE AND CONSISTENCY OF COST ACCOUNTING PRACTICES (SEP 1987)**

(a) The Contractor, in connection with this contract, shall—

(1) Comply with the requirements of 30.401, Consistency in Estimating, Accumulating, and Reporting Costs, and 30.402, Consistency in Allocating Costs Incurred for the Same Purpose, in effect on the date of award of this contract as indicated in Federal Acquisition Regulation (FAR) Subpart 30.4.

(2) (National Defense Contracts Only) If it is a business unit of a company required to submit a Disclosure Statement, disclose in writing its cost accounting practices as required by FAR 30.202-1 through 30.202-5. If the Contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets and commercial or financial information which is privileged and confidential, the Disclosure Statement shall be protected and shall not be released outside of the Government.

Note (1): Subcontractors shall be required to submit their Disclosure Statements to the Contractor. However, if a subcontractor has previously submitted its Disclosure Statement to a Government Administrative Contracting Officer (ACO), it may satisfy that requirement by certifying to the Contractor the date of the Statement and the address of the Contracting Officer.

Note (2): In any case where a subcontractor determines that the Disclosure Statement information is privileged and confidential and declines to provide it to the Contractor or higher tier subcontractor, the Contractor may authorize direct submission of the subcontractor's Disclosure Statement to the same Government offices to which the Contractor was required to make submission of its Disclosure Statement. Such authorization shall in no way relieve the Contractor of liability if it or a subcontractor fails to comply with an applicable Cost Accounting Standard (CAS) or to follow any practice disclosed pursuant to this paragraph and such failure results in any increased costs paid by the



United States. In view of the foregoing and since the contract may be subject to adjustment under this clause by reason of any failure to comply with rules, regulations, and Standards as specified in FAR Subparts 30.3 and 30.4 in connection with covered subcontracts, it is expected that the Contractor may wish to include a clause in each such subcontract requiring the subcontractor to appropriately indemnify the Contractor. However, the inclusion of such a clause and the terms thereof are matters for negotiation and agreement between the Contractor and subcontractor, provided that they do not conflict with the duties of the Contractor under its contract with the Government. It is also expected that any subcontractor subject to such indemnification will generally require substantially similar indemnification to be submitted by its subcontractors.

Note (3): The terms defined in FAR Subpart 30.3 and FAR 31.001 shall have the same meanings in this clause. As there defined, "negotiated subcontract" means any subcontract except a firm-fixed-price subcontract made by a Contractor or subcontractor after receiving offers from at least two persons not associated with each other or such Contractor or subcontractor, providing (1) the solicitation to all competitors is identical, (2) price is the only consideration in selecting the subcontractor from among the competitors solicited, and (3) the lowest offer received in compliance with the solicitation from among those solicited is accepted.

(3) (i) Follow consistently the Contractor's cost accounting practices. A change to such practices may be proposed, however, by either the Government or the Contractor, and the Contractor agrees to negotiate with the Contracting Officer the terms and conditions under which a change may be made. After the terms and conditions under which the change is to be made have been agreed to, the change must be applied prospectively to this contract, and the Disclosure Statement, if affected, must be amended accordingly.

(ii) The Contractor shall, when the parties agree to a change to a cost accounting practice and the Contracting Officer has made the finding that the change is desirable and not detrimental to the interests of the Government, negotiate an equitable adjustment as provided in the Changes clause of this contract. In the absence of the required finding, no agreement may be made under this contract clause that will increase costs paid by the United States.

(4) Agree to an adjustment of the contract price or cost allowance, as appropriate, if the Contractor or a subcontractor fails to comply with the applicable CAS or to follow any cost accounting practice, and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States together with interest

thereon computed at the rate determined by the Secretary of the Treasury pursuant to Pub. L. 92-41, 85 Stat. 97, from the time the payment by the United States was made to the time the adjustment is effected.

(b) If the parties fail to agree whether the Contractor has complied with an applicable CAS, rule, or regulation as specified in FAR Subparts 30.3 and 30.4 and as to any cost adjustment demanded by the United States, such failure to agree shall be a dispute within the meaning of the Disputes clause of this contract.

(c) The Contractor shall permit any authorized representatives of the Government to examine and make copies of any documents, papers, and records relating to compliance with the requirements of this clause.

(d) The Contractor shall include in all negotiated subcontracts, which the Contractor enters into, the substance of this clause, except paragraph (b), and shall require such inclusion in all other subcontracts of any tier, except that—

(1) If the subcontract is awarded to a business unit which pursuant to FAR 30.201 is required to follow all CAS, the clause entitled "Cost Accounting Standards," set forth in FAR 52.230-3, shall be inserted in lieu of this clause; or

(2) This requirement shall apply only to negotiated subcontracts in excess of \$100,000 where the price negotiated is not based on—

(i) Established catalog or market prices of commercial items sold in substantial quantities to the general public; or

(ii) Price set by law or regulation; or

(3) The requirement shall not apply to negotiated subcontracts otherwise exempt from the requirement to include a CAS clause as specified in FAR 30.201-1.

(End of clause)

#### 52.230-6 Consistency in Cost Accounting Practices.

As prescribed in 30.201-4(d), insert the following clause:

#### CONSISTENCY IN COST ACCOUNTING PRACTICES (SEP 1987)

The Contractor agrees that it will consistently follow the cost accounting practices disclosed on Form No. CASB DS-1 in estimating, accumulating and reporting costs under this contract. In the event the Contractor fails to follow such practices, it agrees that the contract price shall be adjusted, together with payment of interest, if such failure results in increased cost paid by the U.S. Government. Interest shall be computed at the rate determined by the Secretary of the Treasury pursuant to Pub L. 92-41 (85 Stat. 97) from the time payment by the Government was made to the time adjustment is effected. The Contractor agrees that the Disclosure Statement filed with the U.K. Ministry of Defence shall be available for inspection and use by authorized representatives of the United States Government.

(End of clause)

**PART 30--COST ACCOUNTING STANDARDS  
SUBPART 30.4--CAS ADMINISTRATION**

**30.401 Responsibility.**

(a) In accordance with FAR Part 30, Cost Accounting Standards, and FAR Part 31, Contract Cost Principles and Procedures, the cognizant contract auditor shall be responsible for making recommendations to the ACO as to whether:

(1) a contractor's Disclosure Statement, submitted as a condition of contracting, adequately describes the actual or proposed cost accounting practices as required by Public Law 91-379, 50 U.S.C. App. 2168, as implemented by the Cost Accounting Standards Board;

(2) a contractor's disclosed cost accounting practices are in compliance with FAR Part 31 and applicable cost accounting standards;

(3) a contractor's or subcontractor's failure to comply with applicable cost accounting standards or to follow consistently his disclosed cost accounting practices has resulted, or may result, in any increased cost paid by the Government; and

(4) a contractor's or subcontractor's proposed price changes, submitted as a result of changes made to previously disclosed or established cost accounting practices, are fair and reasonable.

### Summary of Current Standards

The following summary describes the basic purpose of each standard. For the specific requirements of each standard refer to DOD FAR Supplement Appendix O. The following summary is only intended to provide you with a general understanding of each standard.

#### CAS 401 Consistency in Estimating, Accounting, and Reporting Costs

Effective Date: 1 July 1972

**Purpose:** The purpose of this standard is to insure that practices used by each contractor in estimating costs for a proposal are consistent with the accounting practices used by each firm in accumulating and reporting costs. Consistency in the application cost accounting practices is necessary to enhance the likelihood that comparable transactions are treated alike.

**General Information:** This standard requires that the cost accounting practices used in estimating costs in pricing a proposal and in accumulating and reporting costs on the resulting contract must be consistent with respect to:

- (1) The classification of elements or functions of cost as direct or indirect.
- (2) The indirect cost pools to which each element or function of cost is charged or proposed to be charged.
- (3) The methods of allocating indirect costs to the contract. The standard allows grouping of homogeneous costs to cover those cases where it is not practical to estimate contract costs by individual cost element or function. However, costs estimated for proposal purposes must be presented so that any significant cost can be compared with the actual cost accumulated and reported. Adherence to the requirements of this standard must be determined as of the date of award of the contract, unless the contractor has submitted cost or pricing data required by Public Law 87-653. In such cases adherence must be determined by the date of final agreement on price, as shown on the signed certificate of current cost or pricing data. Changes in cost accounting practices during contract performance may be made when authorized by standards, rules, and regulations issued by the Cost Accounting Standards Board.

**Exemptions:** None

**CAS 402 Consistency in Allocating Costs Incurred for the Same Purpose**

**Effective Date: 1 July 1972**

**Purpose:** The purpose of this standard is to insure that each type of cost is allocated only once and on only one basis to any contract or other cost objective. The criteria for determining the allocation of costs to a product, contract, or other cost objective should be the same for all similar cost objectives. Adherence to these cost accounting concepts is necessary to guard against the overcharging of some cost objectives and to prevent double counting. Double counting occurs most often when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools allocated to that cost objective.

**General Information:** Under this standard all costs incurred for the same purpose under like circumstances are either direct costs or indirect costs only with respect to final cost objectives. No cost may be allocated as an indirect cost to a final cost objective if other costs have been included as a direct cost of that or any other final cost objective for the same purpose and under like circumstances. The contractor's disclosure statement will generally be the guide to determine whether or not costs are incurred for the same purpose. For those types of cost that are sometimes accounted for as direct or indirect, the contractor will set forth in the disclosure statement the specific criteria and circumstances for making such distinctions. Whenever costs serving the same purpose cannot equitably be indirectly allocated to one or more final cost objectives by the contractor's disclosed accounting practices, the contractor may amend the disclosure statement to reflect new practices that:

(1) Use a method for reassigning all such costs that would provide an equitable distribution to all final cost objectives.

(2) Directly assign all such costs to final cost objectives with which they are specifically identified.

## CAS 403 Allocation of Home Office Expenses to Segments

Effective Date: 1 July 1973

**Purpose:** The purpose of this standard is to establish criteria for allocation of the expenses of a home office to the segments of the organization based on the beneficial or causal relationship between such expenses and the receiving segments. It does not cover the reallocation of a segment's share of home office expenses to contracts and other cost objectives. It provides for:

(1) Identification of expenses for direct allocation to segments to the maximum extent.

(2) Accumulation of significant nondirectly allocated expenses into logical and relatively homogeneous pools to be allocated on bases reflecting the relationship of the expenses to the segments concerned.

(3) Allocation of any limited remaining or residual home office expenses to all segments.

**General Information:** Home office expenses must be allocated on the basis of the beneficial or causal relationship between supporting and receiving activities. When practical, such expenses must be allocated directly to segments. Significant expenses not directly allocated must be grouped in logical and homogeneous expense pools for allocation. Expenses of centralized home office service functions must be allocated on the basis of the service furnished to or received by each segment. Significant expenses incurred by a home office for staff management or policy guidance functions must be allocated to segments receiving more than a minimal benefit using a base, or bases, representative of the activity being managed. Central payments or accruals that are made by a home office on behalf of its segments must be allocated directly to segments when they can be identified specifically with individual segments. The costs of independent research and development and bidding and proposal (IR&D and B&P) efforts allocated by a home office must continue to be allocated under provision of existing laws, regulations, and other controlling factors. The expenses incurred by a home office for staff management, supervisory, or policy functions that are not identifiable to specific activities of segments must be allocated as residual expenses. Typical residual expenses are those for the chief executive, the chief financial officer, and normally any staff not identifiable with specific activities of segments. Residual expenses are allocated to all segments by the arithmetic average of the three percentages relating each segment to the total of all segments for the accounting period. These three are the segment's percentage of total operating revenue, and the segment's percentage of total net book value.

**Exemptions:** Contractors subject to the cost principles of the Office of Management Budget concerning grants and contracts with educational institutions or state and local governments are exempt from this standard.

## CAS 404 Capitalization of Tangible Assets

Effective Date: 1 July 1973

**Purpose:** This standard requires that contractors establish and adhere to certain asset capitalization policies for the purpose of cost measurement. Under these policies, costs applicable to current and future accounting periods can be consistently allocated to cost objectives for those periods.

**General Information:** Contractors must capitalize the acquisition cost of tangible capital assets. Capitalization must be based on a written policy that is reasonable and consistently applied. This policy must designate minimum economic and physical characteristics for the capitalization decision. As a minimum, assets with a useful service life of two years and an acquisition cost of \$500 must be capitalized. For assets acquired at or after the beginning of the next cost accounting period beginning after 10 December 1980, the minimum acquisition cost is \$1,000. Depending on contractor policy, assets of shorter useful life or small acquisition cost may also be capitalized. The contractor's policy may designate higher minimum dollar limitations for an original complement of low cost equipment and for betterments and improvements provided that such higher limitations are reasonable in the contractor's circumstances.

The cost to acquire a tangible capital asset includes the purchase price of the asset and costs necessary to prepare the asset for use. Costs necessary to prepare the asset include the cost of placing the asset in location and bringing the asset to a condition necessary for normal or expected use. Where material in amount, such costs including initial inspection and testing, installation, and similar expenses, must be capitalized. Donated assets which, at the time of receipt, meet the contractor's criteria for capitalization must be capitalized at their fair value at that time. Tangible capital assets constructed or fabricated by a contractor for their own use must be capitalized at amounts which include all costs direct and indirect, properly allocable to such assets.

Costs incurred after the acquisition of a tangible capital asset which result in extending the life or increasing the productivity of that asset (betterments and improvements) and meet the contractor's established criteria for capitalization must be capitalized. However, costs incurred for repairs and maintenance to a tangible capital asset that either restore the asset to, or maintain it at, its normal or expected service life or production capacity will be treated as costs of the current period.

**Exemptions:** None

## CAS 405 Accounting for Unallowable Costs

Effective Date: 1 July 1974

**Purpose:** The purpose of this standard is to facilitate the negotiation, audit, administration, and settlement of contracts by establishing guidelines that cover accounting for unallowable costs. These guidelines cover identification of costs specifically described as unallowable, and the cost accounting treatment to be accorded such costs promote the consistent application of sound cost accounting principles covering all incurred costs. The standard is based on the theory that costs incurred in carrying on the activities of an enterprise, regardless of the allowability of such costs under Government contracts, are allocable to the cost objectives with which they are identified on the basis of their beneficial or causal relationships. This standard does not govern the allowability of costs.

**General Information:** Costs expressly unallowable or to be unallowable by mutual agreement, and associated costs must be identified and excluded from any billing, claim, or proposal applicable to a Government contract. Costs that specifically become designated as unallowable because of a written decision furnished by a contracting officer pursuant to contract disputes procedures must be identified if used in the computation of any billing, claim, or proposal applicable to a Government contract. This identification requirement also applies to any costs specifically identified as unallowable. The costs of any work project not contractually authorized, whether or not related to performance of a proposed or existing contract, must be accounted for, to the extent appropriate in a manner that permits ready separation from the costs of authorized work projects. All unallowable costs are subject to the same cost accounting principles governing cost allocability as allowable costs.

**Exemptions:** None

**CAS 406 Cost Accounting Period**

**Effective Date: 1 July 1974**

**Purpose:** The purpose of this standard is to provide the criteria for the selection of the time periods to be used as cost accounting periods for contract cost estimating, accumulating, and reporting. Following the criteria of this standard will reduce the effects of variations in the flow of costs in each cost accounting period. It will also enhance objectivity, consistency, and verifiability, and promote uniformity and comparability in contract cost measurements.

**General Information:** A contractor must use the firm's fiscal year as its cost accounting period except that:

(1) Costs of an indirect function that exists for only a part of a cost accounting period may be allocated to cost objectives of that same part of the period.

(2) An annual period other than the fiscal year may be used as the cost accounting period if its use is an established practice of the contractor and mutually agreed to by the Government.

(3) A transitional cost accounting period other than a year will be used whenever a change of fiscal year occurs.

(4) Where a contractor's cost accounting period is different from the reporting period required by Renegotiation Board regulations, the latter may be used for such reporting.

A contractor must follow consistent practices in the selection of the cost accounting period or periods in which expenses and adjustments to expenses, including prior-period adjustments, are accumulated and allocated.

The same cost accounting period must be used for accumulating costs in an indirect cost pool for establishing its allocation base, except that the contracting parties may agree to use a different period for establishing an allocation base under certain limited circumstances.

**Exemptions: None**



**CAS 407 Use of Standard Costs for Direct Material and Direct Labor**

**Effective Date: 10 October 1974**

**Purpose:** The purposes of this standard are to provide the criteria under which standard costs may be used for estimating, accumulating, and reporting costs of direct material and direct labor; and to provide the criteria relating to the establishment of standards, accumulation of standard costs, and accumulation and disposition of variances from standard costs. Standard costs include any costs computed with the use of preestablished measures.

**General Information:** Standard costs may be used for estimating, accumulating, and reporting costs of direct material and direct labor only when all of the following criteria are met:

- (a) Standard costs are entered into the books of account.
- (b) Standard costs and related variances are appropriately accounted for at the level of the production unit.
- (c) Practices with respect to the setting and revising of standards, use of standard costs, and disposition of variances are stated in writing and are consistently followed.

A contractor's written statement of practices with respect to standards must include the bases and criteria, such as engineering studies, experience, or other supporting data, used in setting and revising standards; the period during which standards are to remain effective; the level, such as ideal or realistic, at which material-quantity standards and labor-time standards are set; and conditions, such as those expected to prevail at the beginning of a period, which material-price standards and labor-rate standards are designed to reflect.

Variances accumulated by production unit must be allocated to cost objectives, including ending-in-process inventory, at least once a year. In material variances may be included in appropriate indirect cost pools for allocation to applicable cost objectives.

**Exemptions: None**

**CAS 408 Accounting for Costs of Compensated Personnel Absence**

**Effective Date: 1 July 1975**

**Purpose:** The purpose of this standard is to improve uniformity in the measurement of costs of vacation, sick leave, holiday, and other compensated personal absence for a cost accounting period.

**General Information:** Any absence from work for reasons such as illness, vacation, holidays, jury duty, military training, or personal activities for which an employer pays compensation directly to an employee in accordance with a plan or a custom is a compensated personal absence. As employee's right to receive such compensation is known as an entitlement.

The costs of compensated personal absence are assigned to the cost accounting period or periods in which the entitlement was earned. Compensated personal absence is earned when the employer becomes liable to compensate the employee for such absence in the event of a nondisciplinary termination or lay-off. Where a new employee must complete a probationary period before the employer becomes liable, the employer may nonetheless treat such services as creating liability, entitlement will be considered earned during the period it is paid.

Liability estimates will normally be made for the total cost of all employees unless individual estimates are required for accuracy. The estimated liability must include all earned entitlements less any significant anticipated nonutilization. Current or anticipated wage rates may be used in estimating liability.

Any increase in liability from implementation of the standard or from a change in the employee's plan or custom must be held in suspense. The amount held in suspense will be reduced by the excess over the employee's liability at the end of the period. The period cost will then be increased by that amount.

The costs of compensated personal absence from an accounting period must be allocated proportionately to the final cost objectives of that period.

**Exemptions:** Contractors subject to cost principles of the Office of Management and Budget concerning grants and contracts with educational institutions or state and local governments are exempt from this standard.

## CAS 409 Depreciation on Tangible Capital Assets

Effective Date: 1 July 1975

**Purpose:** The purpose of this standard is to provide the criteria and guidance for assigning costs of tangible capital assets to cost accounting periods and for allocating such costs to cost objectives within such periods in a fair and consistent manner. The standard is based on the concept that depreciation costs identified with cost accounting periods should be a reasonable measure of the expiration of service potential of the tangible assets subject to depreciation. Adherence to this standard should provide a systematic and rational flow of the costs of tangible capital assets to benefited cost objectives over the expected service lives of the assets. This standard does not cover nonwasting assets or natural resources subject to depletion.

**General Information:** The depreciable cost of a tangible capital asset, or group of assets, must be assigned to cost accounting periods by the following criteria:

(1) The depreciable cost of a tangible capital asset will be its capitalized cost less its estimated residual (salvage) value.

(2) The estimated service life of a tangible capital asset, or group of assets, will be used to determine the cost accounting periods to which the depreciable cost will be assigned.

(3) The method of depreciation selected must reflect the pattern of consumption of services over the life of the asset. The estimated life of the asset must be supported by historical experience. The historical experience may be modified by changes in expected physical or economic usefulness. Where historical records are not available, estimates may be based on the expected useful life of the time. However, the estimate must not be less than the average period set forth for such assets in Internal Revenue Service Procedure 72-10.

(4) Any gain or loss that is recognized on disposal of a tangible capital asset must be assigned to the cost accounting period in which the disposition occurs.

The annual depreciation cost of a tangible capital asset, or group of assets, must be allocated to the cost objectives for which it provides service. The gain or loss recognized upon disposition of a tangible capital asset, where material in an amount, must be allocated just as the depreciation cost of the asset has been or would have been allocated for the cost accounting period in which the disposition occurs. Where such gain or loss is not material, the amount may be included in an appropriate indirect cost pool.

**Exemptions:** Contractors subject to cost principles of the Office of Management and Budget concerning grants and contracts with educational institutions or state and local governments are exempt from this standard.

**CAS 410 Allocation of Business Unit General and Administrative Expense to Final Cost Objectives**

**Effective Date: 1 October 1976**

**Purpose:** The purpose of this standard is to provide the criteria for the allocation of business unit general and administrative (G&A) expenses to final cost objectives based on their beneficial or causal relationship. G&A expenses represent the cost of the management and administration of the business unit as a whole. The standard also provides criteria for the Allocation of home office expenses received by a segment to the cost objectives of that segment.

**General Information:** Business unit G&A expenses must be grouped in a separate indirect cost pool that is allocated only to final cost objectives, including items produced or worked on for stock. The G&A expense pool of a business unit for a cost accounting period must be allocated to final cost objectives of that cost accounting period by means of a cost input base representing the total activity of the business unit. The cost input base selected will be the one that best represents the total activity of a typical cost accounting period. Sometimes a particular cost objective receives significantly more or less benefit from a G&A expense pool than what would be reflected by a total activity cost input based allocation. The business unit must account for this cost objective by a special allocation from the G&A pool based on the benefit received.

Independent research and development costs and bidding and proposal (IR&D and R&P) costs will be treated pursuant to provisions of existing laws, regulations, and other controlling factors. Any costs that do not satisfy the definition of G&A expenses in this standard, but have been classified by a business unit as G&A expenses, can remain in the G&A pool unless they can be allocated to business unit cost objectives on a beneficial or causal relationship that is best measured by a base other than a cost input base.

The cost input base selected to represent the total activity of business unit should be the one that best represents total business activity.

(1) A total cost input base is generally acceptable as an appropriate measure of the total activity of a business unit.

(2) A value-added cost input base is that of total cost input less material and subcontract costs. Value-added cost input will be used as an allocation base where inclusion of material and subcontract costs would significantly distort the allocation of the G&A expense pool in relation to the benefits received, and where costs other than direct labor are significant measures of total activity.

(3) A single element cost input base, for example, direct labor hours or direct labor dollars, which represents the total activity of a business unit, may be used to allocate the G&A expense pool where it produces equitable results.

Where, prior to the effective date of this standard, business unit's disclosed or established cost accounting practice was to use a cost of sales or sales base, that business unit may use the transition method set out in Appendix A of the standard.

**CAS 411 Accounting for Acquisition Costs of Material**

**Effective Date: 1 July 1977**

**Purpose:** The purpose of this standard is to provide the criteria for the accounting of acquisition costs of material. It includes provisions on the use of inventory costing methods.

**General Information:** The contractor must have, and must consistently apply, written statements of accounting policies and practices for accumulating the costs of material and for allocating costs of material to cost objectives. The cost of units of a category of material and for allocating costs of material to cost objectives. The cost of units of a category of material may be allocated directly to a cost objective, provided that the cost objective was specifically identified at the time of purchase or production of the units. The cost of material that (1) is used solely for performing indirect functions, or (2) is not a significant element of production cost whether or not incorporated in an end product, may be allocated to an indirect cost pool. When significant, the cost of such indirect material not consumed in a cost accounting period must be established as an asset at the end of the period. In general, the cost of a category of material will be accounted for in material inventory records. One of the following inventory costing methods will be used when issuing material from a company-owned inventory:

- (1) First-in, first-out (FIFO) method.
- (2) Moving average cost method.
- (3) Weighted average cost method.
- (4) Standard cost method.
- (5) Last-in, first-out (LIFO) method.

The method of computation used for any inventory costing method selected pursuant to the provisions of this standard must be consistently followed.

**Exemptions: None.**

**CAS 412 Composition and Measurement of Pension Cost**

**Effective Date: 1 January 1976**

**Purpose:** The purpose of this standard is to provide guidance for determining and measuring the components of pension cost. It establishes the basis on which pension costs will be assigned to cost accounting periods.

**General Information:** This standard considers two basic types of pension plans; defined-benefit and defined-contribution. Under the defined-benefit plan, benefits are established in advanced, and contributions are intended to provide those benefits. Under the defined-contribution plan, contributions are established in advance, and benefits are whatever amount results from those contributions.

The period pension cost of defined-contribution pension plans is the net contribution required for that period, after a consideration of applicable dividends and other credits.

Period pension costs for defined-benefit pension plans are (1) the normal cost of the period, (2) a part of any unfunded actuarial liability, (3) an interest equivalent on the unamortized portion of any unfunded actuarial liability, and (4) an adjustment for any actuarial gains and losses. For defined-benefit pension plans, the amount of pension cost of a cost accounting period is determined by use of an actuarial cost method that measures separately each of the components of pension cost.

The amount of pension cost computed for a cost accounting period is assignable only to that period. Except for pay-as-you-go plans, the cost assignable to a period is allocable to cost objectives of that period to the extent that liquidation of the liability for such cost can be compelled. If payment is optional with the company, the amount of assignable costs allocable to cost objectives of that period is limited to the amount of benefits actually paid to retirees or beneficiaries in that period.

**Exemptions: None**

**CAS 413 Adjustment and Allocation of Pension Cost**

**Effective Date: 10 March 1978**

**Purpose:** This standard has two primary purposes. One is that of providing guidance for adjusting pension cost by measuring actuarial gains and losses and assigning such gains and losses to cost accounting periods. The other is to provide guidelines for allocation of pension cost to segments of an organization.

**General Information:** Actuarial gains and losses result from differences between expense estimated by using actuarial assumptions and actual expense. An actuarial assumption is a prediction of future conditions affecting pension cost; for example, mortality rate, employee turnover, compensation levels, pension fund earnings, and changes in values of pension fund assets. Actuarial gains and losses must be calculated annually and assigned to the cost accounting period for which the actuarial valuation is made and for subsequent periods. Significant actuarial gains and losses for pension plans, using an immediate-gain actuarial cost method, must be amortized equally over a 15-year period, beginning with the rate as of which the actuarial valuation is made. Insignificant gains or losses may be included as a component of the current or ensuing year's pension cost. Actuarial gains and losses applicable to a pension plan, using a spread-gain actuarial cost method, will be included as part of current and before normal cost and is spread over the remaining average working lives of the work force.

The value of all pension fund assets must be determined under an asset valuation method that takes into account unrealized appreciation and depreciation of pension fund assets. Except when plans are funded by guaranteed benefit payments of insurance company the actuarial value of the assets or a pension fund will be used in measuring actuarial gains and losses and in measuring other components of pension cost. The actuarial value may be determined by using any recognized asset valuation method that provides equivalent recognition of appreciation and depreciation of pension fund assets. However, the total asset value produced by the method must fall within a corridor from 80 to 120 percent of the market value of the assets, determined as of the valuation date. If the method produces a value that falls outside the corridor, the value of the assets must be adjusted to equal the nearest boundary of the corridor.

Contractors must allocate pension cost to each segment having participants in the plan. For contractors who compute a composite pension cost covering plan participants in two or more segments, the base to be used for allocating such costs must be representative of the factors on which the pension benefits are based. For example, a base consisting of salaries and wages will be used for pension costs that are calculated as a percentage of salaries and wages; a base consisting of the number of employees will be used for pension costs that are calculated as an amount

per employee. Separate pension cost for a segment must be calculated whenever any of several conditions exist that materially affect the amount of pension cost allocated to the segments. Whenever the pension cost of a segment is required to be calculated separately such calculations will be prospective only; pension costs need not be redetermined for prior years. For a segment a base pension costs are required to be calculated separately, there must be an initial allocation of a share in the undivided pension fund assets to that segment according to criteria established in the standard. If, before a contractor is required to use this standard, the firm has been calculating pension cost separately for individual segments, the amount of assets previously allocated to those segments need not be changed. Further, criteria are specified by the standard for handling separately calculated pension costs.

Exemptions: None



**CAS 414 Cost of Money as an Element of the Cost of Facilities  
Capital**

**Purpose:** The purpose of this standard is to establish criteria for the measurement and allocation of the cost of capital committed to facilities as an element of contract cost.

**General Information:** A contractor's facilities capital net book value (NBV) must be measured and allocated to accounts in accordance with the criteria set forth in this standard.

This NBV is then multiplied by the interest rate determined by the Secretary of the Treasury under Public Law 92-41(86 Statute 97) to find an estimated period cost of money for the account. This cost of money is then divided by the appropriate overhead base to develop a cost of money factor. These factors are then applied to the appropriate bases in each contract to determine the cost of money applicable to each accounting period of the contract.

**Exemptions:** Contractors subject to cost principles of the Office of Management and Budget concerning grants and contracts with educational institutions or state and local governments are exempt from this standard.

CAS 415 Accounting for the Cost of Deferred Compensation

Effective Date: 10 July 1977

**Purpose:** The purpose of this standard is to provide the criteria for the measurement of the cost of deferred compensation, except compensation for personnel absence and pension plans, and the assignment of such cost to cost accounting periods.

**General Information:** The cost of deferred compensation must be assigned to the cost accounting period in which the contractor incurs an obligation to compensate the employee. The period cost of deferred compensation will be the present value of the future benefits to be paid by the contractor. Unless the cost of deferred compensation for the employees covered by a deferred compensation plan can be measured with reasonable accuracy on a group basis, separate computations for each employee is required. For the purpose of recording costs, contractor obligation to future employee compensation occurs in the period in which the following criteria are met:

(1) The contractor cannot unilaterally avoid a requirement to make the future payment(s). When compensation awards are contingent on future employee services, obligation does not occur until those service are performed. In the event no obligation to future employee compensation occurs in the period in which the following criteria are met:

(2) The deferred compensation award is to be satisfied by a future payment of money, other assets, or shares of stock of the contractor.

(3) The amount of the future payment can be measured with reasonable accuracy.

(4) The recipient of the award is known.

(5) If the terms of the award require that certain events must occur before an employee is entitled to receive the benefits, there is a reasonable probability that such events will occur.

(6) For stock options, there must be a reasonable probability that the options ultimately will be exercised.

The period cost of contractor obligation includes the stated amount of any compensation award plus an estimate of any applicable interest less an estimate of employee forfeitures of compensation. Any material changes in contractor obligation resulting from changes in the interest rate or employee forfeitures will be recorded in the period in which those changes become known. Contractor obligations to deliver assets other than cash will be recorded at asset market value in the period of those obligations.

**CAS 416 Accounting for Insurance Costs**

**Effective Date: 10 July 1979**

**Purpose:** The purpose of this standard is to provide the criteria for the measurement of insurance costs, the assignment of such costs to cost accounting periods, and their allocation to cost objectives.

**General Information:** The amount of insurance cost to be assigned to a cost accounting period is the projected average loss for that period plus insurance administration expenses in that period. Insurance costs that may be defined as deposits under current accounting principles must be accounted for as deposits. Other premium costs accounting periods covered by the policy term. A refund, dividend, or additional assessment becomes an adjustment to the premium costs of the earliest cost accounting period in which the refund or dividend is actually or constructively received or in which the additional assessment is payable.

If an objective of an insurance program is to prefund insurance coverage on retired persons, payments must be made to an insurer or trustee to establish and maintain a fund or reserve for that purpose. The policyholder or trustor has no right of recapture of the fund or reserve so long as any active or retired participant in the program remains alive unless the interests of such remaining participants are satisfied. The amount added to the fund or reserve in any cost accounting period must not be greater than an amount that would be required to apportion the cost of the insurance coverage fairly over the working lives of the active employees in the plan.

The contractor may adopt a practice of determining insurance costs based on the estimated premium and assessments net of estimated refunds and dividends. Adjustments must be made in the earliest possible cost accounting period for differences between estimates and actual expenses.

For exposure to risk of loss not covered by the purchase of insurance or by payments to a trustee fund, the contractor may follow a program of self-insurance. Normally, actual losses will not become a part of insurance costs. Instead, the contractor shall make a self-insurance charge for each period for each type of self-insured risk that represents the projected average loss for that period.

The allocation of insurance costs to cost objectives will be based on the beneficial or causal relationship between the insurance costs and the benefiting or causing objectives. Insurance costs, including costs of administration, must be allocated on the basis of the factors used to determine the premium, assessment, refund, dividend, or self-insurance charge. However, insurance costs incurred by a segment or allocated to a segment from a home office may be combined with costs of other direct cost.

**Exemptions: None**

**CAS 417 Cost of Money as an Element of Cost of Capital Assets  
Under Construction**

**Effective Date: 15 December 1980**

**Purpose:** The purpose of this standard is to provide for the inclusion of cost of money or its equivalent in the capitalized cost of facilities under construction.

**General Information:** The asset value to be depreciated will include an amount representative of the contractors investment for the period plus an amount representative of the associated cost of money. The investment value will be measured using the contractor's costs. Where the construction/fabrication period extends over more than one cost accounting periods, the investment cost will be spread over the periods with consideration given to the rate at which the contractor is incurring costs.

The determination of the cost of money will be done using CAS 414 methodology. The treasury rate pursuant to P.L. 92-41 will be used in calculating cost of money. It is permissible for the contractor to use some other method for calculating cost of money as long as the result does not differ materially from the above methodology.

**Exemptions: None**

**CAS 418 Allocation of Direct and Indirect Costs**

**Effective Date: 20 September 1980**

**Purpose:** The purpose of this standard is to provide for consistent determination of direct and indirect costs; for the accumulation and indirect costs into cost pools; and, for selection of allocation bases.

**General Information:** Each contractor will have a written policy for classifying costs as direct or indirect. The degree of detail in the written policy shall be decided on by the contractor and cognizant government representative. The policy will require the use of actual costs; standard costs as covered in CAS 407 may be used. Average or preestablished rates are acceptable as long as the employees involved are interchangeable with respect to their functions; or, if their functions are dissimilar, they function as an integral team or their collective efforts result in a homogeneous output.

Indirect costs with the same or similar beneficial or causal relationships to cost objectives should be grouped into pools. Costs may also be regarded as homogeneous if the allocation to cost objectives is approximately the same as would result if the costs were allocated separately.

Pooled costs shall be allocated to cost objectives in reasonable proportion to the beneficial or causal relationship of the pooled costs to the cost objectives. The preferred representation of this relationship is a measure of resource consumption such as pool cost per direct labor hour or dollar. If a measure of resource consumption is impractical or not available, the next best representation is a measure of pooled cost-output such as square footage as an allocation base for occupancy costs. If neither of these representations are practical or available, then a surrogate measure that approximates the proportional consumption of the pooled resource shall be used; for example, the value of materials issued as an allocation base for material handling cost. If the pooled cost includes significant amounts of managerial/supervisory cost then the allocation base should be representative of the activities being managed or supervised. Keep in mind that while this hierarchy is the required basis for selecting and evaluating the allocation bases, no change in the contractor's existing bases is required if the resulting difference is immaterial.

**Exemptions:** Contractors subject to cost principles of the Office of Management and Budget concerning grants and contracts with educational institutions or state and local governments are exempt from this standard.

**CAS 420 Accounting for Independent Research and Development  
Costs and Bid and Proposal Costs**

**Effective Date: 15 March 1980**

**Purpose:** The purpose of this standard is to provide criteria for the accumulation and allocation of independent research and development costs (IR&D) and bid and proposal (B&P).

**General Information:** All allocable IR&D/B&P cost shall be accumulated by individual project. Small projects may be grouped into one or more IR&D projects and B&P projects. Allocable IR&D/B&P costs include direct project costs and applicable overhead costs. Segment general and administrative costs will not be charged to IR&D/B&P projects.

Individual segments will normally allocate their IR&D/B&P costs by means of the same base used for general and administrative expense. In those cases where the general and administrative expense base would result in an allocation of costs to a final cost objective that receives significantly more or less benefit from the IR&D or B&P costs, a special allocation commensurate with the benefit received may be negotiated. When a segment performs IR&D or B&P by the performing segment. The performing segment will accumulate the project cost including an allocation of its general and administrative cost and then allocate the cost, via the home office, to the benefiting segment(s).

The costs of IR&D and B&P projects accumulated at the home office will be allocated to its segment by one or two methods. The first method allocates costs to specific segments when the segments can be identified with specific segments. In this case the costs are assumed to be for the general benefit of the entire company and will be allocated on the same basis as home office residual expenses covered under CAS 403.

**Exemptions:** Contractors subject to cost principles of the Office of Management and Budget concerning grants and contracts with educational institutions or state and local governments are exempt from this standard.

NOTES

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CHAPTER D  
OVERHEAD AND PRICING

Through techniques of cost and price analysis, defense contractors and government representatives attempt to reach fair and reasonable prices for defense acquisitions. Since open market competition often does not exist, alternative methods of determining reasonableness must be used. This chapter will look at price analysis, cost analysis, profit considerations and cost and pricing data requirements.

The reading assignment is as follows:

<u>Topic</u>	<u>Page</u>	<u>ASSIGNMENT</u>
1. The Systematic Acquisition of Overhead	D-2 thru D-10	Read
2. Criteria For Allowability of Cost	D-11	Review
3. Truth In Negotiation Act Summary	D-12 thru D-17	Review
4. FAR 15.8 Price Negotiation	D-18 thru D-35	Review
5. FAR PART 31 Contract Cost Principles and Procedures	D-36 thru D-79	Review
6. DFARS 15.8 Price Negotiation	D-80 thru D-101	Review
7. DFARS PART 31 Contract Cost Principles and Procedures	D-102 thru D-103	Review



SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Overhead and Pricing Support

TIME: 4.5 Hrs

OBJECTIVE: Comprehend selected techniques for Cost/Price analysis and evaluation, negotiation, and monitoring of direct/indirect costs on Government contracts.

SAMPLES OF BEHAVIOR:

- a. State the nature and importance of Overhead Costs.
- b. Describe DOD objectives and policies for analyzing, monitoring and tracking direct and indirect costs in Government contracts.
- c. Explain the use of forward pricing rate agreements.
- d. Defend cost and pricing data requirements in Government contracts.

METHODS OF INSTRUCTION: Lecture/Discussion  
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS: ACA Textbook

REQUIRED STUDENT PREPARATION: As defined in Chapter "D" of the ACA textbook.

THE SYSTEMATIC ACQUISITION OF OVERHEAD

BY

CAPTAIN JEFFREY D. SMITH

Edited Sep 1986, R.L. Wells

## OVERHEAD IS IMPORTANT

Overhead, or indirect expense, represent plant-wide costs required to support the contractor's business. Indirect costs are those costs that cannot be directly identified with a particular contract or program. Simply stated, indirect costs are all contractor costs except direct labor, direct material (including subcontract), and other direct costs. These indirect costs account for approximately two-thirds of in-plant costs (total cost less direct material and subcontracts). With this in mind, it is easy to see why indirect cost has been receiving so much attention!

### IN-PLANT COSTS

INDIRECT COST	DIRECT COSTS
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Normally, your first exposure to indirect cost is not through looking at the costs themselves, but through an overhead rate on a contractor's proposal. So how do we get from contractor indirect costs to overhead rates?

### DEVELOPING OVERHEAD

The genesis of overhead costs and overhead rates is through the contractors planning and budgeting system. Any company, whether it is engaged in the defense market or commercial enterprises, must make some estimate of its future business. While the exact process varies from contractor to contractor, the general sequence is the same. Before any costs can be estimated, the contractor must first estimate the total goods and services they expect to sell to all customers during each of their forecast years. After the sales have been estimated, the second step is to estimate the direct costs (direct labor, direct material/subcontract and other direct costs) that will be needed to produce the goods and services they expect to sell. After the direct costs have been estimated, the third step is to estimate the cost of indirect activities needed to support the direct activities. These indirect costs include a variety of cost elements ranging from depreciation to taxes to office supplies, but the largest portion of indirect costs are people related (indirect labor, supervision fringe benefits, and other personnel related expenses). After the indirect costs have been estimated the fourth step is to estimate those expenses incurred for the overall benefit of the contractor, these costs are commonly known as general and administrative expenses (G&A).

#### Contractor Estimates for Accounting Year 19XX

Step 1	Sales Estimate	1,000 units
Step 2	Direct Cost Estimates	
	Direct Labor	\$1,000,000
	Direct Material/Subcontract	<u>\$4,000,000</u>

	Total Estimated Direct Costs	\$5,000,000
Step 3	Indirect Cost Estimate	\$3,000,000
Step 4	General & Administrative Expense Estimate	\$5,000,000

Having completed the estimates for the year, the contractor takes these plant-wide estimates and converts them into the percentage rates we see on cost proposals and reports of contract costs incurred. The conversion to rates is done using the basic equation:

$$\text{rate} = \frac{\text{indirect cost POOL}}{\text{direct activity BASE}}$$

The indirect costs are gathered into pools and divided by the direct activity base to which it will be charged.

$$\text{O/H Rate} = \frac{\$3,000,000 \text{ (Est I/C)}}{\$1,000,000 \text{ (Est D/L\$)}} = 300\% \text{ of Direct Labor Dollars}$$

$$\text{G\&A Rate} = \frac{5,000,000 \text{ (Est G\&A)}}{1,000,000 \text{ (DL\$)} + 3,000,000 \text{ (Est I/C)} + 4,000,000 \text{ (Est DM)}} = 62.5\% \text{ of Total Cost Input}$$

As you can see by the development of these rates, the overhead rates are based on plant-wide estimates and should be applied to all categories of costs included in the allocation base. You should also note that while the overhead rate in this example is "higher", the G&A rate actually represents more cost (\$5 million vs. \$3 million). Focusing solely on the rates often conceals the real importance of the pooled costs. The decisions on what costs should be pooled together and the selection of appropriate allocation bases are subject to Federal Acquisition Regulations (FAR) and Cost Accounting Standards (CAS). Typically, the cognizant Administrative Contracting Officer (ACO) is responsible for determining compliance, adequacy, and reasonableness of the contractor's overhead system and rates.

### BUYING OVERHEAD

We "buy" overhead through the use of rates applied against direct cost allocation bases. Using the rates we developed earlier, let's assume the contractor submitted the following proposal:

#### Cost Proposal for ECP-0000

Direct Labor	100 Hrs.
Direct Labor \$ @ \$25.00/Hr.	\$ 2,500
Overhead @ 300%/DL\$	\$ 7,500
Direct Material	\$ 1,000
Subtotal	\$11,000
G&A @ 62.5%	\$ 6,875
Total Cost	\$17,875

The contractor estimated the direct material cost and direct labor hours;

then, using their labor rate, they determined the direct labor cost. Next the contractor applied the plant-wide estimated overhead and G&A rates. Through the application of rates and the negotiation of contract cost using rates we "buy" indirect costs.

### OVERHEAD COSTS ARE LEGITIMATE

The Government recognizes indirect costs as a legitimate and fundamental cost of doing business. It is the contractors' responsibility to manage their indirect costs. On the other hand, it is the Government's responsibility to insure fair and reasonable contract costs through the systematic monitorship of contractor's cost management. The systematic monitorship of contractor costs can be divided into three phases; the Forward Pricing Rate Agreement phase, the cost tracking phase, and the final settlement phase.

### Life Cycle of Overhead

#### FPRA

#### COST TRACKING

#### FINAL SETTLEMENT

Throughout the cost monitorship cycle, two basic concepts are present, the cost avoidance concept and the government team concept. The cost avoidance concept is our most viable approach to dealing with cost reasonableness. Simply stated, if an unreasonable or otherwise unacceptable cost can be identified before the cost is incurred we are more apt to succeed in negotiating the cost out of our contracts. Experience has shown that efforts to disallow actual incurred costs on the grounds of reasonableness have been marginally effective. The reason for this is simple, whether we feel the cost should be reimbursed or not, the contractor did incur the expense and must pay it. If the contractor cannot charge the expense to our contracts via the overhead rates, then the expense must be paid out of profit. If you enter into negotiations on reducing questionable costs before the contractor has incurred a significant amount of cost, you will drastically improve your chances of reaching a mutually agreeable settlement.

The other concept is the use of a government team. The team members come from three agencies; the contract administration office (CAO), the Defense Contract Audit Agency (DCAA), and the buying activity. The focal point for much of the team activity is the ACO. The cognizant ACO is the team leader. The ACO negotiates Final Settlements, Forward Pricing Rate Agreements (FPRA), or issues Forward Pricing Rate Recommendations (FPRR) when an agreement with the contractor has not been reached. Supporting the ACO is a staff dedicated to negotiating and tracking contractor direct and indirect costs. This staff typically possesses the expertise to deal with issues such as cost

accounting, Cost Accounting Standards, industrial engineering, and automatic data processing.

The DCAA auditor's advisory role contributes to overhead monitorship through audits of proposed FPRA's, incurred costs, final settlement proposals, and proposed changes to the contractors disclosed accounting practices. The auditors contribute to the cost avoidance concept through operations audits. These audits are reviews of the efficiency and effectiveness of selected contractor operations. By pointing out areas where the contractors can reduce cost or increase efficiency the costs associated with future defense contracts may be reduced.

The buying office supports the team concept through substantiating contractor sales forecasts, providing information to the ACO on significant changes in volume, deliveries, and other areas that may effect overhead rates, insuring proper application of FPRA's, supporting FPRR's, and insuring the submittal of required documents and materials such as contractor Disclosure Statements.

### TOOLS OF THE TRADE

There are several tools for monitoring costs available to the Government the purpose of these tools is to help insure fair and reasonable costs on our contracts. No one tool is the solution in itself, but all the tools used effectively along with the cooperative efforts of all the members of the Government team can insure fair and reasonable prices The cost monitorship tools include; Cost Accounting Standards (CAS), FAR 31 Cost Principles, Forward Pricing Rate Agreements (FPRA's), Should Cost Reviews, and Cost Monitoring Plans.

#### --Cost Accounting Standards--

CAS had its origins in the late 1960's. Perceived abuses on defense contracts led Congress to establish the Cost Accounting Standards Board. The purpose of this board was to provide a body of cost accounting practices to guard against excessive profits and unfavorable contract costs. CAS attempts to accomplish this through the establishment of standards governing cost accounting practices. The standards are intended for defense contractors who regularly deal in negotiated national defense contracts over \$100,000. Contractors are required to disclose to the Government their cost accounting procedures and to consistently account for and allocate proportionately all contract costs.

The primary responsibility for insuring CAS compliance lies with the ACO. The ACO, with assistance from the other team members, determines whether the contractor's disclosed practices are adequate and if the practices are in compliance with the CAS. Since the ACO has the responsibility to insure uniform and consistent cost accounting on a plant-wide basis, buying offices should be very cautious about influencing contractors changes in accounting practices.

#### --Forward Pricing Rate Agreements--

The FPRA is a very useful tool for insuring consistent cost estimating and implementing the cost avoidance concept. Since overhead is a plant-wide cost, the Government should, to the greatest extent possible, consistently use overhead rates based on plant-wide estimates. Tunnel vision on the part of a buying office could lead to excessive contract costs through the use of overhead rates higher than those supported by the plant-wide estimates or cost overruns through the use of unrealistic overhead rates that are lower than those supported by the plant-wide estimates.

The FPRA provides an opportunity to resolve some cost issues before the costs are incurred. During the negotiation process leading to an FPRA, general agreement between the Government and the contractor needs to be reached on the composition and reasonableness of the pools and bases used to develop the rates. Since issues of allowability, allocability, and reasonableness are part of the negotiation, the government and contractor are afforded an opportunity to work out differences before the costs are incurred. The general agreement reached in the FPRA also provides a basis for tracking contractor costs.

If the ACO and contractor cannot agree on a rate structure, the ACO will issue a Forward Pricing Rate Recommendation (FPRR). The FPRR is distributed to all concerned buying activities and represents the cognizant ACO's estimate of fair and reasonable rates. While FPRR's are not binding on the negotiator, buyers should attempt to negotiate with FPRR rates for two reasons. First, the government representatives most familiar with the contractor's total operations have declared their best estimate of fair and reasonable rates. Second, the buyer by holding to the FPRR helps support the ACO's efforts to secure an FPRA.

#### --Cost Principles--

The cost principles contained in FAR 31 are tools that help determine the allowability and reasonableness of selected costs. Over 50 cost principles ranging from employee compensation to lobbying costs are defined in FAR 31.201. Many of the cost principles are identified as unallowable; that is, these costs cannot be charged to defense contracts either directly or through overhead rate. Other cost principles are identified as allowable. In some cases, a cost may be identified as allowable but with a limit placed on the amount allowed.

#### --Should Cost--

One of the more far reaching tools is Should Cost. The Federal Acquisition Regulation refers to Should Cost as a concept of contract pricing that employs an integrated team of Government procurement, contract administration, audit, and engineering representatives to conduct a coordinated, indepth cost analysis at the contractor's plant. This analysis can be conducted for ongoing procurements as well as one requiring a Defense Systems Acquisition Review Council (DSARC) approval. Why would a contracting officer go through an extensive review of the contractor's operation? One such example may be a sole source situation that has evolved over the years. At this point, it is beneficial to the Government to assess the contractor's efficiency of operations and methods. Once analyzed by this team of

professionals, the Government can then be prepared for negotiations. If the contractor persists in attempting to sell an inefficient manner of production and an uneconomical use of resources, the Government may be forced to determine the feasibility of developing an alternate source. Actually, those government representatives located in a contractor's plant provide an "Ongoing Should Cost" analysis through the Cost Monitoring Program.

#### --Cost Monitoring Program--

The Cost Monitoring Program involves the cooperative efforts of the contract administration office and the DCAA auditors. Through a series of Cost Monitoring Reviews (CMR's) the government reviews the efficiency and effectiveness of selected contractor activities. In effect, CMR's are "mini-should cost" studies on contractor activities that appear to have the room for reduced costs or improved productivity. By highlighting areas needing improvement and working with contractors to make needed improvements, we can realize reduced acquisition costs. Reviews are performed by elements of the contract administration office when the CMR involves their expertise, by the DCAA auditor when the CMR involves audit expertise, or by a joint review when the capabilities of both offices are needed. The DCAA operations audits are considered CMR's and may be incorporated in the cost monitoring plan.

#### Putting the Cycle in Motion

The best way to understand how the government interacts with contractors is to go through the life cycle of overhead and briefly describe each phase and the activities of the primary team players. Again, the cycle is divided into three phases; FPRA, tracking, and final settlement.

#### FPRA

#### COST TRACKING

#### FINAL SETTLEMENT

The Forward Pricing Rate Agreement phase begins with the contractor's proposed direct and indirect rates. These rates along with the supporting data are provided to the cognizant ACO and the DCAA resident auditor. DCAA provides an audit report to the ACO based on their review of the sales forecast and the direct and indirect estimates to meet the anticipated sales. The ACO's staff prepares their negotiation position using the audit report, their own analysis, and other supporting information. The buying offices can be extremely helpful at this point by providing information on sales, deliveries, and other program activities that can be used to validate the sales forecast. A good sales forecast is critical to developing and negotiating good rates! At the conclusion of the negotiations, the ACO and the contractor sign an agreement to use the negotiated rates for all forward pricing during the term of the agreement.

The tracking phase runs throughout the contractor's accounting year. The ACO's staff tracks contractor actual direct and indirect expenses. If the



contractor's expenditures are consistent with the proposed expenditures that support the negotiated rates, then it is apparent that the rates are accurate. If the contractor's expenditures do not coincide with the anticipated expense pattern, the ACO's staff queries the contractor for the reason. Depending on the reasons for the variance, the ACO may choose to continue the FPRA, terminate all or a portion of the FPRA, renegotiate the rates, or publish an FPRR.

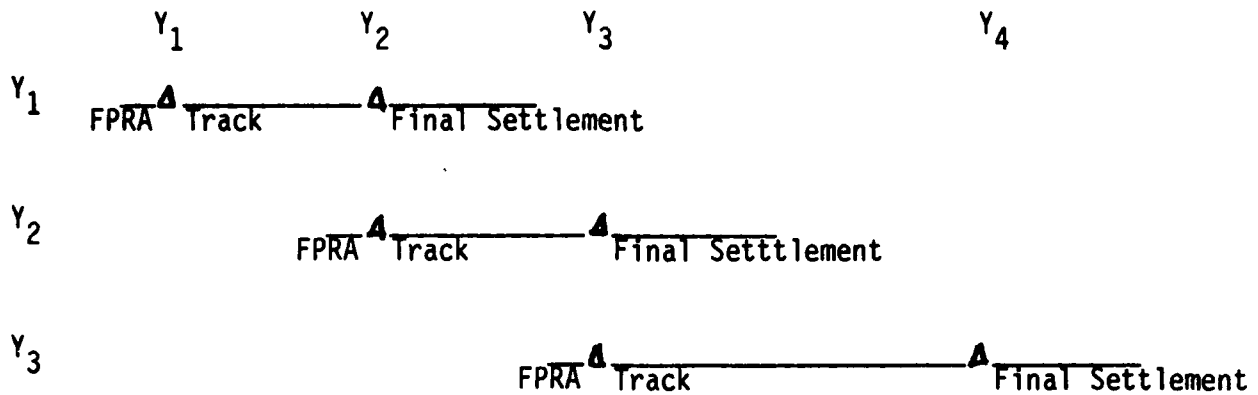
During the tracking phase, buying office should alert the ACO to any changes or major procurement actions that may impact the negotiated rates. Upon notification, the ACO will review the changes and advise the buying office of the validity of the rates. If the rates are no longer valid, the ACO will advise the buying offices and attempt to reach agreement with the contractor on new rates as soon as possible. In the interim, the ACO may publish FPRR rates.

Effective cost tracking can help insure reasonable contract cost by monitoring the accuracy of the rates. Tracking also can alert the government to unexpected and unfavorable cost trends. Early identification of trends or questionable costs maximizes the government's and contractor's opportunity to correct the situation and avoid needless costs.

Final settlement is the last phase of the cycle. The purpose of final settlement is to provide rates for the final pricing of cost plus contracts, fixed price incentive contracts, and fixed price redeterminable contracts; in other words, for use anytime you need to determine contract costs after contract completion. This phase focuses on the contractor's submittal of actual direct and indirect costs from the proceeding year and negotiation of final rates. Theoretically, if a good working relationship has existed between the government team and the contractor, then the major issues in the final settlement would have been identified and dealt with during the FPRA and Tracking phases. If, for whatever reason, the major issues have not been addressed until they appear as incurred costs on the final, then final settlement negotiation may become difficult or impossible to consummate. Past experience has shown that in the latter case, final settlement negotiation can drag on for several years resulting in overage contracts and increased administrative workload. Our past experience also indicates that it becomes difficult to support negotiation positions on costs incurred five, six, or more years ago! All members of the government team can help preclude excessively drawn out final settlements by actively supporting the negotiation of FPRA's and effective cost tracking.

#### And The Beat Goes On!

The life cycle of overhead does not exist in a vacuum. The cycle overlaps with the cycles of proceeding and subsequent years:



While tracking contractor performance in Y<sub>2</sub>, the government team is also involved in final settlement for Y<sub>1</sub>, and FPRA negotiations for Y<sub>3</sub>. Taking the process one step further, problems and issues that arose in tracking and final settlement from Y<sub>1</sub> may ultimately become negotiation points and resolved in FPRA negotiations in Y<sub>2</sub> or Y<sub>3</sub>, or included in future Cost Monitoring Plans. In any event, you can see that the continuous process of cost monitorship provides opportunities for the government and the contractor to get together on cost issues throughout the process.

### MAKING IT WORK

With 67¢ out of every \$1.00 spent within contractor plants going to pay indirect costs, it is easy to see the potential for both cost reduction and cost abuse. Paying more for defense than is fair and reasonable undermines the credibility of the defense acquisition process and limits our ability to provide the goods and services essential to our national security. But, tools and monitoring cycles are useless without skilled hands and minds using them. The cooperative efforts of auditors, PCO's, ACO's, buyers, price analysts, contract administrators, industrial engineers, financial analysts, and others is the real stuff that makes cost monitorship work. With committed team members, the acquisition process is enhanced through more reasonable prices, reduced administrative efforts, and more timely negotiation; in other words, a more credible and efficient acquisition process. All team members are important, and any team member (perhaps you) can make the difference between government waste or effective contracting.

**CRITERIA FOR ALLOWABILITY OF COST (FAR 31.201-2)**

- REASONABLENESS
- ALLOCABILITY
- COST ACCOUNTING STANDARDS (CAS) OR  
GENERALLY ACCEPTED ACCOUNTING PRINCIPLES  
(GAAP)
- SPECIAL CONTRACT PROVISIONS
- COST PRINCIPLES IN FAR 31

THE "TRUTH IN NEGOTIATION" ACT

IS.....

- AN ACT OF CONGRESS
- ENACTED IN 1962
- AMENDING TITLE 10, UNITED STATES CODE, SECTION 2306
- BY REQUIRING CONTRACTOR AND SUBCONTRACTORS TO  
SUBMIT COST OR PRICING DATA AND CERTIFY TO ITS  
COMPLETENESS, CURRENCY AND ACCURACY
- IN THE NEGOTIATION OF NON-COMPETITIVE PROPOSALS
- FOR THE PURPOSE OF ARRIVING AT FAIR AND REASONABLE  
PRICES IN GOVERNMENT CONTRACTS

THE "TRUTH IN NEGOTIATIONS" ACT

COVERS.....

- \* NEGOTIATED PRIME CONTRACTS OVER \$100,000;
- \* CHANGES OR MODIFICATIONS WITH TOTAL INCREASES AND DECREASES OVER \$100,000;
- \* SUBCONTRACTS OVER \$100,000 WHERE THE PRIME AND HIGHER TIER SUBS WERE REQUIRED TO FURNISH CERTIFICATES;
- \* CHANGES OR MODIFICATIONS WITH TOTAL INCREASES AND DECREASES OVER \$100,000 TO SUBCONTRACTS COVERED ABOVE;
- \* CHANGES OR MODIFICATIONS UNDER \$100,000 TO PRIME OR SUBCONTRACTS ABOVE IF SO PRESCRIBED BY THE HEAD OF THE AGENCY.

THE "TRUTH IN NEGOTIATIONS" ACT

DOES NOT COVER

- \* PRIME CONTRACTS AWARDED BY SEALED BID PROCEDURES;
- \* NEGOTIATED PRIME CONTRACTS UNDER \$100,000;
- \* SUBCONTRACTS UNDER \$100,000;
- \* CHANGES OR MODIFICATIONS UNDER \$100,000 (TO PRIME OR SUBCONTRACTS) NOT PRESCRIBED BY THE HEAD OF THE AGENCY;
- \* NEGOTIATED PRIME AND SUBCONTRACTS WHERE THE PRICE IS BASED ON:
  - ADEQUATE PRICE COMPETITION;
  - ESTABLISHED CATALOG OR MARKET PRICES OF COMMERCIAL ITEMS SOLD IN SUBSTANTIAL QUANTITIES TO THE GENERAL PUBLIC;
  - PRICES SET BY LAW OR REGULATION;
  - EXCEPTIONAL CASES WHERE THE HEAD OF THE AGENCY WAIVES.

TO COMPLY WITH PL-87-653

THE CONTRACTOR MUST:



- SUBMIT COST OR PRICING DATA.
- CERTIFY THAT THE COST OR PRICING DATA SUBMITTED ARE ACCURATE, COMPLETE, AND CURRENT.
- AGREE TO INCORPORATION IN THE CONTRACT OF A PROVISION FOR PRICE REDUCTION TO EXCLUDE ANY SIGNIFICANT AMOUNTS BY WHICH THE PRICE WAS OVERSTATED BECAUSE DEFECTIVE COST OR PRICING DATA WERE SUBMITTED.
- AGREE TO ACCEPT AUDIT AND SUBCONTRACTOR CERTIFICATION CLAUSES IN HIS CONTRACT.

TO ACHIEVE THE OBJECTIVES OF THE  
TRUTH IN NEGOTIATION ACT.

THE CONTRACTING OFFICER MUST:

- ANALYZE THE DATA WHICH IS NEEDED TO NEGOTIATE A FAIR AND REASONABLE PRICE.
- AFTER NEGOTIATION REQUIRE THE CONTRACTOR TO CERTIFY THAT HE HAS EITHER ACTUALLY SUBMITTED - OR IDENTIFIED IN WRITING - ALL SIGNIFICANT FACTUAL DATA AND THAT SUCH DATA ARE ACCURATE, COMPLETE AND CURRENT AS OF THE DATE OF AGREEMENT ON PRICE.
- ASSURE THE APPROPRIATE CLAUSES ARE INCLUDED IN THE CONTRACT.
- DOCUMENT THE FILES TO ASSURE TRACKABILITY-THAT IS-THAT THE DATA THE CONTRACTOR SUBMITTED AND CERTIFIED WAS OR WAS NOT THE DATA ON WHICH THE CONTRACTING OFFICER RELIED IN NEGOTIATION.



CERTIFICATE OF CURRENT COST OR PRICING DATA

THIS IS TO CERTIFY THAT, TO THE BEST OF MY KNOWLEDGE AND BELIEF, THE COST OR PRICING DATA (AS DEFINED IN SECTION 15.801 OF THE FEDERAL ACQUISITION REGULATION (FAR) AND REQUIRED UNDER FAR SUBSECTION 15.804-2) SUBMITTED, EITHER ACTUALLY OR BY SPECIFIC IDENTIFICATION IN WRITING TO THE CONTRACTING OFFICER OR TO THE CONTRACTING OFFICER'S REPRESENTATIVE IN SUPPORT OF..... ARE ACCURATE, COMPLETE, AND CURRENT AS OF .....

THIS CERTIFICATION INCLUDES THE COST OR PRICING DATA SUPPORTING ANY ADVANCE AGREEMENTS AND FORWARD PRICING RATE AGREEMENTS BETWEEN THE OFFEROR AND THE GOVERNMENT THAT ARE PART OF THE PROPOSAL.

FIRM.....  
NAME.....  
TITLE.....  
DATE OF EXECUTION.....

FAR 15.804-4 1 APR 85

PART 15—CONTRACTING BY NEGOTIATION

15.801

(c) The contractor has the basic responsibility for make-or-buy decisions. Therefore, its recommendations should be accepted unless they are inconsistent with Government interests or policy.

(d) Contracting officers shall give primary consideration to the effect of the proposed make-or-buy program on price, quality, delivery, and performance, including technical or financial risk involved. The evaluation of "must make" and "must buy" items should normally be confined to ensuring that they are properly categorized. The effect of the following factors on the Government's interests shall also be considered:

(1) Whether the contractor has justified performing work in plant that differs significantly from its normal operations.

(2) Whether the contractor's recommended program requires Government investment in new or other facilities in order for the contractor to perform the work in plant. (This additional cost to the Government would not be reflected in the contract price.)

(3) The impact of the contractor's projected plant work loading on indirect costs.

(4) The contractor's consideration of the competence, ability, experience, and capacity available in other firms, especially small business, small disadvantaged business, or labor surplus area concerns.

(5) The projected location of any required additional facilities in or near labor surplus areas.

(6) The contractor's make-or-buy history regarding the type of item concerned.

(7) The scope of proposed subcontracts, including the type and level of technical effort involved.

(8) Other factors such as future requirements, engineering, tooling, starting load costs, market conditions, technical superiority, and the availability of personnel and materials.

(e) Contracting officers shall not normally agree to proposed "make items" when the products or services are (1) not regularly manufactured or provided by the contractor and are available—quality, quantity, delivery, and other essential factors considered—from another firm at equal or lower prices or when they are (2) regularly manufactured or provided by the contractor, but available—quality, quantity, delivery, and other essential factors considered—from another firm at lower prices. However, the contracting officer may agree to these as "make items" if their categorization as "buy items" would increase the Government's overall cost for the contract or acquisition program.

**15.707 Incorporating make-or-buy programs in contracts.**

(a) After agreement is reached, the contracting officer may incorporate the make-or-buy program in negotiated contracts for—

(1) Major systems (see Part 34) or their subsystems or components, regardless of contract type; or

(2) Other supplies and services if (i) the contract is a cost-reimbursable contract, or a cost-sharing contract in which the contractor's share of the cost is less than 25 percent, and (ii) the contracting officer determines that technical or cost risks justify Government review and approval of changes or additions to the make-or-buy program.

(b) It may be necessary to incorporate some items of significant value in the make-or-buy program as "make" or, alternatively, as "buy" even though the opposite categorization would result in greater economy for the Government. If this situation occurs in any fixed-price incentive or cost-plus-incentive-fee contract, the contracting officer shall specify these items in the contract and state that they are subject to paragraph (d) of the clause at 52.215-21, Changes or Additions to Make-or-Buy Program (see 15.708 below). If the contractor proposes to reverse the categorization of such items during contract performance, the contract price shall be subject to equitable reduction.

**15.708 Contract clause.**

The contracting officer shall insert the clause at 52.215-21, Changes or Additions to Make-or-Buy Program, in solicitations and contracts when it is contemplated that a make-or-buy program will be incorporated in the contract. If a less economical "make" or "buy" categorization is selected for one or more items of significant value, the contracting officer shall use the clause with (a) its Alternate I, if a fixed-price incentive contract is contemplated, or (b) its Alternate II, if a cost-plus-incentive-fee contract is contemplated.

**SUBPART 15.8—PRICE NEGOTIATION**

**15.800 Scope of subpart.**

This subpart prescribes the cost and price negotiation policies and procedures applicable to initial and revised pricing of (a) negotiated prime contracts (including subcontract pricing under them when required) and (b) contract modifications (including modifications to contracts awarded by sealed bidding).

**15.801 Definitions.**

"Cost analysis" means the review and evaluation of the separate cost elements and proposed profit of (a) an offeror's or contractor's cost or pricing data and (b) the judgmental factors applied in projecting from the data to the estimated costs in order to form an opinion on the degree to which the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

"Cost or pricing data" means all facts as of the time of price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data are factual, not judgmental, and are therefore verifiable. While they do not indicate the accuracy of the prospective contractor's judgment about estimated future costs or projections,

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they do include the data forming the basis for that judgment. Cost or pricing data are more than historical accounting data; they are all the facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred. They also include such factors as (a) vendor quotations; (b) nonrecurring costs; (c) information on changes in production methods and in production or purchasing volume; (d) data supporting projections of business prospects and objectives and related operations costs; (e) unit-cost trends such as those associated with labor efficiency; (f) make-or-buy decisions; (g) estimated resources to attain business goals; and (h) information on management decisions that could have a significant bearing on costs.

"Field pricing support" means a review and evaluation of the contractor's or subcontractor's proposal by any or all field pricing support personnel (see 15.805-5(a)(2)).

"Forward pricing rate agreement" means a written agreement negotiated between a contractor and the Government to make certain rates available during a specified period for use in pricing contracts or modifications. Such rates represent reasonable projections of specific costs that are not easily estimated for, identified with, or generated by a specific contract, contract end item, or task. These projections may include rates for labor, indirect costs, material obsolescence and usage, spare parts provisioning, and material handling.

"Price," as used in this subpart, means cost plus any fee or profit applicable to the contract type.

"Price analysis" means the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit.

"Technical analysis," as used in this subpart, means the examination and evaluation by personnel having specialized knowledge, skills, experience, or capability in engineering, science, or management of proposed quantities and kinds of materials, labor, processes, special tooling, facilities, and associated factors set forth in a proposal in order to determine and report on the need for and reasonableness of the proposed resources assuming reasonable economy and efficiency.

#### 15.802 Policy.

(a) 10 U.S.C. 2306(f) and 41 U.S.C. 254(d) provide that all executive agencies shall require a prime contractor or any subcontractor to submit and certify cost or pricing data under certain circumstances. The Acts also require inclusion of contract clauses that provide for reduction of the contract price by any significant amounts that such price was increased because of submission of contractor or subcontractor defective cost or pricing data.

(b) Contracting officers shall—

(1) Purchase supplies and services from responsible sources at fair and reasonable prices;

(2) Price each contract separately and independently and not (i) use proposed price reductions under other contracts as an evaluation factor or (ii) consider losses or profits realized or anticipated under other contracts; and

(3) Not include in a contract price any amount for a specified contingency to the extent that the contract provides for price adjustment based upon the occurrence of that contingency.

#### 15.803 General.

(a) Since information from sources other than an offeror's or contractor's records may significantly affect the Government's negotiating position, Government personnel shall not disclose to an offeror or contractor any conclusions, recommendations, or portions of administrative contracting officer or auditor reports regarding the offeror's or contractor's proposal without the concurrence of the contracting officer responsible for negotiation. This prohibition does not preclude disclosing discrepancies or mistakes of fact (such as duplications, omissions, and errors in computation) contained in the cost or pricing data supporting the proposal.

(b) Before issuing a solicitation, the contracting officer shall (when it is feasible to do so) develop an estimate of the proper price level or value of the supplies or services to be purchased. Estimates can range from simple budgetary estimates to complex estimates based on inspection of the product itself and review of such items as drawings, specifications, and prior data.

(c) Price negotiation is intended to permit the contracting officer and the offeror to agree on a fair and reasonable price. Price negotiation does not require that agreement be reached on every element of cost. Reasonable compromises may be necessary, and it may not be possible to negotiate a price that is in accord with all the contributing specialists' opinions or with the contracting officer's prenegotiation objective. The contracting officer is responsible for exercising the requisite judgment and is solely responsible for the final pricing decision. The recommendations and counsel of contributing specialists, including auditors, are advisory only. However, the contracting officer should include comments in the price negotiation memorandum when significant audit or other specialist recommendations are not adopted.

(d) The contracting officer's primary concern is the price the Government actually pays; the contractor's eventual cost and profit or fee should be a secondary concern. The contracting officer's objective is to negotiate a contract of a type and with a price providing the contractor the greatest incentive for efficient and

economical performance. The negotiation of a contract type and a price are related and should be considered together with the issues of risk and uncertainty to the contractor and the Government. Therefore the contracting officer should not become preoccupied with any single element and should balance the contract type, cost, and profit or fee negotiated to achieve a total result and price fair and reasonable to both the Government and the contractor. If, however, the contractor insists on a price or demands a profit or fee that the contracting officer considers unreasonable and the contracting officer has taken all authorized actions (including determining the feasibility of developing an alternative source) without success, the contracting officer shall then refer the contract action to higher authority. Disposition of the action by higher authority should be documented.

#### 15.804 Cost or pricing data.

##### 15.804-1 General.

(a) Cost or pricing data submitted by an offeror or contractor enable the Government to perform cost or price analysis and ultimately enable the Government and the contractor to negotiate fair and reasonable prices. Cost or pricing data may be submitted actually or by specific identification in writing.

(b) The Armed Services Procurement Manual for Contract Pricing (ASPM No.1) was issued by the Department of Defense to guide pricing and negotiating personnel. It provides detailed discussions and examples applying pricing policies to pricing problems. ASPM No. 1 is available for use for instruction and professional guidance. However, it is not directive, and its references to Department of Defense forms and regulation should be considered informational only. Copies of ASPM No. 1 (Stock No. 008-000-00221-5) may be purchased from the Superintendent of Documents, Attn: Mail List Section, U.S. Government Printing Office, Washington, DC 20402.

##### 15.804-2 Requiring certified cost or pricing data.

(a) (1) Except as provided in 15.804-3, certified cost or pricing data are required before accomplishing any of the following actions:

(i) The award of any negotiated contract (except for unpriced actions such as letter contracts) expected to exceed \$100,000.

(ii) The modification of any sealed bid or negotiated contract (whether or not cost or pricing data were initially required) when the modification involves a price adjustment expected to exceed \$100,000. (For example, a \$30,000 modification resulting from a reduction of \$70,000 and an increase of \$40,000 is a pricing adjustment exceeding \$100,000. This requirement does not apply when unrelated and separately priced changes for which cost or pricing data would not otherwise be required are included for administrative convenience in the same modification.

(iii) The award of a subcontract at any tier, if the contractor and each higher tier subcontractor have been required to furnish certified cost or pricing data, when the subcontract is expected to exceed \$100,000.

(iv) The modification of any subcontract covered by subdivision (iii) above, when the price adjustment (see subdivision (ii) above) is expected to exceed \$100,000.

(2) If cost or pricing data are needed for pricing actions over \$25,000 and not in excess of \$100,000, certified cost or pricing data may be obtained. There should be relatively few instances where certified cost or pricing data and inclusion of defective pricing clauses would be justified in awards between \$25,000 and \$100,000. The amount of data required to be submitted should be limited to that data necessary to allow the contracting officer to determine the reasonableness of the price. Whenever certified cost or pricing data are required for pricing actions of \$100,000 or less, the contracting officer shall document the file to justify the requirement. When awarding a contract of \$25,000 or less, the contracting officer shall not require certified cost or pricing data.

(b) When certified cost or pricing data are required, the contracting officer shall require the contractor or prospective contractor to submit to the contracting officer (and to have any subcontractor or prospective subcontractor submit to the prime contractor or appropriate subcontractor tier) the following in support of any proposal:

(1) The cost or pricing data.

(2) A certificate of current cost or pricing data, in the format specified in 15.804-4, certifying that to the best of its knowledge and belief, the cost or pricing data were accurate, complete, and current as of the date of final agreement on price.

##### 15.804-3 Exemptions from or waiver of submission of certified cost or pricing data.

(a) *General.* Except as provided in paragraphs (b) and (c) below, the contracting officer shall not require submission or certification of cost or pricing data when the contracting officer determines that prices are—

(1) Based on adequate price competition (see paragraph (b) below);

(2) Based on established catalog or market prices of commercial items sold in substantial quantities to the general public (see paragraph (c) below); or

(3) Set by law or regulation (see paragraph (d) below).

(b) *Adequate price competition.* (1) Price competition exists if—

(i) Offers are solicited;

(ii) Two or more responsible offerors that can satisfy the Government's requirements submit

priced offers responsive to the solicitation's expressed requirements; and

(iii) These offerors compete independently for a contract to be awarded to the responsible offeror submitting the lowest evaluated price.

(2) If price competition exists, the contracting officer shall presume that it is adequate unless—

(i) The solicitation is made under conditions that unreasonably deny to one or more known and qualified offerors an opportunity to compete;

(ii) The low offeror has such a decided advantage that it is practically immune from competition; or

(iii) There is a finding, supported by a statement of the facts and approved at a level above the contracting officer, that the lowest price is unreasonable.

(3) A price is "based on" adequate price competition if it results directly from price competition or if price analysis alone clearly demonstrates that the proposed price is reasonable in comparison with current or recent prices for the same or substantially the same items purchased in comparable quantities, terms, and conditions under contracts that resulted from adequate price competition.

(c) *Established catalog or market prices.* A proposal is exempt from the requirement for submission of certified cost or pricing data if the prices are, or are based on, established catalog or established market prices of commercial items sold in substantial quantities to the general public. In order to qualify for this exemption, the terms of the proposed purchase, such as quantity and delivery requirements, should be sufficiently similar to those of the commercial sales that the catalog or market price will be fair and reasonable.

(1) "Established catalog prices" must be recorded in a form regularly maintained by the manufacturer or vendor. This form may be a catalog, price list, schedule, or other verifiable and established record. The record must (i) be published or otherwise available for customer inspection and (ii) state current or last sales price to a significant number of buyers constituting the general public (see subparagraph (5) below).

(2) "Established market prices" are current prices that (i) are established in the course of ordinary and usual trade between buyers and sellers free to bargain and (ii) can be substantiated by data from sources independent of the manufacturer or vendor.

(3) "Commercial items" are supplies or services regularly used for other than Government purposes and sold or traded to the general public in the course of normal business operations.

(4) An item is "sold in substantial quantities" only when the quantities regularly sold are sufficient to constitute a real commercial market. Nominal quantities, such as models, samples, prototypes, or experimental units, do not meet this requirement. For serv-

ices to be sold in substantial quantities, they must be customarily provided by the offeror, using personnel regularly employed and equipment (if any is necessary) regularly maintained solely or principally to provide the services.

(5) The "general public" is a significant number of buyers other than the Government or affiliates of the offeror; the item involved must not be for Government end use. For the purpose of this subsection 15.804-3, items acquired for "Government end use" include items acquired for foreign military sales.

(6) A price is "based on" a catalog or market price only if the item being purchased is sufficiently similar to the catalog- or market-priced commercial item to ensure that any difference in prices can be identified and justified without resort to cost analysis.

(7) If an item is substantially similar to a commercial item for which there is an established catalog or market price at which substantial quantities are sold to the general public, but the price proposed is not *based on* this catalog or market price (see subparagraph (6) above), the contracting officer may, if doing so will result in a fair and reasonable price, limit any requirement for cost or pricing data to those data that pertain to the differences between the items. When the difference between the catalog or market price of an item or items and the proposed total contract price is \$100,000 or more, the contracting officer shall require submission of certified cost or pricing data to identify and justify that difference unless an exemption or waiver is granted.

(8) Even though there is an established catalog or market price of commercial items sold in substantial quantities to the general public, the contracting officer may require cost or pricing data if (i) the contracting officer makes a written finding that the price is not reasonable, including the facts upon which the finding is based, and (ii) the finding is approved at a level above the contracting officer.

(d) *Prices set by law or regulation.* A price set by law or regulation is exempt from the requirement for submission of certified cost or pricing data. Pronouncements in the form of periodic rulings, reviews, or similar actions of a governmental body, or embodied in the laws, are sufficient to establish the price.

(e) *Claiming and granting exemption.* To receive an exemption under paragraph (c) or (d) above, the offeror must ordinarily claim it on Standard Form 1412, Claim for Exemption from Submission of Certified Cost or Pricing Data, when the total proposed amount exceeds \$100,000 and more than one catalog item for which an exemption is claimed exceeds \$25,000. When an exemption is claimed for more than one item in a proposal, a separate SF 1412 is required for each such item exceeding \$25,000 except as otherwise provided in the solicitation. The contracting officer may grant an

exemption and need not require the submission of SF 1412 when—

(1) The Government has acted favorably on an exemption claim for the same item or similar items within the past year. In that case, except as otherwise directed by the contracting officer, the offeror may furnish a copy of the prior claim and related Government action. The offeror must also submit a statement to the effect that to its knowledge since the prior submission, except as expressly set forth in the statement, there have been no changes in the catalog price or discounts, volume of actual sales, or the ratio of sales for Government end use to sales in other categories which would cause a cumulative change in price exceeding \$25,000;

(2) Special arrangements for the submission of exemption claims have been made in anticipation of repetitive acquisitions of catalog items; or

(3) There is evidence, before solicitation, that the item has an acceptable established catalog or market price or a price set by law or regulation. Evidence may include (i) recent submissions by offerors or (ii) the contracting officer's knowledge of market conditions, prevailing prices, or sources.

(f) *Verification.* (1) When a prospective contractor requests exemption from submission of certified cost or pricing data, the contracting officer shall ensure that applicable criteria in either paragraph (c) or (d) above, as appropriate, are satisfied before issuing the exemption.

(2) SF 1412 lists three categories of sales related to the established catalog price of a commercial item sold in substantial quantities to the general public: A, Sales to the U.S. Government or to contractors for U.S. Government use; B, Sales at catalog price to the general public; and C, Sales to the general public at other than catalog price. Although "substantial quantities" cannot be precisely defined (see subparagraph (c)(4) above), the following guidelines are provided for determining whether exemption claims submitted under the catalog price provision of SF 1412 meet the "substantial quantities" criterion:

(i) Sales to the general public are normally regarded as substantial if (A) Category B and C sales are not negligible in themselves and comprise at least 55 percent of total sales of the item and (B) Category B sales comprise at least 75 percent of the total of Category B and C sales.

(ii) Sales to the general public are rarely considered substantial enough to grant an exemption if (A) Category B and C sales comprise less than 35 percent of total sales of the item or (B) Category B sales comprise less than 55 percent of the total of Category B and C sales.

(iii) When percentages fall between those above, the contracting officer should analyze the individual situation in order to determine whether or not an exemption is justified.

(3) The contracting officer may verify or obtain verification (including audit or contract administration assistance) of the submitted data pertaining to catalog or market prices or prices set by law or regulation. Access to the prospective contractor's records is limited to access to the facts bearing directly on the exemption claimed. It does not extend to cost, profit, or other data relevant solely to the reasonableness of the catalog or proposed price.

(g) *Individual or class exemptions.* The chief of the contracting office may authorize individual or class exemptions for exceptional cases when the contracting officer recommends that an exemption should be made, even though the case does not strictly meet all the criteria for catalog- or market-price exemption. The quantity and prices of actual commercial sales compared with prices offered to the Government, and price relationships as influenced by prevailing trade practices, are the important factors for consideration. The Government's need and the prospective contractor's resistance are not appropriate considerations.

(h) *Price analysis.* Even though an item qualifies for exemption from the requirement for submission of certified cost or pricing data, the contracting officer shall make a price analysis to determine the reasonableness of the price and any need for further negotiation. Unless information is available from Government sources, it may be necessary to obtain from the prospective contractor information such as that regarding—

(1) The supplier's marketing system (e.g., use of jobbers, brokers, sales agencies, or distributors);

(2) The services normally provided commercial purchasers (e.g., engineering, financing, or advertising or promotion);

(3) Normal quantity per order; and

(4) Annual volume of sales to largest customers.

(i) *Waiver for exceptional cases.* The agency head (or, if the contract is with a foreign government or agency, the head of the contracting activity) may, in exceptional cases, waive the requirement for submission of certified cost or pricing data. The authorization for the waiver and the reasons for granting it shall be in writing. The agency head may delegate this authority.

#### 15.804-4 Certificate of Current Cost or Pricing Data.

(a) When certified cost or pricing data are required under 15.804-2, the contracting officer shall require the contractor to execute a Certificate of Current Cost or Pricing Data, shown below, and shall include the executed certificate in the contract file. The certificate states that the cost or pricing data are accurate, complete, and current as of the date the contractor and the Government agreed on a price. Only one certificate shall be required; the contractor shall submit it as soon as practicable after price agreement is reached.

#### CERTIFICATE OF CURRENT COST OR PRICING DATA

15.804-5

FEDERAL ACQUISITION REGULATION (FAR)

This is to certify that, to the best of my knowledge and belief, the cost or pricing data (as defined in section 15.801 of the Federal Acquisition Regulation (FAR) and required under FAR subsection 15.804-2) submitted, either actually or by specific identification in writing, to the contracting officer or to the contracting officer's representative in support of .....\* are accurate, complete, and current as of .....\*\*. This certification includes the cost or pricing data supporting any advance agreements and forward pricing rate agreements between the offeror and the Government that are part of the proposal.

Firm.....  
Name.....  
Title.....  
Date of execution\*\*\* .....

\* Identify the proposal, quotation, request for price adjustment, or other submission involved, giving the appropriate identifying number (e.g., RFP No. ).

\*\* Insert the day, month, and year when price negotiations were concluded and price agreement was reached.

\*\*\* Insert the day, month, and year of signing, which should be as close as practicable to the date when the price negotiations were concluded and the contract price was agreed to.

(End of certificate)

(b) The certificate does not constitute a representation as to the accuracy of the contractor's judgment on the estimate of future costs or projections. It does apply to the data upon which the judgment or estimate was based. This distinction between fact and judgment should be clearly understood. If the contractor had information reasonably available at the time of agreement showing that the negotiated price was not based on accurate, complete, and current data, the contractor's responsibility is not limited by any lack of personal knowledge of the information on the part of its negotiators.

(c) Closing or cutoff dates should be included as part of the data submitted with the proposal. Certain data may not be reasonably available before normal periodic closing dates (e.g., actual indirect costs). Before agreement on price, the contractor shall update all data as of the latest dates for which information is reasonably available. Data within the contractor's or a subcontractor's organization on matters significant to contractor management and to the Government will be treated as reasonably available. What is significant depends upon the circumstances of each acquisition.

(d) Possession of a Certificate of Current Cost or Pricing Data is not a substitute for examining and analyzing the contractor's proposal.

(e) Even though the solicitation may have requested cost or pricing data, the contracting officer shall not

require a Certificate of Current Cost or Pricing Data when the resulting award is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation (see 15.804-3(a) through (d)).

(f) The exercise of an option at the price established in the initial negotiation in which certified cost or pricing data were used does not require recertification.

(g) Contracting officers shall not require certification at the time of agreement for data supplied in support of forward pricing rate agreements (see 15.809) or other advance agreements. When a forward pricing rate agreement or other advance agreement is used in partial support of a later contractual action that requires a certificate, the price proposal certificate shall cover (1) the data originally supplied to support the forward pricing rate agreement or other advance agreement and (2) all data required to update the price proposal to the time of agreement on contract price.

(h) Negotiated final pricing actions (such as termination settlements and total final price agreements for fixed-price incentive and redeterminable contracts) are contract modifications requiring certified cost or pricing data if (1) the total final price agreement for such settlements or agreements exceeds \$100,000 or (2) the partial termination settlement plus the estimate to complete the continued portion of the contract exceeds \$100,000 (see 49.105(c)(15)).

15.804-5 Reserved.

15.804-6 Procedural requirements.

(a) The contracting officer shall specify (1) whether or not cost or pricing data are required, (2) whether or not certification will be required, (3) the extent of cost or pricing data required if complete data are not necessary, and (4) the form (see paragraph (b) below) in which the cost or pricing data shall be submitted. Even if the solicitation does not so specify, however, the contracting officer is not precluded from requesting such data if they are later found necessary.

(b) (1) Cost or pricing data shall be submitted on Standard Form 1411 (SF 1411), Contract Pricing Proposal Cover Sheet, unless required to be submitted on one of the termination forms specified in Subpart 49.6. Data supporting forward pricing rate agreements or final indirect cost proposals shall be submitted in a format acceptable to the contracting officer.

(2) Contract pricing proposals submitted on SF 1411 with supporting attachments shall be prepared to satisfy the instructions and appropriate format of Table 15-2.

TABLE 15-2 INSTRUCTIONS FOR SUBMISSION OF A CONTRACT PRICING PROPOSAL

1. SF 1411 provides a vehicle for the offeror to submit to the Government a pricing proposal of estimated and/or incurred costs by contract line item with supporting information, adequately cross-referenced, suitable for detailed analysis. A cost-element breakdown, using the applicable format prescribed in 7A, B, or C below, shall be attached for each proposed line item and must reflect any specific requirements established by the contracting officer. Supporting breakdowns must be furnished for each cost element, consistent with offeror's cost accounting system.

PART 15—CONTRACTING BY NEGOTIATION

15.804-6

When more than one contract line item is proposed, summary total amounts covering all line items must be furnished for each cost element. If agreement has been reached with Government representatives on use of forward pricing rates/factors, identify the agreement, include a copy, and describe its nature. Depending on offeror's system, breakdowns shall be provided for the following basic elements of cost, as applicable:

**Materials**—Provide a consolidated priced summary of individual material quantities included in the various tasks, orders, or contract line items being proposed and the basis for pricing (vendor quotes, invoice prices, etc.).

**Subcontracted Items**—Include parts, components, assemblies, and services that are to be produced or performed by others in accordance with offeror's design, specifications, or direction and that are applicable only to the prime contract. For each subcontract over \$100,000, the support should provide a listing by source, item, quantity, price, type of subcontract, degree of competition, and basis for establishing source and reasonableness of price, as well as the results of review and evaluation of subcontract proposals when required by FAR 15.806.

**Standard Commercial Items**—Consists of items that offeror normally fabricates, in whole or in part, and that are generally stocked in inventory. Provide an appropriate explanation of the basis for pricing. If price is based on cost, provide a cost breakdown; if priced at other than cost, provide justification for exemption from submission of cost or pricing data, as required by FAR 15.804-3(e).

**Interorganizational Transfer (at other than cost)**—Explain pricing method used. (See FAR 31.205-26).

**Raw Material**—Consists of material in a form or state that requires further processing. Provide priced quantities of items required for the proposal.

**Purchased Parts**—Includes material items not covered above. Provide priced quantities of items required for the proposal.

**Interorganizational Transfer (at cost)**—Include separate breakdown of cost by element.

**Direct Labor**—Provide a time-phased (e.g., monthly, quarterly, etc.) breakdown of labor hours, rates, and cost by appropriate category, and furnish bases for estimates.

**Indirect Costs**—Indicate how offeror has computed and applied offeror's indirect costs, including cost breakdowns, and showing trends and budgetary data, to provide a basis for evaluating the reasonableness of proposed rates. Indicate the rates used and provide an appropriate explanation.

**Other Costs**—List all other costs not otherwise included in the categories described above (e.g., special tooling, travel, computer and consultant services, preservation, packaging and packing, spoilage and rework, and Federal excise tax on finished articles) and provide bases for pricing.

**Royalties**—If more than \$250, provide the following information on a separate page for each separate royalty or license fee: name and address of licensor; date of license agreement; patent numbers, patent application serial numbers, or other basis on which the royalty is payable; brief description (including any part or model numbers of each contract item or component on which the royalty is payable); percentage or dollar rate of royalty per unit; unit price of contract item; number of units; and total dollar amount of royalties. In addition, if specifically requested by the contracting officer, provide a copy of the current license agreement and identification of applicable claims of specific patents. (See FAR 27.204 and 31.205-37).

**Facilities Capital Cost of Money**—When the offeror elects to claim facilities capital cost of money as an allowable cost, the offeror must submit Form CASB-CMF and show the calculation of the proposed amount (see FAR 31.205-10).

2. As part of the specific information required, the offeror must submit with offeror's proposal, and clearly identify as such, cost or pricing data (that is, data that are verifiable and factual and otherwise as defined at FAR 15.801). In addition, submit with offeror's proposal any information reasonably required to explain offeror's estimating process, including—

- a. The judgmental factors applied and the mathematical or other methods used in the estimate, including those used in projecting from known data; and
- b. The nature and amount of any contingencies included in the proposed price.

3. There is a clear distinction between submitting cost or pricing data and merely making available books, records, and other documents without identification. The requirement for submission of cost or pricing data is met when all accurate cost or pricing data reasonably available to the offeror have been submitted, either actually or by specific identification, to the contracting officer or an authorized representative. As later information comes into the offeror's possession, it should be promptly submitted to the contracting officer. The requirement for submission of cost or pricing data continues up to the time of final agreement on price.

4. In submitting offeror's proposal, offeror must include an index, appropriately referenced, of all the cost or pricing data and information accompanying or identified in the proposal. In addition, any future additions and/or revisions, up to the date of agreement on price, must be annotated on a supplemental index.

5. By submitting offeror's proposal, the offeror, if selected for negotiation, grants the contracting officer or an authorized representative the right to examine those books, records, documents, and other supporting data that will permit adequate evaluation of the proposed price. This right may be exercised at any time before award.

6. As soon as practicable after final agreement on price, but before the award resulting from the proposal, the offeror shall, under the conditions stated in FAR 15.804-4, submit a Certificate of Current Cost or Pricing Data.

7. HEADINGS FOR SUBMISSION OF LINE-ITEM SUMMARIES:

- A. New Contracts (including Letter contracts).

COST ELEMENTS	PROPOSED CONTRACT ESTIMATE—TOTAL COST	PROPOSED CONTRACT ESTIMATE—UNIT COST	REFERENCE
(1)	(2)	(3)	(4)

Under Column (1)—Enter appropriate cost elements.



Under Column (2)—Enter those necessary and reasonable costs that in offeror's judgment will properly be incurred in efficient contract performance. When any of the costs in this column have already been incurred (e.g., under a letter contract or unpriced order), describe them on an attached supporting schedule. When preproduction or startup costs are significant, or when specifically requested to do so by the contracting officer, provide a full identification and explanation of them.

Under Column (3)—Optional, unless required by the contracting officer.

Under Column (4)—Identify the attachment in which the information supporting the specific cost element may be found. Attach separate pages as necessary.

B. Change Orders (modifications).

COST ELEMENTS	ESTIMATED COST OF ALL WORK DELETED	COST OF DELETED WORK ALREADY PERFORMED	NET COST TO BE DELETED	COST OF WORK ADDED	NET COST OF CHANGE	REFERENCE
(1)	(2)	(3)	(4)	(5)	(6)	(7)

Under Column (1)—Enter appropriate cost elements.

Under Column (2)—Include (i) current estimates of what the cost would have been to complete deleted work not yet performed, and (ii) the cost of deleted work already performed.

Under Column (3)—Include the incurred cost of deleted work already performed, actually computed if possible, or estimated in the contractor's accounting records. Attach a detailed inventory of work, materials, parts, components, and hardware already purchased, manufactured, or performed and deleted by the change, indicating the cost and proposed disposition of each line item. Also, if offeror desires to retain these items or any portion of them, indicate the amount offered for them.

Under Column (4)—Enter the net cost to be deleted which is the estimated cost of all deleted work less the cost of deleted work already performed. Column (2) less Column (3) = Column (4).

Under Column (5)—Enter the offeror's estimate for cost of work added by the change. When nonrecurring costs are significant, or when specifically requested to do so by the contracting officer, provide a full identification and explanation of them.

Under Column (6)—Enter the net cost of change which is the cost of work added, less the net cost to be deleted. When this result is negative, place the amount in parentheses. Column (4) less Column (5) = Column (6).

Under Column (7)—Identify the attachment in which the information supporting the specific cost element may be found. Attach separate pages as necessary.

C. Price Revision/Redetermination.

CUTOFF DATE	NUMBER OF UNITS COMPLETED	NUMBER OF UNITS TO BE COMPLETED	CONTRACT AMOUNT	REDETERMINATION PROPOSAL AMOUNT	DIFFERENCE
(1)	(2)	(3)	(4)	(5)	(6)

COST ELEMENTS	INCURRED COST—PREPRODUCTION	INCURRED COST—COMPLETED UNITS	INCURRED COST—WORK IN PROCESS	TOTAL INCURRED COST	ESTIMATED COST TO COMPLETE	ESTIMATED TOTAL COST	REFERENCE
(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)

Under Column (1)—Enter the cutoff date required by the contract, if applicable.

Under Column (2)—Enter the number of units completed during the period for which experienced costs of production are being submitted.

Under Column (3)—Enter the number of units remaining to be completed under the contract.

Under Column (4)—Enter the cumulative contract amount.

Under Column (5)—Enter the offeror's redetermination proposal amount.

Under Column (6)—Enter the difference between the contract amount and the redetermination proposal amount. When this result is negative, place the amount in parenthesis. Column (4) less Column (5) = Column (6).

Under Column (7)—Enter appropriate cost elements. When residual inventory exists, the final costs established under fixed-price-incentive and fixed-price-redeterminable arrangements should be net of the fair market value of such inventory. In support of subcontract costs, submit a listing of all subcontracts subject to repricing action, annotated as to their status.

Under Column (8)—Enter all costs incurred under the contract before starting production and other nonrecurring costs (usually referred to as startup costs) from offeror's books and records as of the cutoff date. These include such costs as preproduction engineering, special plant rearrangement, training program, and any identifiable nonrecurring costs such as initial rework, spoilage, pilot runs, etc. In the event the amounts are not segregated in or otherwise available from offeror's records, enter in this column offeror's best estimates. Explain the basis for

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each estimate and how the costs are charged on offeror's accounting records (e.g., included in production costs as direct engineering labor, charged to manufacturing overhead, etc.). Also show how the costs would be allocated to the units at their various stages of contract completion.

Under Columns (9) and (10)—Enter in Column (9) the production costs from offeror's books and records (exclusive of preproduction costs reported in Column (8)) of the units completed as of the cutoff date. Enter in Column (10) the costs of work in process as determined from offeror's records or inventories at the cutoff date. When the amounts for work in process are not available in contractor's records but reliable estimates for them can be made, enter the estimated amounts in Column (10) and enter in Column (9) the differences between the total incurred costs (exclusive of preproduction costs) as of the cutoff date and these estimates. Explain the basis for the estimates, including identification of any provision for experienced or anticipated allowances, such as shrinkage, rework, design changes, etc. Furnish experienced unit or lot costs (or labor hours) from inception of contract to the cutoff date, improvement curves, and any other available production cost history pertaining to the item(s) to which offeror's proposal relates.

Under Column (11)—Enter total incurred costs (Total of Columns (8), (9), and (10)).

Under Column (12)—Enter those necessary and reasonable costs that in contractor's judgment will properly be incurred in completing the remaining work to be performed under the contract with respect to the item(s) to which contractor's proposal relates.

Under Column (13)—Enter total estimated cost (Total of Columns (11) and (12)).

Under Column (14)—Identify the attachment in which the information supporting the specific cost element may be found. Attach separate pages as necessary.

(c) Closing or cutoff dates should be included as part of the data submitted with the proposal. If possible, the contracting officer and offeror should reach a prior understanding on criteria for establishing closing or cutoff dates (see 15.804-4(c)).

(d) The requirement for submission of cost or pricing data is met if all cost or pricing data reasonably available to the offeror are either submitted or identified in writing by the time of agreement on price. However, there is a clear distinction between submitting cost or pricing data and merely making available books, records, and other documents without identification. The latter does not constitute "submission" of cost or pricing data.

(e) If cost or pricing data and information required to explain the estimating process are required and the offeror initially refuses to provide necessary data, or the contracting officer determines that the data provided is so deficient as to preclude adequate analysis and evaluation, the contracting officer shall again attempt to secure the data and/or elicit corrective action. If the offeror still persists in refusing to provide the needed data or to take corrective action, the contracting officer shall withhold the award or price adjustment and refer the contract action to higher authority, including details of the attempts made to resolve the matter and a statement of the practicability of obtaining the supplies or services from another source.

(f) Preproduction and startup costs include costs such as preproduction engineering, special tooling, special plant rearrangement, training programs, and such nonrecurring costs as initial rework, initial spoilage, and pilot runs. When these costs may be a significant cost factor in an acquisition, the contracting officer shall require in the solicitation that the offeror provide (1) an estimate of total preproduction and startup costs, (2) the extent to which these costs are included in the proposed price, and (3) the intent to absorb, or plan for recovery of, any remaining costs. If a successful offeror has indicated an intent to absorb any portion of these costs, the contract shall expressly provide that such portion will not be charged to the Government in any future noncompetitive pricing action.

(g) (1) The requirement for contractors to obtain

cost or pricing data from prospective subcontractors is prescribed at 15.806. However, these data do not have to be submitted to the Government unless called for under subparagraph (2) below.

(2) The contracting officer shall require a contractor that is required to submit certified cost or pricing data also to submit to the Government (or cause the submission of) accurate, complete, and current cost or pricing data from prospective subcontractors in support of each subcontract cost estimate that is (i) \$1,000,000 or more, (ii) both more than \$100,000 and more than 10 percent of the prime contractor's proposed price, or (iii) considered to be necessary for adequately pricing the prime contract.

(3) If the prospective contractor satisfies the contracting officer that a subcontract will be priced on the basis of one of the exemptions in 15.804-3, the contracting officer normally shall not require submission of subcontractor cost or pricing data to the Government in that case. If the subcontract estimate is based upon the cost or pricing data of the prospective subcontractor most likely to be awarded the subcontract, the contracting officer shall not require submission to the Government of data from more than one proposed subcontractor for that subcontract.

(4) The contracting officer shall require the prospective contractor to support subcontractor cost estimates below the threshold in 15.806(b) with any data or information (including other subcontractor quotations) needed to establish a reasonable price.

(h) Subcontractor cost or pricing data shall be accurate, complete, and current as of the date of final price agreement given on the contractor's Certificate of Current Cost or Pricing Data. The prospective contractor shall be responsible for updating a prospective subcontractor's data.

(i) When the prospective contractor has generally complied with subcontract cost or pricing data requirements, the contracting officer may, in exceptional cases, excuse failure to do so for particular subcontracts and award the prime contract. Each such excuse, unless limited to allowing additional time, requires approval by the chief of the contracting office. For each subcontract involved, the contractor remains obligated

to obtain prospective subcontractor cost or pricing data before actual award of that subcontract. For each such subcontract, the contracting officer shall—

- (1) Allow additional time for submission of data up to the date of agreement upon the prime contract price;
- (2) Withdraw the requirement if data submitted are adequate to support the subcontract estimate;
- (3) Reserve the subcontract item for future pricing;
- (4) Consider another contract type; or
- (5) Make other arrangements to provide an adequate basis for price agreement.

#### 15.804-7 Defective cost or pricing data.

(a) If, before agreement on price, the contracting officer learns that any cost or pricing data submitted are inaccurate, incomplete, or noncurrent, the contracting officer shall immediately bring the matter to the attention of the prospective contractor, whether the defective data increase or decrease the contract price. The contracting officer shall negotiate, using any new data submitted or making satisfactory allowance for the incorrect data. The price negotiation memorandum shall reflect the revised facts.

(b) If, after award, cost or pricing data are found to be inaccurate, incomplete, or noncurrent as of the date of final agreement on price given on the contractor's or subcontractor's Certificate of Current Cost or Pricing Data, the Government is entitled to a price adjustment, including profit or fee, of any significant amount by which the price was increased because of the defective data. This entitlement is ensured by including in the contract one of the clauses prescribed in 15.804-8 and set forth at 52.215-22, Price Reduction for Defective Cost or Pricing Data, and 52.215-23, Price Reduction for Defective Cost or Pricing Data—Modifications. The clauses give the Government the right to a price adjustment for defects in cost or pricing data submitted by the contractor, a prospective subcontractor, or an actual subcontractor. In arriving at a price adjustment under the clause, the contracting officer shall consider—

- (1) The time by which the cost or pricing data became reasonably available to the contractor;
- (2) The extent to which the Government relied upon the defective data; and
- (3) Any understated cost or pricing data submitted in support of price negotiations, up to the amount of the Government's claim for overstated pricing data arising out of the same pricing action (for example, the initial pricing of the same contract or the pricing of the same change order). Such offsets need not be in the same cost groupings (e.g., material, direct labor, or indirect costs).

(c) If, after award, the contracting officer learns or suspects that the data furnished were not accurate, complete, and current, or were not adequately verified

by the contractor as of the time of negotiation, the contracting officer shall request an audit to evaluate the accuracy, completeness, and currency of the data. Only if the audit reveals that the data certified by the contractor were defective may the Government evaluate the profit-cost relationships. The contracting officer shall not reprice the contract solely because the profit was greater than forecast or because some contingency specified in the submission failed to materialize.

(d) For each advisory audit received based on a postaward review which indicates defective pricing, the contracting officer shall make a determination as to whether or not the data submitted were defective and relied upon. Before making such a determination, the contracting officer should give the contractor an opportunity to support the accuracy, completeness, and currency of the data in question. The contracting officer shall prepare a memorandum indicating (1) the contracting officer determination as to whether or not the submitted data were accurate, complete, and current as of the certified date and whether or not the Government relied on the data, and (2) the results of any contractual action taken. The contracting officer shall send one copy of this memorandum to the auditor and, if the contract has been assigned for administration, one copy to the administrative contracting officer (ACO). The contracting officer shall notify the contractor by copy of this memorandum, or otherwise, of the determination.

(e) If (1) both contractor and subcontractor submitted and (2) the contractor certified cost or pricing data, the Government has the right, under the clauses at 52.215-22, Price Reduction for Defective Cost or Pricing Data, and 52.215-23, Price Reduction for Defective Cost or Pricing Data—Modifications, to reduce the prime contract price if it was significantly increased because a subcontractor submitted defective data. This right applies whether these data supported subcontract cost estimates or supported firm agreements between subcontractor and contractor.

(f) If Government audit discloses defective subcontractor cost or pricing data, the information necessary to support a reduction in prime contract and subcontract prices may be available only from the Government. To the extent necessary to secure a prime contract price reduction, the contracting officer should make this information available to the prime contractor or appropriate subcontractors upon request. If release of the information would compromise Government security or disclose trade secrets or confidential business information, the contracting officer shall release it only under conditions that will protect it from improper disclosure. Information made available under this paragraph shall be limited to that used as the basis for the prime contract price reduction. In order to afford an opportunity for corrective action, the contracting offi-

cer should give the prime contractor reasonable advance notice before determining to reduce the prime contract price.

(1) When a prime contractor includes defective subcontract data in arriving at the price but later awards the subcontract to a lower priced subcontractor (or does not subcontract for the work), any adjustment in the prime contract price due to defective subcontract data is limited to the difference (plus applicable indirect cost and profit markups) between (i) the subcontract price used for pricing the prime contract and (ii) either the actual subcontract price or the actual cost to the contractor, if not subcontracted, provided the data on which the actual subcontract price is based are not themselves defective.

(2) Under cost-reimbursement contracts and under all fixed-price contracts except (i) firm-fixed-price contracts and (ii) contracts with economic price adjustment, payments to subcontractors that are higher than they would be had there been no defective subcontractor cost or pricing data shall be the basis for disallowance or nonrecognition of costs under the clauses prescribed in 15.804-8. The Government has a continuing and direct financial interest in such payments that is unaffected by the initial agreement on prime contract price.

#### 15.804-8 Contract clauses.

(a) *Price Reduction for Defective Cost or Pricing Data.* The contracting officer shall, when contracting by negotiation, insert the clause at 52.215-22, Price Reduction for Defective Cost or Pricing Data, in solicitations and contracts when it is contemplated that cost or pricing data will be required (see 15.804-2).

(b) *Price Reduction for Defective Cost or Pricing Data—Modifications.* The contracting officer shall, when contracting by negotiation, insert the clause at 52.215-23, Price Reduction for Defective Cost or Pricing Data—Modifications, in solicitations and contracts when (1) it is contemplated that cost or pricing data will be required (see 15.804-2) for the pricing of contract modifications, and (2) the clause prescribed in paragraph (a) above has not been included.

(c) *Subcontractor Cost or Pricing Data.* The contracting officer shall insert the clause at 52.215-24, Subcontractor Cost or Pricing Data, in solicitations and contracts when the clause prescribed in paragraph (a) above is included.

(d) *Subcontractor Cost or Pricing Data—Modifications.* The contracting officer shall insert the clause at 52.215-25, Subcontractor Cost or Pricing Data—Modifications, in solicitations and contracts when the clause prescribed in paragraph (b) above is included.

#### 15.805 Proposal analysis.

##### 15.805-1 General.

(a) The contracting officer, exercising sole responsibility for the final pricing decision, shall, as appropriate,

coordinate a team of experts and request and evaluate the advice of specialists in such fields as contracting, finance, law, contract audit, packaging, quality control, engineering traffic management, and contract pricing. The contracting officer should have appropriate specialists attend the negotiations when complex problems involving significant matters will be addressed. The contracting officer may assign responsibility to a negotiator or price analyst for (1) determining the extent of specialists' advice needed and evaluating that advice, (2) coordinating a team of experts, (3) consolidating pricing data and developing a prenegotiation objective (see 15.807), and (4) conducting negotiations.

(b) When cost or pricing data are required, the contracting officer shall make a cost analysis to evaluate the reasonableness of individual cost elements. In addition, the contracting officer should make a price analysis to ensure that the overall price offered is fair and reasonable. When cost or pricing data are not required, the contracting officer shall make a price analysis to ensure that the overall price offered is fair and reasonable.

(c) The contracting officer shall require prospective contractors to perform (1) price analysis for all significant proposed subcontracts and purchase orders and (2) cost analysis when the prospective subcontractor is required to submit cost or pricing data or the contractor is unable to perform an adequate price analysis (see 15.806(a)).

##### 15.805-2 Price analysis.

The contracting officer is responsible for selecting and using whatever price analysis techniques will ensure a fair and reasonable price. One or more of the following techniques may be used to perform price analysis:

(a) Comparison of proposed prices received in response to the solicitation.

(b) Comparison of prior proposed prices and contract prices with current proposed prices for the same or similar end items.

(c) Application of rough yardsticks (such as dollars per pound or per horsepower, or other units) to highlight significant inconsistencies that warrant additional pricing inquiry.

(d) Comparison with competitive published price lists, published market prices of commodities, similar indexes, and discount or rebate arrangements.

(e) Comparison of proposed prices with independent Government cost estimates (see 15.803(b)).

##### 15.805-3 Cost analysis.

The contracting officer shall, as appropriate, use the techniques and procedures outlined in paragraphs (a) through (f) below to perform cost analysis:

(a) Verification of cost or pricing data and evaluation of cost elements, including—

- (1) The necessity for and reasonableness of proposed costs, including allowances for contingencies;
- (2) Projection of the offeror's cost trends, on the basis of current and historical cost or pricing data;
- (3) A technical appraisal of the estimated labor, material, tooling, and facilities requirements and of the reasonableness of scrap and spoilage factors; and
- (4) The application of audited or negotiated indirect cost rates (see Subpart 42.7), labor rates, and cost of money or other factors.

(b) Evaluating the effect of the offeror's current practices on future costs. In conducting this evaluation, the contracting officer shall ensure that the effects of inefficient or uneconomical past practices are not projected into the future. In pricing production of recently developed, complex equipment, the contracting officer should make a trend analysis of basic labor and materials even in periods of relative price stability.

(c) Comparison of costs proposed by the offeror for individual cost elements with—

- (1) Actual costs previously incurred by the same offeror;
- (2) Previous cost estimates from the offeror or from other offerors for the same or similar items;
- (3) Other cost estimates received in response to the Government's request;
- (4) Independent Government cost estimates by technical personnel; and
- (5) Forecasts or planned expenditures.

(d) Verification that the offeror's cost submissions are in accordance with the contract cost principles and procedures in Part 31 and, when applicable, the requirements and procedures in Part 30, Cost Accounting Standards.

(e) Review to determine whether any cost or pricing data necessary to make the contractor's proposal accurate, complete, and current have not been either submitted or identified in writing by the contractor. If there are such data, the contracting officer shall attempt to obtain them and negotiate, using them or making satisfactory allowance for the incomplete data.

(f) Analysis of the results of any make-or-buy program reviews, in evaluating subcontract costs.

#### 15.805-4 Technical analysis.

When cost or pricing data are required, the contracting officer should generally request a technical analysis of proposals, asking that requirements, logistics, or other appropriate qualified personnel review and assess, as a minimum—

- (a) The quantities and kinds of material proposed;
- (b) The need for the number and kinds of labor hours and the labor mix;
- (c) The special tooling and facilities proposed;
- (d) The reasonableness of proposed scrap and spoilage factors; and
- (e) Any other data that may be pertinent to the cost or price analysis.

#### 15.805-5 Field pricing support.

(a) (1) When cost or pricing data are required, contracting officers shall request a field pricing report (which may include an audit review by the cognizant contract audit activity) before negotiating any contract or modification resulting from a proposal in excess of \$500,000, except as otherwise authorized under agency procedures, unless information available to the contracting officer is considered adequate to determine the reasonableness of the proposed cost or price. When available data are considered adequate for a reasonableness determination, the contracting officer shall document the contract file to reflect the basis of the determination.

(2) Field pricing reports are intended to give the contracting officer a detailed analysis of the proposal, for use in contract negotiations. Field pricing support personnel include, but are not limited to, administrative contracting officers, contract auditors, price analysts, quality assurance personnel, engineers, and small business and legal specialists.

(b) Contracting officers should not request field pricing support for proposed contracts or modifications of an amount less than that specified in subparagraph (a)(1) above. An exception may be made when a reasonable pricing result cannot be established, because of (1) lack of knowledge of the particular contractor, (2) sensitive conditions, or (3) an inability to evaluate the price reasonableness through price analysis or cost analysis of existing data.

(c) (1) When initiating field pricing support, the contracting officer shall do so by sending a request to the cognizant administrative contracting officer (ACO). When field pricing support is not available, or is exempted by agency regulations, the contracting officer may initiate an audit by sending the request directly to the cognizant audit office. In both cases, the contracting officer shall, in the request, (i) prescribe the extent of the support needed, (ii) state the specific areas for which input is required, (iii) include the information necessary to perform the review (such as the offeror's proposal and the applicable portions of the solicitation, particularly those describing requirements and delivery schedules), and (iv) assign a realistic deadline for receipt of the report.

(2) Assignment of unrealistically short deadlines may reduce the quality of the audit and field pricing reports and may make it impossible to establish the fairness and reasonableness of the price.

(3) Agency field pricing procedures shall not preclude free and open communication among the contracting officer, ACO, and auditor.

(d) Only the auditor shall have general access to the offeror's books and financial records. This limitation does not preclude the contracting officer, the ACO, or their representatives from requesting any data from or reviewing offeror records necessary to the discharge of

their responsibilities. The duties of auditors and those of other specialists may require both to evaluate the same elements of estimated costs. They shall review the data jointly or concurrently when possible, the auditor rendering services within the audit area of responsibility and the other specialists rendering services within their own areas of responsibility. The ACO or auditor, as appropriate, shall orally notify the contracting officer immediately of data provided that is so deficient as to preclude review and any denial of access to records or to cost or pricing data considered essential to the performance of a satisfactory review. The oral notification shall be promptly confirmed in writing to the contracting officer describing the deficient or denied data or records, with copies of the deficient data if requested by the contracting officer, the need for the evidence, and the costs unsupported as a result of the denial. The contracting officer shall review the written notification and shall take immediate action to obtain the data needed. If the offeror persists in refusing to provide the data, and the contracting officer determines that the data is essential for a fair and reasonable price determination, then the contracting officer shall proceed with the action outlined in 15.804-6(e).

(e) The auditor shall begin the audit as soon as possible after receiving the contracting officer's request. The auditor is responsible for the scope and depth of the audit. As a minimum, the audit report shall include the following:

- (1) The findings on specific areas listed in the contracting officer's request.
- (2) An explanation of the basis and method used by the offeror in proposal preparation.
- (3) An identification of the original proposal and of all subsequent written formal and other identifiable submissions by which cost or pricing data were either submitted or identified.
- (4) A description of cost or pricing data coming to the attention of the auditor that were not submitted but that may have a significant effect on the proposed cost or price.
- (5) A list of any cost or pricing data submitted that are not accurate, complete, and current and of any cost representations that are unsupported. When the result of deficiencies is so great that the auditor cannot perform an audit or considers the proposal unacceptable as a basis for negotiation, the contracting officer shall be orally notified so that prompt corrective action may be taken, as provided by 15.805-5(d). The auditor will immediately confirm the notification in writing, explaining the deficiencies and the cost impact on the proposal.
- (6) The originals of all technical analyses received by the auditor and a quantification of the dollar effect of the technical analysis findings.
- (7) If the auditor believes that the offeror's estimat-

ing methods or accounting system are inadequate to support the proposal or to permit satisfactory administration of the contract contemplated, a statement to that effect.

(8) A statement of the extent to which the auditor has discussed discrepancies or mistakes of fact in the proposal with the offeror.

(f) The auditor shall not discuss auditor conclusions or recommendations on the offeror's estimated or projected costs with the offeror unless specifically requested to do so by the contracting officer.

(g) If field pricing support was not requested, the auditor shall send the completed audit report directly to the contracting officer. If field pricing support was requested, the auditor shall send the completed audit report to the ACO for forwarding, without change, with the field pricing report. The ACO shall consolidate the field pricing report inputs and send a field pricing report, accompanied by the original copy of the audit report, to the contracting officer by the assigned date. The ACO shall send the auditor a copy of the field pricing report (without the audit report and technical analysis). Audit and field pricing reports shall be made a part of the official contract file.

(h) If any information is disclosed after submission of a proposal that may significantly affect the audit findings, the contracting officer shall require the offeror to provide concurrent copies to the appropriate field pricing office (ACO and audit offices). In that case, the ACO or auditor, as appropriate, will be requested to immediately review the disclosed information and orally report the findings to the contracting officer, followed by a supplemental report when considered necessary.

(i) The prime contractor or higher tier subcontractor is responsible for conducting appropriate cost analyses before awarding subcontracts. However, the contracting officer may request audit or field pricing support to analyze and evaluate the proposal of a subcontractor at any tier (notwithstanding availability of data or analyses performed by the prime contractor) if the contracting officer believes that such support is necessary to ensure reasonableness of the total proposed price. This step may be appropriate when, for example—

- (1) There is a business relationship between the contractor and subcontractor not conducive to independence and objectivity;
- (2) The contractor is a sole source and the subcontract costs represent a substantial part of the contract cost;
- (3) The contractor has been denied access to the subcontractor's records; or
- (4) The contracting officer determines that, because of factors such as the size of the proposed subcontractor price, audit or field pricing support for a subcontract or subcontracts at any tier is critical to

a fully detailed analysis of the prime contract proposal.

(j) When the contracting officer requests the cognizant ACO or auditor to review a subcontractor's cost estimates, the request shall include, when available, a copy of any review prepared by the prime contractor or higher tier subcontractor, the subcontractor's proposal, cost or pricing data provided by the subcontractor, and the results of the prime contractor's cost or price analysis.

(k) When the Government performs the subcontract analysis, the Government shall furnish to the prime contractor or higher tier subcontractor, with the consent of the subcontractor reviewed, a summary of the analysis performed in determining any unacceptable costs, by element, included in the subcontract proposal. If the subcontractor withholds consent, the Government shall furnish a range of unacceptable costs for each element in such a way as to prevent giving away subcontractor proprietary data.

#### 15.806 Subcontract pricing considerations.

(a) Subcontractors must submit to the contractor or higher tier subcontractor cost or pricing data or claims for exemption from the requirement to submit them. The contractor and higher tier subcontractor are responsible for (1) conducting price analysis and, when the subcontractor is required to submit cost or pricing data or if the contractor or higher tier subcontractor is unable to perform an adequate price analysis, cost analysis for all subcontracts and (2) including the results of subcontract reviews and evaluations as part of their own cost or pricing data submission (see 15.805-5(i) through (k)).

(b) Except when the subcontract prices are based on adequate price competition or on established catalog or market prices of commercial items sold in substantial quantities to the general public or are set by law or regulation, any contractor required to submit certified cost or pricing data also shall obtain certified cost or pricing data before awarding any subcontract or purchase order expected to exceed \$100,000 or issuing any modification involving a price adjustment expected to exceed \$100,000 (see example of pricing adjustment at 15.804-2(a)(1)(ii) and see 15.804-6(g) through (i)). To waive subcontractor cost or pricing data, follow the procedures at 15.804-3(i).

(c) The requirements in paragraphs (a) and (b) above, modified to relate to higher tier subcontractors rather than to the prime contractor, shall apply to lower tier subcontracts for which subcontractor cost or pricing data are required.

#### 15.807 Prenegotiation objectives.

(a) The process of determining prenegotiation objectives helps the contracting officer to judge the overall reasonableness of proposed prices and to negotiate a fair and reasonable price or cost and fee. In setting the prenegotiation objectives, the contracting officer shall analyze the offeror's proposal, taking into account the

field pricing report, if any; any audit report and technical analysis whether or not part of a field pricing report; and other pertinent data such as independent Government cost estimates and price histories. This process may include fact-finding sessions with the offeror when the contracting officer deems appropriate.

(b) The contracting officer shall establish prenegotiation objectives before the negotiation of any pricing action. The scope and depth of the analysis supporting the objectives should be directly related to the dollar value, importance, and complexity of the pricing action. When cost analysis is required, the analysis shall address (1) the pertinent issues to be negotiated, (2) the cost objectives, and (3) a profit or fee objective.

(c) The Government's cost objective and proposed pricing arrangement directly affect the profit or fee objective. Because profit or fee is only one of several interrelated variables, the contracting officer shall not agree on profit or fee without concurrent agreement on cost and type of contract. Specific agreement on the exact values or weights assigned to individual profit-analysis factors (see 15.905) is not required during negotiations and should not be attempted.

#### 15.808 Price negotiation memorandum.

(a) At the conclusion of each negotiation of an initial or revised price, the contracting officer shall promptly prepare a memorandum of the principal elements of the price negotiation. The memorandum shall be included in the contract file and shall contain the following minimum information:

- (1) The purpose of the negotiation.
- (2) A description of the acquisition, including appropriate identifying numbers (e.g., RFP No.).
- (3) The name, position, and organization of each person representing the contractor and the Government in the negotiation.
- (4) The current status of the contractor's purchasing system when material is a significant cost element.
- (5) If certified cost or pricing data were required, the extent to which the contracting officer—
  - (i) Relied on the cost or pricing data submitted and used them in negotiating the price; and
  - (ii) Recognized as inaccurate, incomplete, or noncurrent any cost or pricing data submitted; the action taken by the contracting officer and the contractor as a result; and the effect of the defective data on the price negotiated.
- (6) If cost or pricing data were not required in the case of any price negotiation over \$100,000, the exemption or waiver used and the basis for claiming or granting it.
- (7) If certified cost or pricing data were required in the case of any price negotiation under \$100,000, the rationale for such requirement.
- (8) A summary of the contractor's proposal, the field pricing report recommendations, and the rea-

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sons for any pertinent variances from the field pricing report recommendations. Where the determination of price reasonableness is based on cost analysis, the summary shall address the amount of each major cost element (i) proposed by the contractor, (ii) recommended by the field or other pricing assistance report (if any), (iii) contained in the Government's negotiation objective, and (iv) considered negotiated as a part of the price.

(9) The most significant facts or considerations controlling the establishment of the prenegotiation price objective and the negotiated price including an explanation of any significant differences between the two positions. To the extent such direction is received, the price negotiation memorandum (PNM) shall dis-

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sons for any pertinent variances from the field pricing report recommendations.

(9) The most significant facts or considerations controlling the establishment of the prenegotiation price objective and the negotiated price including an explanation of any significant differences between the two positions.

(10) The basis for determining the profit or fee prenegotiation objective and the profit or fee negotiated.

(b) Whenever a field pricing report has been submitted, the contracting officer shall forward a copy of the price negotiation memorandum (PNM) to the cognizant audit office and a copy to the cognizant administrative contracting officer. When appropriate, information on how the advisory services of the field pricing support team can be made more effective should be provided separately.

**15.809 Forward pricing rate agreements.**

(a) Negotiation of forward pricing rate agreements (FPRA's) may be requested by the contracting officer or the contractor or initiated by the administrative contracting officer (ACO). In determining whether or not to establish such an agreement, the ACO should consider whether the benefits to be derived from the agreement are commensurate with the effort of establishing and monitoring it. Normally, FPRA's should be negotiated only with contractors having a significant volume of Government contract proposals. The cognizant contract administration agency shall determine whether an FPRA will be established.

(b) The ACO shall obtain the contractor's proposal and require that it include cost or pricing data that are accurate, complete, and current as of the date of submission. The ACO shall invite the cognizant contract auditor and contracting offices having a significant interest to participate in developing a Government objective and in the negotiations. Upon completing negotiations, the ACO shall prepare a price negotiation memorandum (PNM) (see 15.808) and forward copies of the PNM and FPRA to the cognizant auditor and to all contracting offices that are known to be affected by the FPRA. A Certificate of Current Cost or Pricing Data shall not be required at this time (see 15.804-4(g)).

(c) The FPRA shall provide specific terms and conditions covering expiration, application, and data requirements for systematic monitoring to assure the validity of the rates. The agreement shall provide for cancellation at the option of either party and shall require the contractor to submit to the ACO and to the cognizant contract auditor any significant change in cost or pricing data.

(d) Offerors are required (see 15.804-4(g)) to describe any FPRA's in each specific pricing proposal to which the rates apply and identify the latest cost or pricing data already submitted in accordance with the agreement. All data submitted in connection with the agreement, updated as necessary, form a part of the total data that the of-

feror certifies to be accurate, complete, and current at the time of agreement on price for an initial contract or for a contract modification.

(e) Contracting officers will use FPRA rates as bases for pricing all contracts, modifications, and other contractual actions to be performed during the period covered by the agreement, unless the ACO determines that changed conditions have invalidated part or all of the agreement. Conditions that may affect the agreement's validity shall be promptly reported to the ACO.

(1) If the ACO determines that the agreement is still valid, the ACO shall notify the individual or agency that reported the changed conditions.

(2) If the ACO determines that a changed condition has invalidated the agreement, the ACO shall notify all interested parties of the extent of its effect and initiate revision of the agreement.

(f) When an FPRA has been invalidated, the contractor, ACO, and contracting officer shall reflect the changed condition in proposals, cost analyses, and negotiations, pending revision of the agreement.

**15.810 Should-cost analysis.**

(a) Should-cost analysis is a specialized form of cost analysis which is used to evaluate the cost of production programs by evaluating and challenging a contractor's management and operating systems or portions thereof. It does not assume the use of the contractor's existing workforce, methods, materials, facilities, or management and operating systems. It addresses significant cost drivers and may be tailored to a specific part of the contractor's operations, for example, indirect expense activities, factory layout, etc. This analysis is accomplished by an integrated team of Government contracting, contract administration, pricing, audit, and engineering representatives. The objective of should-cost analysis is to promote both short- and long-range improvements in the contractor's economy and efficiency by evaluating and challenging the contractor's existing workforce, methods, materials, facilities, or management and operating systems to identify uneconomical or inefficient practices. In addition, by providing rationale for any recommendations and quantifying their impact on cost, the Government will be better able to develop realistic price objectives for negotiation.

(b) A should-cost analysis should be considered, particularly in the case of a major system acquisition (see Part 34), when—

(1) Some initial production has already taken place;

(2) The contract will be awarded on a sole-source basis;

(3) There are future year production requirements for substantial quantities of like items;

(4) The items being acquired have a history of increasing costs;

(5) The work is sufficiently defined to permit an effective analysis and major changes are unlikely;

(6) Sufficient time is available to plan and conduct the should-cost analysis adequately; and

(7) Personnel with the required skills are available or can be assigned for the duration of the should-cost analysis.

(c) The scope of a should-cost analysis can range from a large-scale review examining the contractor's entire operation (including plant-wide overhead and selected major sub-contractors) to a small-scale review examining specific portions of a contractor's operation. When a should-cost analysis is conducted relative to a contractor proposal, a separate audit report on the proposal is required. In determining the team size for the review, the various factors outlined in this paragraph (c) should be considered.

(d) The contracting officer should decide which elements of the contractor's operation have the greatest potential for cost savings and assign the available personnel resources accordingly. While the particular elements to be analyzed are a function of the contract work task, elements such as manufacturing, pricing and accounting, management and organization, and subcontract and vendor management are normally reviewed in a should-cost analysis.

(e) In acquisitions for which a should-cost analysis is conducted, a separate should-cost analysis team report, prepared in accordance with agency procedures, is required. Field pricing reports are required only to the extent that they contribute to the combined team position. The contracting officer shall consider the findings and recommendations contained in the should-cost analysis team report when negotiating the contract price. After completing the negotiation, the contracting officer shall provide the administrative contracting officer a report of any identified uneconomical or inefficient practices, together with a report of correction or disposition agreements reached with the contractor. The contracting officer shall establish a follow-up plan to monitor the correction of the uneconomical or inefficient practices.

(f) When a should-cost analysis is planned, the contracting officer should state this fact (1) in the acquisition plan (see Subpart 7.1) and (2) in the solicitation.

#### 15.811 Estimating systems.

(a) The consistent preparation of proposals using an acceptable estimating system benefits both the Government and the contractor by increasing the accuracy and reliability of individual proposals. Cognizant audit activities, when it is appropriate to do so, shall establish and manage regular programs for reviewing selected contractors' estimating systems or methods, in order to (1) reduce the scope of reviews to be performed on individual proposals, (2) expedite the negotiation process, and (3) increase the reliability of proposals. The results of estimating system reviews shall be documented in survey reports.

(b) The auditor shall send a copy of the estimating system survey report and a copy of the official notice of corrective action required to each contracting office and contract administration office having substantial business with that contractor. Significant deficiencies not corrected by the contractor shall be a consideration in subsequent proposal

analyses and negotiations.

(c) In determining the acceptability of a contractor's estimating system, the auditor should consider—

(1) The source of data for estimates and the procedures for ensuring that the data are accurate, complete, and current;

(2) The documentation developed and maintained in support of the estimate;

(3) The assignment of responsibilities for originating, reviewing, and approving estimates;

(4) The procedures followed for developing estimates for direct and indirect cost elements;

(5) The extent of coordination and communication between organizational elements responsible for the estimate; and

(6) Management support, including estimate approval, establishment of controls, and training programs.

#### 15.812 Unit prices.

##### 15.812-1 General.

(a) Direct and indirect costs are generally allocated to contracts in accordance with the Cost Accounting Standards of Part 30 (when applicable) and the Contract Cost Principles and Procedures of Part 31. However, for the purpose of pricing all items of supplies, distribution of those costs within contracts shall be on a basis that ensures that unit prices are in proportion to the item's base cost (e.g., manufacturing or acquisition costs). Any method of distributing costs to line items that distorts the unit prices shall not be used. For example, distributing costs equally among line items is not acceptable except when there is little or no variation in base cost.

(b) However, the policy in paragraph (a) of this subsection does not apply to any Department of Defense (DoD) or National Aeronautics and Space Administration (NASA) contract or subcontract item of supply for which the price is, or is based on, an established catalog or market price of a commercial item sold in substantial quantities to the general public. A price is "based on" a catalog or market price only if the item is sufficiently similar to the catalog or market price commercial item to ensure that any difference in price can be identified and justified without resort to cost analysis.

(c) In addition, when contracting by negotiation without full and open competition, contracting officers shall require that offerors identify in their proposals those items of supply which they will not manufacture or to which they will not contribute significant value. The contracting officer shall require similar information when contracting by negotiation with full and open competition if adequate price competition is not expected (see 15.804-3(b)). The information need not be requested in connection with the award of contracts under the General Services Administration's competitive Multiple Award Schedule Program. For DoD and NASA contracts, the information shall not be requested for

commercial items sold in substantial quantities to the general public when the prices are, or are based on, established catalog or market prices. Such information shall be used to determine whether the intrinsic value of an item has been distorted through application of overhead and whether such items should be considered for breakout. The contracting officer may require such information in any other negotiated contracts when appropriate.

#### 15.812-2 Contract clause.

(a) The contracting officer shall insert the clause at 52.215-26, Integrity of Unit Prices, in all solicitations and contracts for other than—

- (1) Small purchases under Part 13;
- (2) Construction or architect-engineer services under Part 36;
- (3) Utility services under Subpart 8.3; or
- (4) Service contracts where supplies are not required.

(b) The contracting officer shall insert the clause with its *Alternate 1* when contracting without full and open competition or when prescribed by agency regulations.

#### 15.813 Commercial pricing certificates.

##### 15.813-1 Policy.

The Government should not purchase items of supply offered for sale to the public at a price that exceeds the lowest price at which such items are sold by the contractor unless the price difference is clearly justified by the seller or unless exempt under 15.813-3. To this end, 10 U.S.C. 2323 and 41 U.S.C. 253e require an offeror to certify that the price offered is not more than its lowest commercial price or to submit a written statement specifying the amount of any difference and providing justification for that difference.

##### 15.813-2 Applicability.

(a) Except as provided in 15.813-3, commercial pricing certificates are required to be submitted with any offer/proposal covering any item or items that are offered for sale to the public which is submitted in connection with any of the following:

- (1) Contracts not awarded on the basis of full and open competition.
- (2) Contract modifications including contract modifications for additional items but not including contract modifications that are within the scope and under the terms of the contract, such as contract modifications issued pursuant to the Changes clause, or funding and other administrative changes.
- (3) Orders under the provisioning line item of a contract or under a Basic Ordering Agreement or under a similar arrangement.

(b) If the contract, modification or order is awarded without a definitive price, such as a letter contract or an unpriced order, the commercial pricing certificate is not required prior to award but rather will be submitted with the offer or proposal furnished to definitize the price.

(c) Notwithstanding any limitations contained in (a) above, the contracting officer may require a commercial pricing certificate whenever it is necessary to protect the interests

of the Government. Examples could be where adequate price competition does not exist despite full and open competition or where a modification issued pursuant to the Changes clause results in a substitution of commercial items for non-commercial items.

##### 15.813-3 Exemptions from commercial pricing certificates.

(a) For civilian agencies, not including NASA, a certificate of commercial pricing is not required in connection with the acquisition of items unless the items being acquired are individual parts, components, subassemblies or subsystems integral to a major system, and other property which may be replaced during the service life of the system, including spare parts and replenishment spare parts, but not including packaging or labeling associated with shipment or identification of an item.

(b) The contracting officer shall not ordinarily require a certificate of commercial pricing when—

- (1) The simplified small purchase procedures of Part 13 are being used;
- (2) An order is placed under an indefinite delivery-type contract (A certificate is required in connection with the award without full and open competition of an indefinite delivery-type contract.);

(3) The contracting officer determines that obtaining the commercial pricing certificate is not appropriate because of (i) national security considerations; or (ii) differences in quantities, quality, delivery, or other terms and conditions of the contract from commercial contract terms; or

(4) The contracting officer determines that no commercial items are included in the contract, modification or order.

##### 15.813-4 Procedures.

(a) When commercial pricing certificates are required in accordance with 15.813-2 above, the contracting officer shall require the contractor to submit the certificate as set forth in the clause at 52.215-32, Certification of Commercial Pricing. The contracting officer should assess market conditions for the items expected to be covered by the certificate to determine whether the standard 60-day time period specified in the certificate is appropriate. If the frequency of price fluctuations or other circumstances persuade the contracting officer that a shorter or longer period is appropriate, the time period should be modified accordingly.

(b) The contracting officer shall request submission of a new certificate when the validity of the certificate originally submitted with an offer/proposal becomes doubtful prior to award due to submission of a new or revised proposal or as a result of discussions.

(c) If, before agreement on price, the contracting officer learns that the certificate is inaccurate, incomplete, or misleading, the contracting officer shall immediately bring the matter to the attention of the offeror/contractor, request a new certificate, and negotiate accordingly.

(d) If, after award, the contracting officer learns or suspects that commercial prices offered were defective, the contracting officer shall request, as appropriate, an audit to evaluate the commercial prices under authority of paragraph (b) of the clause at 52.215-32. If the contracting officer determines that a certificate is inaccurate, incomplete or misleading, the Government is entitled to a price adjustment for the overcharge (see paragraph (c) of the clause at 52.215-32).

(e) Individual or class determinations made under 15.813-3(b)(3) or (b)(4) will be documented in the contract file.

(f) Possession of a contractor's Certificate of Commercial Pricing is not a substitute for examining and analyzing a contractor's proposal.

#### 15.813-5 Contract clause.

The contracting officer shall insert the clause at 52.215-32, Certification of Commercial Pricing, in all solicitations and contracts unless exempted under 15.813-3(a) or (b)(1).

### SUBPART 15.9—PROFIT

#### 15.900 Scope of subpart.

This subpart—

(a) Prescribes policies for establishing the profit or fee portion of the Government prenegotiation objective;

(b) Applies to price negotiations based on cost analysis;

(c) Prescribes policies for agencies' development and use of a structured approach for determining the profit or fee prenegotiation objective (see 15.905 for the contents of a structured approach); and

(d) Specifies (1) situations requiring contracting officers to analyze profit and (2) considerations for that analysis.

#### 15.901 General.

(a) Profit or fee prenegotiation objectives do not necessarily represent net income to contractors. Rather, they represent that element of the potential total remuneration that contractors may receive for contract performance over and above allowable costs. This potential remuneration element and the Government's estimate of allowable costs to be incurred in contract performance together equal the Government's total prenegotiation objective. Just as actual costs may vary from estimated costs, the contractor's actual realized profit or fee may vary from negotiated profit or fee, because of such factors as efficiency of performance, incurrence of costs the Government does not recognize as allowable, and contract type.

(b) It is in the Government's interest to offer contractors opportunities for financial rewards sufficient to (1) stimulate efficient contract performance, (2) attract the best capabilities of qualified large and small business concerns to Government contracts, and (3) maintain a viable industrial base.

(c) Both the Government and contractors should be concerned with profit as a motivator of efficient and effective contract performance. Negotiations aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the Government's interest. Negotiation of extremely low profits, use of historical averages, or automatic application of predetermined percentages to total estimated costs do not provide proper motivation for optimum contract performance. With the exception of statutory ceilings in 15.903(d) on profit and fee, agencies shall not (1) establish administrative ceilings or (2) create administrative procedures that could be represented to contractors as de facto ceilings.

#### 15.902 Policy.

(a) Structured approaches (see 15.905) for determining profit or fee prenegotiation objectives provide a discipline for ensuring that all relevant factors are considered. Subject to the authorities in 1.301(c), agencies making non-competitive contract awards over \$100,000 totaling \$50 million or more a year—

(1) Shall use a structured approach for determining the profit or fee objective in those acquisitions that require cost analysis; and

(2) May prescribe specific exemptions for situations in which mandatory use of a structured approach would be clearly inappropriate.

(b) Agencies may use another agency's structured approach.

#### 15.903 Contracting officer responsibilities.

(a) When the price negotiation is not based on cost analysis, contracting officers are not required to analyze profit.

(b) When the price negotiation is based on cost analysis, contracting officers in agencies that have a structured approach shall use it to analyze profit. When not using a structured approach, contracting officers shall comply with 15.905-1 in developing profit or fee prenegotiation objectives.

(c) Contracting officers shall use the Government prenegotiation cost objective amounts as the basis for calculating the profit or fee prenegotiation objective. Before the allowability of facilities capital cost of money, this cost was included in profits or fees. Therefore, before applying profit or fee factors, the contracting officer shall exclude any facilities capital cost of money included in the cost objective amounts. If the prospective contractor fails to identify or propose facilities capital cost of money in a proposal for a contract that will be subject to the cost principles for contracts with commercial organizations (see Subpart 31.2), facilities capital cost of money will not be an allowable cost in any resulting contract (see 15.904).

**PART 31**  
**CONTRACT COST PRINCIPLES AND PROCEDURES**

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**PART 31**  
**CONTRACT COST PRINCIPLES AND**  
**PROCEDURES**

**31.000 Scope of part.**

This part contains cost principles and procedures for (a) the pricing of contracts, subcontracts, and modifications to contracts and subcontracts whenever cost analysis is performed (see 15.805-3) and (b) the determination, negotiation, or allowance of costs when required by a contract clause.

**31.001 Definitions.**

"Accrued benefit cost method" means an actuarial cost method under which units of benefit are assigned to each cost accounting period and are valued as they accrue; i.e., based on the services performed by each employee in the period involved. The measure of normal cost under this method for each cost accounting period is the present value of the units of benefit deemed to be credited to employees for service in that period. The measure of the actuarial liability at a plan's inception date is the present value of the units of benefit credited to employees for service prior to that date. (This method is also known as the unit credit cost method.)

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

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

"Actual costs," as used in this part (other than Subpart 31.6), means amounts determined on the basis of costs incurred, as distinguished from forecasted costs. Actual costs include standard costs properly adjusted for applicable variances.

"Actuarial assumption" means a prediction of future conditions affecting pension costs; e.g., mortality rate, employee turnover, compensation levels, pension fund earnings, and changes in values of pension funds assets.

"Actuarial cost method" means a technique which uses actuarial assumptions to measure the present value of future pension benefits and pension fund administrative expenses, and which assigns the cost of such benefits and expenses to cost accounting periods.

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

"Actuarial liability" means pension cost attributable, under the actuarial cost method in use, to years before the date of a particular actuarial valuation. As of such date, the actuarial liability represents the excess of the present value of the future benefits and administrative expenses over the present value of future contributions, for the normal cost for all plan participants and beneficiaries. The excess of the actuarial liability over the value of the assets of a pension plan is the unfunded actuarial liability.

"Actuarial valuation" means the determination, as of a specified date, of the normal cost, actuarial liability, value of the assets of a pension fund, and other relevant values for the pension plan.

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

"Automatic data processing equipment (ADPE)," as used in this part means:

(a) Digital and analog computer components and systems, irrespective of type of use, size, capacity, or price;

(b) All peripheral, auxiliary, and accessorial equipment used in support of digital and/or analog computers, either cable connected, or "self standing," and whether selected or acquired with the computers or separately;

(c) Punched card machines (PCM) and systems used in conjunction with or independently of digital or analog computers; and

(d) Digital and analog terminal and conversion equipment that is acquired solely or primarily for use with a system which employs a computer or punched card machines.

"Business unit" means any segment of an organization, or an entire business organization which is not divided into segments.

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

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

"Cost objective," as used in this part (other than Subpart 31.6), means a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

"Cost of capital committed to facilities" means an imputed cost determined by applying a cost of money rate to facilities capital.

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

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

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

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

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

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

"Facilities capital" means the net book value of tangible capital assets and of those intangible capital assets that are subject to amortization.

"Final cost objective," as used in this part (other than Subparts 31.3 and 31.6), means a cost objective that has allocated to it both direct and indirect costs and, in the contractor's accumulation system, is one of the final accumulation points.

"Fiscal year" as used in this part, means the accounting period for which annual financial statements are regularly prepared, generally a period of 12 months, 52 weeks, or 53 weeks.

"General and administrative (G&A) expense" means any management, financial, and other expense which is incurred by or allocated to a business unit and which is for the general management and administration of the business unit as a whole. G&A expense does not include those management expenses whose beneficial or causal relationship to cost objectives can be more directly measured by a base other than a cost input base

representing the total activity of a business unit during a cost accounting period.

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

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

"Independent research and development (IR&D) cost" means the cost of effort which is neither sponsored by a grant, nor required in performing a contract, and which falls within any of the following four areas: (a) basic research, (b) applied research, (c) development, and (d) systems and other concept formulation studies.

"Indirect cost pools," as used in this part (other than Subparts 31.3 and 31.6), means groupings of incurred costs identified with two or more cost objectives but not identified specifically with any final cost objective.

"Insurance administration expenses" means the contractor's costs of administering an insurance program; e.g., the costs of operating an insurance or risk-management department, processing claims, actuarial fees, and service fees paid to insurance companies, trustees, or technical consultants.

"Intangible capital asset" means an asset that has no physical substance, has more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the benefits it yields.

"Labor cost at standard" means a preestablished measure of the labor element of cost, computed by multiplying labor-rate standard by labor-time standard.

"Labor-rate standard" means a preestablished measure, expressed in monetary terms, of the price of labor.

"Labor-time standard" means a preestablished measure, expressed in temporal terms, of the quantity of labor.

"Material cost at standard" means a preestablished measure of the material elements of cost, computed by multiplying material-price standard by material-quantity standard.

"Material-price standard" means a preestablished measure, expressed in monetary terms, of the price of material.

clude contracts for vessels, aircraft, or other kinds of personal property.

(b) Except as otherwise provided in (d) below, the cost principles and procedures in Subpart 31.2 shall be used in the pricing of contracts and contract modifications in this category if cost analysis is performed as required by 15.805-3.

(c) In addition, the contracting officer shall incorporate the cost principles and procedures in Subpart 31.2 (as modified by (d) below) by reference in contracts in this category as the basis for—

(1) Determining reimbursable costs under cost-reimbursement contracts, including cost-reimbursement subcontracts thereunder;

(2) Negotiating indirect cost rates;

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

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

(5) Pricing changes and other contract modifications.

(d) Except as otherwise provided in this paragraph (d), the allowability of costs for construction and architect-engineer contracts shall be determined in accordance with Subpart 31.2.

(1) Because of widely varying factors such as the nature, size, duration, and location of the construction project, advance agreements as set forth in 31.109, for such items as home office overhead, partners' compensation, employment of consultants, and equipment usage costs, are particularly important in construction and architect-engineer contracts. When appropriate they serve to express the parties' understanding and avoid possible subsequent disputes or disallowances.

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

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

(A) Actual cost data shall be used when such data can be determined for both ownership and operations costs for each piece of equipment, or groups of similar serial or series equipment, from the contractor's accounting records. When such costs cannot be so determined, the contracting agency may specify the use of a particular schedule of predetermined rates or any part thereof to determine ownership and operating costs of construction equipment (see subdivisions (d)(2)(i)(B) and (C) of this section). However, costs otherwise unallowable under this part shall not become allowable through the use of any schedule (see 31.109(c)). For example, schedules need to be adjusted for Government contract costing purposes if they are based on replacement cost, include unallowable interest costs, or use improper cost of

money rates or computations. Contracting officers should review the computations and factors included within the specified schedule and ensure that unallowable or unacceptably computed factors are not allowed in cost submissions.

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

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

(ii) Reasonable costs of renting construction equipment are allowable (but see paragraph (C) below).

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

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

(C) The allowability of charges for construction equipment rented from any division, subsidiary, or organization under common control, will be determined in accordance with 31.205-36(b)(3).

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



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

### 31.106 Facilities contracts.

#### 31.106-1 Applicable cost principles.

The cost principles and procedures applicable to the evaluation and determination of costs under facilities contracts (as defined in 45.301), and subcontracts thereunder, will be governed by the type of entity to which a facilities contract is awarded. Except as otherwise provided in 31.106-2 below, Subpart 31.2 applies to facilities contracts awarded to commercial organizations; Subpart 31.3 applies to facilities contracts awarded to educational institutions; and 31.105 applies to facilities contracts awarded to construction contractors. Whichever cost principles are appropriate will be used in the pricing of facilities contracts and contract modifications if cost analysis is performed as required by 15.805-3. In addition, the contracting officer shall incorporate the cost principles and procedures appropriate in the circumstances (e.g., Subpart 31.2; Subpart 31.3; or 31.105) by reference in facilities contracts as the basis for—

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

(b) Negotiating indirect cost rates; and

(c) Determining costs of terminated contracts when the contractor elects to "voucher out" costs (see Subpart 49.3), and for settlement by determination (see 49.109-7).

#### 31.106-2 Exceptions to general rules on allowability and allocability.

(a) A contractor's established accounting system and procedures are normally directed to the equitable allocation of costs to the types of products which the contractor produces or services rendered in the course of normal operating activities. The acquisition of, or work on, facilities for the Government normally does not involve the manufacturing processes, plant departmental operations, cost patterns of work, administrative and managerial control, or clerical effort usual to production of the contractor's normal products or services.

(b) Advance agreements (see 31.109) should be made between the contractor and the contracting officer as to indirect cost items to be applied to the facilities acquisition. A contractor's normal accounting practice for allocating indirect costs to the acquisition of contractor facilities may range from charging all these costs to this acquisition to not charging any. When necessary to produce an equitable result, the contractor's usual method of allocating indirect cost shall be varied, and appropriate adjustment shall be made to the pools of indirect cost and the bases of their distribution.

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

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

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

#### 31.106-3 Contractor's commercial products.

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

#### 31.107 Contracts with State and local governments.

(a) Subpart 31.6 provides principles and standards for determining costs applicable to contracts with State and local governments. They provide the basis for a uniform approach to the problem of determining costs and to promote efficiency and better relationships between State and local and Federal Government entities. They apply to all programs that involve contracts with State and local governments, except contracts with—

(1) Publicly financed educational institutions subject to Subpart 31.3; or

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

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

**31.108 Contracts with nonprofit organizations.**

Subpart 31.7 provides principles and standards for determining costs applicable to contracts with nonprof-

it organizations other than educational institutions, State and local governments, and those nonprofit organizations exempted under OMB Circular No. A-122.

(The next page is 31-7.)

**31.109 Advance agreements.**

(a) The extent of allowability of the costs covered in this part applies broadly to many accounting systems in varying contract situations. Thus, the reasonableness and allocability of certain costs may be difficult to determine, particularly for firms or their divisions that may not be under effective competitive restraints. To avoid possible subsequent disallowance or dispute based on unreasonableness or nonallocability, contracting officers and contractors should seek advance agreement on the treatment of special or unusual costs. However, an advance agreement is not an absolute requirement and the absence of an advance agreement on any cost will not, in itself, affect the reasonableness or allocability of that cost.

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

(c) The contracting officer is not authorized by this 31.109 to agree to a treatment of costs inconsistent with this part. For example, an advance agreement may not provide that, notwithstanding 31.205-20, interest is allowable.

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

(e) The cognizant administrative contracting officer (ACO), or other contracting officer established in Part 42, shall negotiate advance agreements except that an advance agreement affecting only one contract, or class of contracts from a single contracting office, shall be negotiated by a contracting officer in the contracting office, or an ACO when delegated by the contracting officer. When the negotiation authority is delegated, the ACO shall coordinate the proposed agreement with the contracting officer before executing the advance agreement.

(f) Before negotiating an advance agreement, the Government negotiator shall—

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

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

(3) As appropriate, invite the office or agency and the cognizant audit agency to participate in prenegotiation discussions and/or in the subsequent negotiations.

(g) Upon completion of the negotiation, the sponsor shall prepare and distribute to other interested agencies and offices, including the audit agency, copies of the executed agreement and a memorandum providing the information specified in 15.808, Price negotiation

memorandum, as applicable.

(h) Examples of costs for which advance agreements may be particularly important are—

(1) Compensation for personal services, including but not limited to allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differential;

(2) Use charges for fully depreciated assets;

(3) Deferred maintenance costs;

(4) Precontract costs;

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

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

(7) Selling and distribution costs;

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

(9) Costs of idle facilities and idle capacity;

(10) Costs of automatic data processing equipment;

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

(12) Plant reconversion;

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

(14) General and administrative costs (e.g., corporate, division, or branch allocations) attributable to the general management, supervision, and conduct of the contractor's business as a whole. These costs are particularly significant in construction, job-site, architect-engineer, facilities, and Government-owned contractor operated (GOCO) plant contracts (see 31.203(f));

(15) Costs of construction plant and equipment (see 31.105(d));

(16) Costs of public relations and advertising; and

(17) Training and education costs (see 31.205-44(h)).

### SUBPART 31.2—CONTRACTS WITH COMMERCIAL ORGANIZATIONS

#### 31.201 General.

##### 31.201-1 Composition of total cost.

The total cost of a contract is the sum of the allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits, plus any allocable cost of money pursuant to 31.205-10. In ascertaining what constitutes a cost, any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used, including standard costs properly adjusted for applicable variances. See 31.201-2(b) and (c) for Cost Accounting Standards (CAS) requirements.

##### 31.201-2 Determining allowability.

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

(1) Reasonableness.

(2) Allocability.

(3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting

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principles and practices appropriate to the particular 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 shall not be allowed in excess of the amount that would have resulted from using practices consistent with this subpart.

**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. Sub-

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ject 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.

**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 which is generated solely as a result of incurring another cost, and which would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.

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

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

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

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

(2) Salary expenses of employees who participate in activities that generate unallowable costs shall be treated as directly associated costs to the extent of the time spent on the proscribed activity, provided the costs are material in accordance with subparagraph (e)(1) above (except when such salary 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, it is intended that such directly associated costs be unallowable only if determined to be material in amount in accordance with the criteria provided in subparagraphs (e)(1) and (e)(2) above, except in those situations where allowance of any of the directly associated costs involved would be considered to be contrary to public policy.

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

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

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

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

#### 31.203 Indirect costs.

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

(b) Indirect costs shall be accumulated by logical cost groupings with due consideration of the reasons for incurring such costs. Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives. Commonly, manufacturing overhead, selling expenses, and general and administrative (G&A) expenses are separately grouped. Similarly, the particular case may require subdivision of these groupings, e.g., building occupancy costs might be separable from those of personnel administration within the manufacturing overhead group. This necessitates selecting a distribution base common to all cost objectives to which the grouping is to be allocated. The base should be selected so as to permit allocation of the grouping on the basis of the benefits accruing to the several cost objectives. When substantially the same results can be achieved through less precise methods, the number and composition of cost groupings should be governed by practical considerations and should not unduly complicate the allocation.

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

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

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

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

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

(e) A base period for allocating indirect costs is the cost accounting period during which such costs are incurred and accumulated for distribution to work performed in that period. The criteria and guidance in CAS 406 for selecting the cost accounting periods to be used in allocating indirect costs are incorporated herein for application to contracts subject to full CAS coverage. For contracts subject to modified CAS coverage and for non-CAS-covered contracts, the base period for allocating indirect costs will normally be the contractor's fiscal year. But a shorter period may be appropriate (1) for contracts in which performance involves only a minor portion of the fiscal year or (2) when it is general practice in the industry to use a shorter period. When a contract is performed over an extended period, as many base periods shall be used as are required to represent the period of contract performance.

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

#### 31.204 Application of principles and procedures.

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

(b) Costs incurred as reimbursements or payments to a subcontractor under a cost-reimbursement, fixed-price incentive, or price redeterminable type subcontract of any tier above the first firm-fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions are allowable to the extent that allowance is consistent with the appropriate subpart of this Part 31 applicable to the subcontract involved. Costs incurred as payments under firm-fixed-price subcontracts or fixed-price subcontracts with economic price adjustment provisions or modifications thereto, when cost

analysis was performed under 15.805-3, shall be allowable only to the extent that the price was negotiated in accordance with 31.102.

(c) Section 31.205 does not cover every element of cost. Failure to include any item of cost does not imply that it is either allowable or unallowable. The determination of allowability shall be based on the principles and standards in this subpart and the treatment of similar or related selected items.

#### 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 advertising costs that are allowable are those specifically required by contract, or that arise from requirements of Government contracts and that are exclusively for—

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

(2) Acquiring scarce items for contract performance; or

(3) Disposing of scrap or surplus materials acquired for contract performance.

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

(e) Allowable public relations costs include the following:

(1) Costs specifically required by contract.

**(2) Costs of —**

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

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

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

(3) Costs of participation in community service activities (e.g., blood bank drives, charity drives, savings bond drives, disaster assistance, etc.).

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

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

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

(1) All advertising costs other than those specified in paragraph (d) of this subsection.

(2) Costs of air shows and other special events, such as conventions and trade shows, including —

(i) Costs of displays, demonstrations, and exhibits;

(ii) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and

(iii) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings.

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

(4) Costs of ceremonies such as corporate celebrations and new product announcements.

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

31.205-13(a), Employee morale, health, welfare, food service, and dormitory costs and credits; 31.205-21, Labor relations costs; 31.205-43(c), Trade, business, technical, and professional activity costs; and 31.205-44, Training and educational costs).

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

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

(8) All public relations costs, other than those specified in paragraph (e) of this subsection, whose primary purpose is to promote the sale of products or services by stimulating interest in a product or product line (except for those costs made allowable under 31.205-38(c)), or by disseminating messages calling favorable attention to the contractor for purposes of enhancing the company image to sell the company's products or services. Nothing in this subparagraph (f)(8) modifies the express unallowability of costs listed in subparagraphs (f)(2) through (f)(7). The purpose of this subparagraph is to provide criteria for determining whether costs not specifically identified should be unallowable.

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

**31.205-2 Automatic data processing equipment leasing costs.**

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

(The next page is 31-11.)

ADPE acquired by means of capital leases, as defined in FAS-13, shall be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges or over the leased life as amortization charges as appropriate. Allowability of costs related to contractor-owned ADPE is governed by other requirements of this subpart.

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

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

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

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

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

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

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

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

(4) Allowable rental costs of ADPE leased from any division, subsidiary, or organization under a common control are limited to the cost of ownership (excluding interest or other costs unallowable under this Subpart 31.2 and including the cost of money (see 31.205-10)). When there is an established prac-

tice of leasing the same or similar equipment to unaffiliated lessees, rental costs shall be allowed in accordance with subparagraphs (b)(1) and (2) above, except that the purchase price and costs of ownership shall be determined under 31.205-26(e).

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

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

(ii) Cost reductions that will produce identifiable savings in production or overhead costs;

(iii) Increase in workload volume that cannot be accomplished efficiently by modifying or augmenting existing ADPE; or

(iv) Consistent pattern of capacity operation (2 ½-3 shifts) on existing ADPE.

(2) Technological advances will not justify replacing existing ADPE before the end of its physical life if it will be able to satisfy future requirements or demands.

(3) In estimating the least cost to the Government for useful life, the cumulative costs that would be allowed if the contractor owned the ADPE should be compared with cumulative costs that would be allowed under any of the various types of leasing arrangements available. For the purpose of this comparison, the costs of ADPE exclude interest or other unallowable costs pursuant to this Subpart 31.2; they include but are not limited to the costs of operation, maintenance, insurance, depreciation, facilities capital cost of money, rental, and the cost of machine services, as applicable.

(d) (1) Except as provided in subparagraph (3) below, the contractor's justification, under paragraph (b) above, of the leasing decisions shall consist of the following supporting data, prepared before acquisition:

(i) Analysis of use of existing ADPE.

(ii) Application of the criteria in paragraph (b) above.

(iii) Specific objectives or requirements, generally in the form of a data system study and specification.

(iv) Solicitation of proposals, based on the data system specification, from qualified sources.



(v) Proposals received in response to the solicitation and reasons for selecting the equipment chosen and for the decision to lease.

(2) Except as provided in subparagraph (3) below, the contractor's annual justification, under subparagraph (b)(2) above, of the decision to retain or change existing ADPE capability and the need to continue leasing shall consist of current data as specified in subdivisions (d)(1)(i) through (iii) above.

(3) If the contractor's prospective ADPE lease cost meets the threshold in 31.205-2(b)(2)(iii) above, the contractor shall furnish data supporting the initial decision to lease (see subparagraph (b)(1) above). If the total cost of leasing ADPE in a single plant, division, or cost center exceeds \$500,000 per year and 50 percent or more of the total leasing cost is allocated to Government contracts which require negotiating or determining costs, the contractor shall furnish data supporting the annual justification for retaining or changing existing ADPE capability and the need to continue leasing shall also be furnished (see subparagraph (b)(2) above).

#### 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 Civil defense costs.

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

(b) Costs of capital assets acquired for civil defense purposes are allowable through depreciation (see 31.205-11).

(c) Contributions to local civil defense funds and projects are unallowable.

#### 31.205-6 Compensation for personal services.

(a) *General.* Compensation for personal services includes all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor during the period of contract performance (except as otherwise provided for severance pay costs in paragraph (g) below and for pension costs in paragraph (j) below). It includes, but is not limited to, salaries; wages; directors' and executive committee members' fees; bonuses (including stock bonuses); incentive awards; employee stock options, stock appreciation rights, and stock ownership plans; employee insurance; fringe benefits; contributions to pension, annuity, and management employee incentive compensation plans; and allowances for off-site pay, incentive pay, location allowances, hardship pay, severance pay, and cost of living differential. Compensation for personal services is allowable subject to the following general criteria and additional requirements contained in other parts of this cost principle:

(1) Compensation for personal services must be for work performed by the employee in the current year and must not represent a retroactive adjustment of prior years' salaries or wages (but see 31.205-6(g), (h), (j), (k), and (m) below).

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

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

(4) No presumption of allowability will exist where the contractor introduces major revisions of existing compensation plans or new plans and the contractor—

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

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

(5) Costs that are unallowable under other paragraphs of this Subpart 31.2 shall not be allowable under this subsection 31.205-6 solely on the basis that they constitute compensation for personal services. (See 31.205-34(c).)

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

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

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

(A) Wages and salaries.

(B) Incentive bonuses.

(C) Deferred compensation.

(D) Pension and savings plan benefits.

(E) Health insurance benefits.

(F) Life insurance benefits.

(G) Compensated personal absence benefits.

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

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

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

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

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

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

(B) Has not provided the Government, either before implementation or within a reasonable

period after it, an opportunity to review the reasonableness of the changes.

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

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

(c) *Labor-management agreements.* Notwithstanding any other requirements of this subsection 31.205-6, costs of compensation are not allowable to the extent that they result from provisions of labor-management agreements that, as applied to work in performing Government contracts, are determined to be unreasonable because they are either unwarranted by the character and circumstances of the work or discriminatory against the Government. The application of the provisions of a labor-management agreement designed to apply to a given set of circumstances and conditions of employment (e.g., work involving extremely hazardous activities or work not requiring recurrent use of overtime) is unwarranted when applied to a Government contract involving significantly different circumstances and conditions of employment (e.g., work involving less hazardous activities or work continually requiring use of overtime). It is discriminatory against the Government if it results in employee compensation (in whatever form or name) in excess of that being paid for similar non-Government work under comparable circumstances. Disallowance of costs will not be made under this paragraph (c) unless—

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

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

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

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

(2) Although the additional taxes in subparagraph (1) above may be considered in establishing foreign

overseas differential, any increased compensation calculated directly on the basis of an employee's specific increase in income taxes is unallowable. Differential allowances for additional Federal, State, or local income taxes resulting from domestic assignments are unallowable.

(f) *Bonuses and incentive compensation.* (1) Incentive compensation for management employees, cash bonuses, suggestion awards, safety awards, and incentive compensation based on production, cost reduction, or efficient performance are allowable provided the awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment and the basis for the award is supported.

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

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

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

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

(g) *Severance pay.* (1) Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages by contractors to workers whose employment is being involuntarily terminated. Payments for early retirement incentive plans are covered in subparagraph (j)(6) below.

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

(i) Severance pay is allowable only to the extent that, in each case, it is required by (A) law, (B) employer-employee agreement, (C) established policy that constitutes, in effect, an implied agreement on the contractor's part, or (D) circumstances of the particular employment. Payments made in the event of employment with a replacement contractor where continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employ-

ment, or continued employment by the contractor at another facility, subsidiary, affiliate, or parent company of the contractor are not severance pay and are unallowable. Severance payments, or amounts paid in lieu thereof, are not allowable when paid to employees in addition to early or normal retirement payments.

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

(iii) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis.

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

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

tablished policy or practice exists and is followed by the contractor so consistently as to imply, in effect, an agreement to make such payment.

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

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

(2) Stock appreciation rights are rights granted to employees by contractors to receive the increase in value, or appreciation, of company stock even though the employee neither purchases the stock nor receives title to it. Stock appreciation rights will be treated as deferred compensation and must comply with the requirements of paragraph (k) of this subsection. The allowable cost of stock appreciation rights is limited to the difference between the stock-appreciation-right base price from which appreciation will be measured and the market price on the first date on which both the number of shares and the stock-appreciation-right base price are known. Accordingly, when the stock-appreciation-right base price is equal to or greater than the market price on that date, then no costs are allowable for contract costing purposes.

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

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

(The next page is 31-15.)

(j) *Pension costs.* (1) A pension plan is a deferred compensation plan that is established and maintained by one or more employers to provide systematically for paying benefits to plan participants after their retirement, provided that the benefits are paid for life or are payable for life at the option of the employee. Additional benefits such as permanent and total disability and death payments and survivorship payments to beneficiaries of deceased employees may be treated as pension costs, provided the benefits are an integral part of the pension plan and meet all the criteria pertaining to pension costs.

(2) Pension plans are normally segregated into two types of plans: defined benefit or defined contribution pension plans. The cost of all defined benefit pension plans shall be measured, allocated, and accounted for in compliance with the provisions of CAS 412, Composition and Measurement of Pension Costs, and CAS 413, Adjustment and Allocation of Pension Cost. The costs of all defined contribution pension plans shall be measured, allocated, and accounted for in accordance with the provisions of CAS 412. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth below in this subparagraph and in subparagraphs (j)(3), (4), (5), (6), and (7) below.

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

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

(iii) Except as provided for early retirement benefits in subparagraph (j)(6) below, one-time-only pension supplements not available to all participants of the basic plan are not allowable as pension costs unless the supplemental benefits represent a separate pension plan and the benefits are payable for life at the option of the employee.

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

(3) *Defined benefit pension plans.* This subparagraph covers pension plans in which the benefits to be paid or the basis for determining such benefits are estab-

lished in advance and the contributions are intended to provide the stated benefits. The cost limitations and exclusions pertaining to defined benefit plans are as follows:

(i) Normal costs of pension plans not funded in the year incurred, and all other components of pension costs (see CAS 412.40(a)(1)) assignable to the current accounting period but not funded during it, shall not be allowable in subsequent years (except that a payment made to a fund by the time set for filing the Federal income tax return or any extension thereof is considered to have been made during such taxable year). However, any part of a pension cost that is computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of the Employee's Retirement Income Security Act of 1974 (ERISA) (see CAS 412.50(c)(3)), will be allowable in those future accounting periods in which the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding occurred in the year the costs would have been assigned except for the waiver.

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

(iii) Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable. If a composite rate is used for allocating pension costs between the segments of a company and if, because of differences in the timing of the funding by the segments, an inequity exists, allowable pension costs for each segment will be limited to that particular segment's calculation of pension costs as provided for in CAS 413.50(c)(5). Determination of unallowable costs shall be made in accordance with the actuarial method used in calculating pension costs.

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

Government work. If a beneficial or other equitable relationship exists, the Government will participate, despite the requirements of 31.205-19(a)(3) and (b), in the indemnification payment to the extent of its fair share.

(4) *Defined contribution pension plans.* This subparagraph covers those pension plans in which the contributions to be made are established in advance and the level of benefits is determined by the contributions made. It also covers profit sharing, savings plans, and other such plans provided the plans fall within the definition of a pension plan in subparagraph (j)(1) above.

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

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

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

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

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

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

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

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

(v) For purposes of determining contract cost where a pay-as-you-go plan is initiated as either a supplemental plan or an additional but separate plan to a basic funded plan, the plans will be treated as one plan; e.g., the actuarial cost method, past service amortization period, etc., of the basic plan will be used on the supplemental or additional pay-as-you-go plan in determining the proper costs assignable to the current period. Any costs in excess of those determined by using the actuarial cost method and assumptions of the basic plan are unallowable. However, where assumption for salary progressions, mortality rates of the participants, and so forth are significantly different, the assumptions used for the basic and supplemental plan may be different.

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

(6) *Early retirement incentive plans.* An early retirement incentive plan is a plan under which employees receive a bonus or incentive, over and above the requirement of the basic pension plan, to retire early. These plans normally are not applicable to all participants of the basic plan and do not represent life income settlements, and as such would not qualify as pension costs. However, for contract costing purposes, early retirement incentive payments are allow-

able subject to the pension cost criteria contained in subdivisions (j)(3)(i) through (iv) provided—

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

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

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

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

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

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

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

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

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

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

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

(ii) Amounts contributed to an ESOP arising from either (A) an additional investment tax credit (see 1975 Tax Reduction Act—TRASOP's); or (B) a payroll-based tax credit (see Economic Recovery Tax Act of 1981) are unallowable.

(iii) The requirements of subdivision (j)(3)(ii) above are applicable to Employee Stock Ownership Plans.

(k) *Deferred compensation.* (1) Deferred compensation is an award given by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods before the date of receipt of compensation by the employee. Deferred compensation does not include the amount of year-end accruals for salaries, wages, or bonuses that are paid within a reasonable period of time after the end of a cost accounting period. Subject to 31.205-6(a), deferred awards are allowable when they are based on current or future services. Awards made in periods subsequent to the period when the work being remunerated was performed are not allowable.

(2) The costs of deferred awards shall be measured, allocated, and accounted for in compliance with the provisions of CAS 415, Accounting for the Cost of Deferred Compensation.

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

(l) Reserved.

(m) *Fringe benefits.* (1) Fringe benefits are allowances

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and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. Fringe benefits include, but are not limited to, the cost of vacations, sick leave, holidays, military leave, employee insurance, and supplemental unemployment benefit plans. Except as provided elsewhere in Subpart 31.2, the costs of fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor.

(2) That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees (see 31.205-46(f)).

(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.

## 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), 31.205-19, and 31.205-24.)

## 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.

## FEDERAL ACQUISITION REGULATION (FAR)

## 31.205-10 Cost of money.

(a) *Facilities capital cost of money.*

(1) *General* (i) Facilities capital cost of money (cost of capital committed to facilities) is an imputed cost determined by applying a cost-of-money rate to facilities capital employed in contract performance. A cost-of-money rate is uniformly imputed to all contractors (see subdivision (ii) below). Capital employed is determined without regard to whether its source is equity or borrowed capital. The resulting cost of money is not a form of interest on borrowings (see 31.205-20).

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

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

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

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

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

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

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

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

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

(1) *General* (i) Cost of money as an element of the



cost of capital assets under construction is an imputed cost determined by applying a cost-of-money rate to the investment in tangible and intangible capital assets while they are being constructed, fabricated, or developed for a contractor's own use. Capital employed is determined without regard to whether its source is equity or borrowed capital. The result-

ing cost of money is not a form of interest on borrowing (see 31.205-20).

(ii) CAS 417, Cost of Money as an Element of the Cost of Capital Assets Under Construction, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital

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committed to capital assets under construction, fabrication, or development.

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

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

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

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

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

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

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

### 31.205-11 Depreciation.

(a) Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life refers to the prospective period of economic usefulness in a particular contractor's operations as distinguished from physical life; it is evidenced by the actual or estimated retirement and replacement practice of the contractor.

(b) Contractors having contracts subject to CAS 409, Depreciation of Tangible Capital Assets, must adhere to the requirement of that standard for all fully CAS-covered contracts and may elect to adopt the standard for all other contracts. All requirements of CAS 409 are applicable if the election is made, and its requirements supersede any conflicting requirements of this cost principle. Once electing to adopt CAS 409 for all

contracts, contractors must continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts. Paragraphs (c) through (e) below apply to contracts to which CAS 409 is not applied.

(c) Normal depreciation on a contractor's plant, equipment, and other capital facilities is an allowable contract cost, if the contractor is able to demonstrate that it is reasonable and allocable (but see paragraph (i) below).

(d) Depreciation shall be considered reasonable if the contractor follows policies and procedures that are—

(1) Consistent with those followed in the same cost center for business other than Government;

(2) Reflected in the contractor's books of accounts and financial statements; and

(3) Both used and acceptable for Federal income tax purposes.

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

(f) Depreciation for reimbursement purposes in the case of tax-exempt organizations shall be determined on the basis described in paragraph (e) immediately above.

(g) Special considerations are required for assets acquired before the effective date of this cost principle if, on that date, the undepreciated balance of these assets resulting from depreciation policies and procedures used previously for Government contracts and subcontracts is different from the undepreciated balance on the books and financial statements. The undepreciated balance for contract cost purposes shall be depreciated over the remaining life using the methods and lives followed for book purposes. The aggregate depreciation of any asset allowable after the effective date of this 31.205-11 shall not exceed the cost basis of the asset less any depreciation allowed or allowable under prior acquisition regulations.

(h) Depreciation should usually be allocated to the contract and other work as an indirect cost. The amount of depreciation allowed in any accounting period may, consistent with the basic objectives in paragraph (a) above, vary with volume of production or use of multishift operations.

(i) In the case of emergency facilities covered by certificates of necessity, a contractor may elect to use normal depreciation without requesting a determination of "true depreciation," or may elect to use either

normal or "true depreciation" after a determination of "true depreciation" has been made by an Emergency Facilities Depreciation Board (EFDB). The method elected must be followed consistently throughout the life of the emergency facility. When an election is made to use normal depreciation, the criteria in paragraphs (c), (d), (e), and (f) above shall apply for both the emergency period and the post-emergency period. When an election is made to use "true depreciation", the amount allowable as depreciation—

(1) With respect to the emergency period (five years), shall be computed in accordance with the determination of the EFDB and allocated rateably over the full five year emergency period; *provided* no other allowance is made which would duplicate the factors, such as extraordinary obsolescence, covered by the Board's determination; and

(2) After the end of the emergency period, shall be computed by distributing the remaining undepreciated portion of the cost of the emergency facility over the balance of its useful life provided the remaining undepreciated portion of such cost shall not include any amount of unrecovered "true depreciation."

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

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

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

(m) CAS 404, Capitalization of Tangible Assets, applies to assets acquired by a "capital lease" as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board (FASB). Compliance with CAS 404 and FAS-13 requires that such leased assets (capital leases) be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the leased life as amortization charges as appropriate. Assets whose leases are classified as capital leases under FAS-13 are subject to the require-

ments of 31.205-11 while assets acquired under leases classified as operating leases are subject to the requirements on rental costs in 31.205-36. The standards of financial accounting and reporting prescribed by FAS-13 are incorporated into this principle and shall govern its application, except as provided in subparagraphs (1), (2), and (3) below.

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

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

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

#### 31.205-12 Economic planning costs.

(a) This category includes costs of generalized long-range management planning that is concerned with the future overall development of the contractor's business and that may take into account the eventual possibility of economic dislocations or fundamental alterations in those markets in which the contractor currently does business. Economic planning costs do not include organization or reorganization costs covered by 31.205-27.

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

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

#### 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, except as limited by paragraph (b) immediately below, and to the extent that the net amount is reasonable. Some examples are house publications, health clinics, recreation, employee counseling services, and food and dormitory services, which include operating or furnishing facilities for cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations, or similar types of services for the contractor's employees at or near the contractor's facilities.

(b) Losses from operating food and dormitory services may be included as costs only if the contractor's objective is to operate such services on a break-even

basis. Losses sustained because food services or lodging accommodations are furnished without charge or at prices or rates which obviously would not be conducive to the accomplishment of the above objective are not allowable. A loss may be allowed, however, to the extent that the contractor can demonstrate that unusual circumstances exist (e.g., (1) where the contractor must provide food or dormitory services at remote locations where adequate commercial facilities are not reasonably available, or (2) where charged but unproductive labor costs would be excessive but for the services provided or where cessation or reduction of food or dormitory operations will not otherwise yield net cost savings) such that even with efficient management, operating the services on a break-even basis would require charging inordinately high prices, or prices or rates higher than those charged by commercial establishments offering the same services in the same geographical areas. Costs of food and dormitory services shall include an allocable share of indirect expenses pertaining to these activities.

(c) When the contractor has an arrangement authorizing an employee association to provide or operate a service, such as vending machines in the contractor's plant, and retain the profits, such profits shall be treated in the same manner as if the contractor were providing the service (but see paragraph (d) immediately below).

(d) Contributions by the contractor to an employee organization, including funds from vending machine receipts or similar sources, may be included as costs incurred under paragraph (a) above only to the extent that the contractor demonstrates that an equivalent amount of the costs incurred by the employee organization would be allowable if directly incurred by the contractor.

#### 31.205-14 Entertainment costs.

Costs of amusement, diversion, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable (but see 31.205-1 and 31.205-13). Costs of membership in social, dining, or country clubs or other organizations having the same purposes are also unallowable, regardless of whether the cost is reported as taxable income to the employees.

#### 31.205-15 Fines and penalties.

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.

#### 31.205-16 Gains and losses on disposition 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 (d) below).

(b) Gains and losses on disposition of tangible capital

assets including those acquired under capital leases (see 31.205-11(m)), shall be considered as adjustments of depreciation costs previously recognized. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds from involuntary conversions, and its undepreciated balance. The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost (or for assets acquired under a capital lease, the value at which the leased asset is capitalized) of the asset and its undepreciated balance (except see subdivisions (c)(2)(i) or (ii) below).

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

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

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

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

(ii) Recognize the gain or loss in the period of disposition, in which case the Government shall participate to the same extent as outlined in subparagraph (c)(1) above.

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

(1) Gains and losses are processed through the depreciation reserve account and reflected in the depreciation allowable under 31.205-11; or

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

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

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

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

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

"Facilities," as used in this subsection, means plant or any portion thereof (including land integral to the operation), equipment, individually or collectively, or any

other tangible capital asset, wherever located, and whether owned or leased by the contractor.

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

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

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

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

(2) Were necessary when acquired and are now idle because of changes in requirements, production 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.

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

within the definition of the term "development," defined below.

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

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

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

"Development," as used in this subsection, means the systematic use, under whatever name, of scientific and technical knowledge in the design, development, test, or evaluation of a potential new product or service (or of an improvement in an existing product or service) for the purpose of meeting specific performance requirements or objectives. Development includes the functions of design engineering, prototyping, and engineering testing. Development excludes: (1) subcontracted technical effort which is for the sole purpose of developing an additional source for an existing product, or (2) development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for sale.

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

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

(b) *Composition and allocation of costs.* The requirements of CAS 420, Accounting for Independent Research and Development Costs and Bid and Proposal Costs, are incorporated in their entirety and shall apply as follows—

(1) *Fully-CAS-covered contracts.* Contracts that are fully-CAS-covered shall be subject to all requirements of CAS 420.

(2) *Modified-CAS-covered and non-CAS-covered contracts.* Contracts that are not CAS-covered or that contain terms or conditions requiring modified CAS coverage shall be subject to all requirements of CAS 420 except 4 CFR 420.50(e)(2) and 4 CFR 420.50(f)(2), which are not then applicable. However, non-CAS covered or modified CAS-covered contracts awarded at a time the contractor has CAS-covered contracts requiring compliance with CAS 420, shall be subject to all the requirements of CAS 420. When the requirements of 4 CFR 420.50(e)(2) and 4 CFR 420.50(f)(2) are not applicable, the following apply:

(i) IR&D and B&P costs shall be allocated to final cost objectives on the same basis of allocation used for the G&A expense grouping of the profit center (see 31.001) in which the costs are incurred. However, when IR&D and B&P costs clearly benefit other profit centers or benefit the entire company, those costs shall be allocated through the G&A of the other profit centers or through the corporate G&A, as appropriate.

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

(c) *Allowability.* Except as provided in paragraph (d) below, costs for IR&D and B&P are allowable only in accordance with the following:

(1) *Companies required to negotiate advance agreements.*

(i) Any company that received payments for IR&D and B&P costs in a fiscal year, either as a prime contractor or subcontractor, exceeding \$4,400,000 from Government agencies, is required to negotiate with the Government an advance agreement which establishes a ceiling for allowability of IR&D and B&P costs for the following fiscal year. This agreement is binding on all Government agencies, unless prohibited by statute. The requirements of Section 203 of Pub. L. 91-441 necessitate that the Department of Defense (DOD) be the lead negotiating agency when the contractor has received more than \$4,400,000 in payments for IR&D and B&P from DOD. Computation of IR&D and B&P costs to determine whether the threshold criterion was reached shall include only recoverable IR&D and B&P costs allocated during the company's previous fiscal year to prime contracts and subcontracts for which the submission and certification of cost or pricing data were required. (Also see paragraph (b) above and 15.804.) The computation shall include full burdening pursuant to CAS 420.

(ii) When a company meets the criterion in (i) above, required advance agreements may be negotiated at the corporate level and/or with those profit centers that contract directly with the Gov-

ernment and that in the preceding year allocated recoverable IR&D and B&P costs exceeding \$550,000, including burdening, to contracts and subcontracts for which the submission and certification of cost or pricing data were required (also see paragraph (b) above and 15.804). When ceilings are negotiated for separate profit centers of the company, the allowability of IR&D and B&P costs for any center that in its previous fiscal year did not reach the \$550,000 threshold may be determined in accordance with subparagraph (c)(2) below.

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

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

(v) When negotiations are held with a company meeting the \$4,400,000 criterion or with separate profit centers (when negotiations are held at that level under (ii) above), and if no advance agreement is reached, payment for IR&D and B&P costs shall be reduced below that which the company or profit center would have otherwise received. The amount of such reduced payment shall not exceed 75 percent of the amount which, in the opinion of the contracting officer, the company or profit center would be entitled to receive under an advance agreement. Written notification of the contracting officer's determination of a reduced amount shall be provided the contractor. In the event that an advance agreement is not reached before the end of the contractor's fiscal year for which the agreement is to apply, negotiations shall immediately be terminated, and the contracting officer shall furnish a determination of the reduced amount.

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

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

(i) Determine the ratio of IR&D/B&P costs to total sales (or other base acceptable to the contracting officer) for each of the preceding three

years and average the two highest of these ratios; this average is the IR&D/B&P historical ratio;

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

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

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

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

### 31.205-19 Insurance and indemnification.

(a) Insurance by purchase or by self-insuring includes coverage the contractor is required to carry, or to have approved, under the terms of the contract and any other coverage the contractor maintains in connection with the general conduct of its business. Any contractor desiring to establish a program of self-insurance applicable to contracts that are not subject to CAS 416, Accounting for Insurance Costs, shall comply with the self-insurance requirements of that standard as well as with Part 28 of this Regulation. However, approval of

a contractor's insurance program in accordance with Part 28 does not constitute a determination as to the allowability of the program's cost. The amount of insurance costs which may be allowed is subject to the cost limitations and exclusions in the following subparagraphs.

(1) Costs of insurance required or approved, and maintained by the contractor pursuant to the contract, are allowable.

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

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

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

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

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

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

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

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

(i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable for contracts not subject to CAS 416 and when the contractor did not establish a self-insurance program. Such contracts are not subject to the self-insurance requirements of CAS 416. For contracts subject to CAS 416, and for those made subject to the self-

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

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

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

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

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

(c) Insurance provided by captive insurers (insurers owned by or under the control of the contractor) is considered self-insurance, and charges for it must comply with the self-insurance provisions of CAS 416. However, if the captive insurer also sells insurance to the general public in substantial quantities and it can be demonstrated that the charge to the contractor is based on competitive market forces, the insurance will be considered purchased insurance.

(d) The allowability of premiums for insurance purchased from fronting insurance companies (insurance companies not related to the contractor but who reinsure with a captive insurer of the contractor) shall not exceed the amount (plus reasonable fronting company charges for services rendered) which the contractor would have been allowed had it insured directly with the captive insurer.

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

(f) The Government is obligated to indemnify the contractor only to the extent authorized by law, as expressly provided for in the contract, except as provided in paragraph (a)(3) above.

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

#### 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, costs of preparing and issuing stock rights, and directly associated costs are unallowable except for interest assessed by State or local taxing authorities under the conditions specified in 31.205-41 (but see 31.205-28).

#### 31.205-21 Labor relations costs.

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

#### 31.205-22 Legislative lobbying 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 or state legislation, or (ii) the enactment or modification of any pending Federal or state legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence state or local officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

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

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

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



## 31.205-23

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

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

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

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

(d) Contractors shall submit as part of their annual indirect cost rate proposals a certification that the requirements and standards of this subsection have been complied with.

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

(f) Time logs, calendars, or similar records shall not be required to be created for purposes of complying with this subsection during any particular calendar month when—

(1) The employee engages in lobbying (as defined in paragraphs (a) and (b) of this subsection) 25 percent or less of the employee's compensated hours of employment during that calendar month; and

(2) Within the preceding 5-year period, the organization has not materially misstated allowable or unallowable costs of any nature, including legislative lobbying costs. When conditions of subparagraphs (f)(1) and (2) of this subsection are met, contractors are not required to establish records to support the allowability of claimed costs in addition to records already required or maintained. Also, when conditions of subparagraphs (f)(1) and (2) of this subsection are met, the absence of time logs, calendars, or similar records will not serve as a basis for disallowing costs by contesting estimates of lobbying time spent by employees during a calendar month.

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(g) 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 Maintenance and repair costs.**

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

(1) Normal maintenance and repair costs are allowable.

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

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

**31.205-25 Manufacturing and production engineering costs.**

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

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

(2) Developing and deploying pilot production lines;

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

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

(b) This cost principle does not cover:

(1) Basic and applied research effort (as defined in 31.205-18(a)) related to new technology, materials, systems, processes, methods, equipment, tools and techniques. Such technical effort is governed by 31.205-18, Independent research and development costs; and

(2) Development effort for manufacturing or production materials, systems, processes, methods,

equipment, tools and techniques that are intended for sale is also governed by 31.205-18.

(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, sub-assemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and intransit insurance. In computing material costs, consideration shall be given to reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work). These costs are allowable, subject to the requirements of paragraphs (b) through (e) below.

(b) Costs of material shall be adjusted for income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts, and credits for scrap, salvage, and material returned to vendors. Such income and other credits shall either be credited directly to the cost of the material or be allocated as a credit to indirect costs. When the contractor can demonstrate that failure to take cash discounts was reasonable, lost discounts need not be credited.

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

(d) When materials are purchased specifically for and are identifiable solely with performance under a con-

tract, the actual purchase cost of those materials should be charged to the contract. If material is issued from stores, any generally recognized method of pricing such material is acceptable if that method is consistently applied and the results are equitable. When estimates of future material costs are required, current market price or anticipated acquisition cost may be used, but the basis of pricing must be disclosed.

(e) Allowance for all materials, supplies, and services that are sold or transferred between any divisions, subsidiaries, or affiliates of the contractor under a common control shall be on the basis of cost incurred in accordance with this subpart. However, allowance may be at a price when it is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary, or affiliate of the contractor under a common control, and when the price—

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

(2) Is the result of "adequate price competition" in accordance with 15.804 and is the price at which an award was made to the affiliated organization after obtaining quotations on an equal basis from such organization and one or more outside sources that produce the item or its equivalent in significant quantity.

(3) Provided, that in either subparagraph (1) or (2) above—

(i) The price is not in excess of the transferor's current sales price to its most favored customer (including any division, subsidiary or affiliate of

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

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

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

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

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

(c) Insurance provided by captive insurers (insurers owned by or under the control of the contractor) is considered self-insurance, and charges for it must comply with the self-insurance provisions of CAS 416. However, if the captive insurer also sells insurance to the general public in substantial quantities and it can be demonstrated that the charge to the contractor is based on competitive market forces, the insurance will be considered purchased insurance.

(d) The allowability of premiums for insurance purchased from fronting insurance companies (insurance companies not related to the contractor but who reinsure with a captive insurer of the contractor) shall not exceed the amount (plus reasonable fronting company charges for services rendered) which the contractor would have been allowed had it insured directly with the captive insurer.

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

(f) The Government is obligated to indemnify the contractor only to the extent authorized by law, as expressly provided for in the contract, except as provided in paragraph (a)(3) above.

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

#### 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, costs of preparing and issuing stock rights, and directly associated costs are unallowable except for interest assessed by State or local taxing authorities under the conditions specified in 31.205-41 (but see 31.205-28).

#### 31.205-21 Labor relations costs.

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

#### 31.205-22 Legislative lobbying 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 or state legislation, or (ii) the enactment or modification of any pending Federal or state legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence state or local officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

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

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

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

## 31.205-23

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

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

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

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

(d) Contractors shall submit as part of their annual indirect cost rate proposals a certification that the requirements and standards of this subsection have been complied with.

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

(f) Time logs, calendars, or similar records documenting the portion of an employee's time that is treated as an indirect cost shall not be required for the purposes of complying with this subsection, and the absence of such records which are not kept pursuant to the discretion of the contractor will not serve as a basis for disallowing allowable costs by contesting estimates of unallowable lobbying time spent by employees during any calendar month unless: (1) the employee engages in lobbying, as defined in (a) and (b) above, more than 25% of the employee's compensated hours of employment during that calendar month; or (2) the organization has materially misstated allowable or unallowable costs within the preceding five year period.

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

## 31.205-23 Losses on other contracts.

An excess of costs over income under any other

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contract (including the contractor's contributed portion under cost-sharing contracts) is unallowable.

## 31.205-24 Maintenance and repair costs.

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

(1) Normal maintenance and repair costs are allowable.

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

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

## 31.205-25 Manufacturing and production engineering costs.

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

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

(2) Developing and deploying pilot production lines;

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

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

(b) This cost principle does not cover:

(1) Basic and applied research effort (as defined in 31.205-18(a)) related to new technology, materials, systems, processes, methods, equipment, tools and techniques. Such technical effort is governed by 31.205-18, Independent research and development costs; and

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

(c) Where manufacturing or production development costs are capitalized or required to be capitalized under the contractor's capitalization policies, allowable cost

the contractor under a common control) for a like quantity under comparable conditions; and

(ii) The contracting officer has not determined the price to be unreasonable.

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

#### **31.205-27 Organization costs.**

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

(b) The cost of activities primarily intended to provide compensation will not be considered organizational costs subject to this subsection, but will be governed by 31.205-6. These activities include acquiring stock for (1) executive bonuses, (2) employee savings plans, and (3) employee stock ownership plans.

#### **31.205-28 Other business expenses.**

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

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

(b) Cost of shareholders' meetings.

(c) Normal proxy solicitations.

(d) Preparing and publishing reports to shareholders.

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

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

(g) Other similar costs.

#### **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 are those incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule. Such costs are allowable to the extent that they would have been allowable if incurred after the date of the contract (see 31.109.)

#### **31.205-33 Professional and consultant service costs.**

(a) Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill and who are not officers or employees of the contractor are allowable subject to paragraphs (b), (c), (d), and (e) below when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government (but see 31.205-30).

(b) In determining the allowability of costs (including retainer fees) in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors, among others, should be considered:

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

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

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

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

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

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

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

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

(c) Retainer fees to be allowable must be supported by evidence that—

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

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

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

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

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

(f) Costs of legal, accounting, and consultant services and directly associated costs incurred in connection with the defense or prosecution of lawsuits or appeals between contractors arising from either (1) an agreement or contract concerning a teaming arrangement, a joint venture, or similar arrangement of shared interest; or (2) dual sourcing, co-production, or similar programs, are unallowable, except when (i) incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer, or (ii) when agreed to in writing by the contracting officer.

#### 31.205-34 Recruitment costs.

(a) Subject to paragraphs (b) and (c) below, and

provided that the size of the staff recruited and maintained is in keeping with workload requirements, the following costs are allowable:

(1) Costs of help-wanted advertising.

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

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

(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) Is for personnel other than those required to perform obligations under a Government contract;

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

(3) Is excessive relative to the number and importance of the positions or to the industry practices;

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

(5) Is designed to "pirate" personnel from another Government contractor; or

(6) Includes color (in publications).

(c) Excessive compensation costs offered to prospective employees to "pirate" them from another Government contractor are unallowable. Such excessive costs may include salaries, fringe benefits, or special emoluments which are in excess of standard industry practices or the contractor's customary compensation practices.

#### 31.205-35 Relocation costs.

(a) Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period, but in either event for not less than 12 months) of an existing employee or upon recruitment of a new employee. The following types of relocation costs are allowable as noted, subject to paragraphs (b) and (f) below:

(1) Cost of travel of the employee and members of the immediate family (see 31.205-46) and transportation of the household and personal effects to the new location.

(2) Cost of finding a new home, such as advance trips by employees and spouses to locate living quarters, and temporary lodging during the transition periods not exceeding separate cumulative totals of 60 days for employees and 45 days for spouses and dependents, including advance trip time.

(3) Closing costs (i.e., brokerage fees, legal fees, appraisal fees, points, finance charges, etc.) incident

to the disposition of actual residence owned by the employee when notified of transfer, except that these costs when added to the costs described in subparagraph (a)(4) below shall not exceed 14 percent of the sales price of the property sold.

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

(5) Other necessary and reasonable expenses normally incident to relocation, such as disconnecting

and connecting household appliances; automobile registration; driver's license and use taxes; cutting and fitting rugs, draperies, and curtains; forfeited utility fees and deposits; and purchase of insurance against damage to or loss of personal property while in transit.

(6) Costs incident to acquiring a home in a new location, except that (i) these costs will not be allowable for existing employees or newly recruited employees who, before the relocation, were not homeowners and (ii) the total costs shall not exceed 5 percent of the purchase price of the new home.

(7) Mortgage interest differential payments, except that these costs are not allowable for existing or newly recruited employees who, before the relocation, were not homeowners and the total payments

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are limited to an amount determined as follows:

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

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

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

(9) Cost of canceling an unexpired lease.

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

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

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

(3) The costs must not otherwise be unallowable under Subpart 31.2.

(4) Amounts to be reimbursed shall not exceed the employee's actual expenses, except that for miscellaneous costs of the type discussed in subparagraph (a)(5) above, a flat amount, not to exceed \$1,000, may be allowed in lieu of actual costs.

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

(1) Loss on sale of a home.

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

(i) Real estate brokers fees and commissions.

(ii) Cost of litigation.

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

(iv) Mortgage life insurance.

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

(vi) Property taxes and operating or maintenance costs.

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

(4) Payments for employee income or FICA (social security) taxes incident to reimbursed relocation costs.

(5) Payments for job counseling and placement

assistance to employee spouses and dependents who were not employees of the contractor at the old location.

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

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

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

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

(1) The term of employment is not less than 12 months;

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

(3) The employment agreement provides for return relocation to the employee's permanent and 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) above. However, the costs to return employees, who are released from employment upon completion of field assignments pursuant to their employment agreements, are not subject to the refund or credit requirement of paragraph (d).

#### 31.205-36 . Rental costs.

(a) This subsection is applicable to the cost of renting or leasing real or personal property, except ADPE (see 31.205-2), acquired under "operating leases" as defined in Statement of Financial Accounting Standards No. 13 (FAS-13), Accounting for Leases. Compliance with 31.205-11(m) requires that assets acquired by means of capital leases, as defined in FAS-13, shall be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the lease term as amortization charges, as appropriate (but see subparagraph (b)(4) below).

(b) The following costs are allowable:

(1) Rental costs under operating leases, to the extent that the rates are reasonable at the time of the lease decision, after consideration of (i) rental costs of comparable property, if any; (ii) market conditions in the area; (iii) the type, life expectancy, condition,



and value of the property leased; (iv) alternatives available; and (v) other provisions of the agreement.

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

(3) Charges in the nature of rent for property between any divisions, subsidiaries, or organization under common control, to the extent that they do not exceed the normal costs of ownership, such as depreciation, taxes, insurance, facilities capital cost of money, and maintenance (excluding interest or other unallowable costs pursuant to Part 31), provided that no part of such costs shall duplicate any other allowed cost. Rental cost of personal property leased from any division, subsidiary, or affiliate of the contractor under common control, that has an established practice of leasing the same or similar property to unaffiliated lessees shall be allowed in accordance with subparagraph (b)(1) above.

(4) Rental costs under leases entered into before March 1, 1970 for the remaining term of the lease (excluding options not exercised before March 1, 1970) to the extent they would have been allowable under Defense Acquisition Regulation (Formerly ASPR) 15-205.34 or Federal Procurement Regulations section 1-15.205-34 in effect 1 January 1969.

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

#### **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. Selling activity includes the following broad categories:

(1) Advertising.

(2) Corporate image enhancement including broadly-targeted sales efforts, other than advertising.

(3) Bid and proposal costs.

(4) Market planning.

(5) Direct selling.

(b) Advertising costs are defined at 31.205-1(b) and are subject to the allowability provisions of 31.205-1(d) and (f). Corporate image enhancement activities are included within the definitions of public relations at 31.205-1(a) and entertainment at 31.205-14 and are subject to the allowability provisions at 31.205-1(e) and (f) and 31.205-14, respectively. Bid and proposal costs are defined at 31.205-18 and have their allowability controlled by that subsection. Market planning involves market research and analysis and generalized management planning concerned with development of the contractor's business. The allowability of long-range market planning costs is controlled by the provisions of 31.205-12. Other market planning costs are allowable to the extent that they are reasonable. Costs of activities which are correctly classified and disallowed under cost principles referenced in this paragraph (b) are not to be reconsidered for reimbursement under any other provision of this subsection.

(c) Direct selling efforts are those acts or actions to induce particular customers to purchase particular products or services of the contractor. Direct selling is characterized by person-to-person contact and includes such activities as familiarizing a potential customer with the contractor's products or services, conditions of sale, service capabilities, etc. It also includes negotiation, liaison between customer and contractor personnel, technical and consulting activities, individual demonstrations, and any other activities having as their 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 if reasonable in amount.

(d) The costs of any selling efforts other than those addressed in paragraphs (b) or (c) of this subsection are unallowable.

(e) Costs of the type identified in paragraphs (b), (c), and (d) of this subsection are often commingled on the contractor's books in the selling expense account because these activities are performed by the sales departments. However, identification and segregation of unallowable costs is required under the provisions of 31.201-6 and CAS 405, and such costs are not allowable merely

because they are incurred in connection with allowable selling activities.

(f) Notwithstanding any other provision of this subsection, costs of direct selling efforts, as defined in paragraph (c) of this subsection, incurred in connection with potential and actual Foreign Military Sales, as defined by the Arms Export Contract Act, or foreign sales of military products or services are unallowable on U.S. Government contracts for U.S. Government requirements.

(g) Notwithstanding any other provision of this subsection, sellers' or agents' compensation, fees, commissions, percentages, retainer or brokerage fees, whether or not contingent upon the award of contracts, are allowable only when paid to bona fide employees or established commercial or selling agencies maintained by the contractor for the purpose of securing business (see 3.408-2).

**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, such service and warranty costs are allowable. However, care should be exercised to avoid duplication of the allowance as an element of both estimated product cost and risk.

**31.205-40 Special tooling and special test equipment costs.**

(a) The terms "special tooling" and "special test equipment" are defined in 45.101.

(b) The cost of special tooling and special test equipment used in performing one or more Government contracts is allowable and shall be allocated to the specific Government contract or contracts for which acquired, except that the cost of (1) items acquired by the contractor before the effective date of the contract (or replacement of such items), whether or not altered or adapted for use in performing the contract, and (2) items which the contract schedule specifically excludes, shall be allowable only as depreciation or amortization.

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

#### 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) below that are required to be and are paid or accrued in accordance with generally accepted accounting principles. Fines and penalties are not considered taxes.

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

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

(ii) Takes all action directed by the contracting officer arising out of subparagraph (2)(i) above or an independent decision of the Government as to the existence of a claim of illegality or erroneous assessment, to (A) determine the legality of the assessment or (B) secure a refund of such taxes.

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

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

(1) Federal income and excess profits taxes.

(2) Taxes in connection with financing, refinancing, refunding operations, or reorganizations (see 31.205-20 and 31.205-27).

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

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

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

(6) Taxes on accumulated funding deficiencies of, or prohibited transactions involving, employee deferred compensation plans pursuant to Section 4971 or Section 4975 of the Internal Revenue Code of 1954, as amended.

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

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

(d) Any taxes, interest, or penalties that were allowed as contract costs and are refunded to the contractor shall be credited or paid to the Government in the manner it directs. However, any interest actually paid or credited to a contractor incident to a refund of tax, interest, or penalty shall be paid or credited to the Government only to the extent that such interest accrued over the period during which the contractor had been reimbursed by the Government for the taxes, interest, or penalties.

#### 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 (see 15.804-6(f)), including starting load and preparatory costs, are allowable as follows:

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

- (i) Excessive spoilage due to inexperienced labor;
- (ii) Idle time and subnormal production due to testing and changing production methods;
- (iii) Training; and
- (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 con-

sistent with 31.201-4 and 31.203(c). 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) Meetings and conferences, including meals, transportation, rental of meeting facilities and other incidental costs when the primary purposes of the incurrence of the costs is the dissemination of technical information or stimulation of production.

### 31.205-44 Training and education costs.

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

(b) *Vocational training.* Costs of preparing and maintaining a noncollege level program of instruction, including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees, are allowable. These costs include (1) salaries or wages of trainees (excluding overtime compensation), (2) salaries of the director of training and staff when the training program is conducted by the contractor, (3) tuition and fees when the training is in an institution not operated by the contractor, and/or (4) training materials and textbooks.

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

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

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

(3) Training materials and textbooks; and

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

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

period not to exceed 2 school years or the length of the degree program, whichever is less, for each employee so trained.

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

(f) *Other expenses.* Maintenance expense and normal depreciation or fair rental on facilities owned or leased by the contractor for training purposes are allowable in accordance with 31.205-11, 31.205-17, 31.205-24, and 31.205-36.

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

(h) *Advance agreements.*

(1) Training and education costs in excess of those otherwise allowable under (c) and (d) of this subsection, including subsistence, salaries or any other emoluments, may be allowed to the extent set forth in an advance agreement negotiated under 31.109. To be considered for an advance agreement, the contractor must demonstrate that the costs are consistently incurred under an established managerial, engineering, or scientific training and education program, and that the course or degree pursued is related to the field in which the employees are now working or may reasonably be expected to work. Before entering into the advance agreement, the contracting officer shall give consideration to such factors as—

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

(ii) Employee's past performance and potential;

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

(iv) The total number of participating employees.

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

(i) *Training or education costs for other than bona-fide employees.* Costs of tuition, fees, textbooks, and similar or related benefits provided for other than bona-fide employees are unallowable, except that the costs incurred for educating employee dependents (primary and secondary level studies) when the employee is working in a foreign country where public education is not available and where suitable private education is

inordinately expensive may be included in overseas differential.

(j) *Employee dependent education plans.* Costs of college plans for employee dependents are unallowable.

#### 31.205-45 Transportation costs.

Allowable transportation costs include freight, express, cartage, and postage charges relating to goods purchased, in process, or delivered. When these costs can be identified with the items involved, they may be directly costed as transportation costs or added to the cost of such items. When identification with the materials received cannot be made, inbound transportation costs may be charged to the appropriate indirect cost accounts if the contractor follows a consistent and equitable procedure. Outbound freight, if reimbursable under the terms of the contract, shall be treated as a direct cost.

#### 31.205-46 Travel costs.

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

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

(i) Federal Travel Regulations, prescribed by the General Services Administration, for travel in the conterminous 48 United States, available on a subscription basis from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, Stock No. 022-001-81003-7;

(ii) Joint Travel Regulations, Volume 2, DoD Civilian Personnel, Appendix A, prescribed by the Department of Defense, for travel in Alaska, Hawaii, The Commonwealth of Puerto Rico, and territories and possessions of the United States, available on a subscription basis from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, Stock No. 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 subparagraph, available on a subscription basis from the Superintendent of Documents, U.S. Government Printing Office,

Washington, DC 20402, Stock No. 744-008-00000-0.

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

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

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

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

(iv) Documentation to support actual costs incurred shall be in accordance with the contractor's established practices provided that a receipt is required for each expenditure in excess of \$25.00. The approved justification required by (a)(3)(ii) and, if applicable, (a)(3)(iii) of this subparagraph must be retained.

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

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

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

(c) Travel costs directly attributable to specific contract performance are allowable and may be charged to the contract under 31.202.

(d) Airfare costs in excess of the lowest customary standard, coach, or equivalent airfare offered during normal business hours are unallowable except when such accommodations require circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased 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 standard airfare to be allowable, the applicable condition(s) set forth above must be documented and justified.

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

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

- (i) Date, time, and points of departure;
  - (ii) Destination, date, and time of arrival;
  - (iii) Name of each passenger and relationship to the contractor;
  - (iv) Authorization for trip; and
  - (v) Purpose of trip.
- (3) Where an advance agreement is proposed (see 31.109), consideration may be given to the following:
- (i) Whether scheduled commercial airlines or other suitable, less costly, travel facilities are available at reasonable times, with reasonable frequency, and serve the required destinations conveniently.
  - (ii) Whether increased flexibility in scheduling results in time savings and more effective use of personnel that would outweigh additional travel costs.

(f) Costs of contractor-owned or -leased automobiles, as used in this paragraph, include the costs of lease, operation (including personnel), maintenance, depreciation, insurance, etc. These costs are allowable, if reasonable, to the extent that the automobiles are used for company business. That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is compensation for personal services and is unallowable as stated in 31.205-6(m)(2).

#### 31.205-47 Defense of fraud proceedings.

(a) *Definitions.* "Costs," as used in this subsection, include, but are not limited to, administrative and clerical expenses; the cost of legal services, whether performed by in-house or private counsel; the costs of the services of accountants, consultants, or others retained by the contractor to assist it; the salaries and wages of employees, officers, and directors; and any of the foregoing costs incurred before commencing the formal judicial or administrative proceedings which bear a direct relationship to the proceedings.

"Fraud," as used in this subsection, means (1) acts of fraud or corruption or attempts to defraud the Government or to corrupt its agents, (2) acts which constitute a cause for debarment or suspension under 9.406-2(a) and 9.407-2(a) and (3) acts which violate the False Claims Act, 31 U.S.C., sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

(b) Costs incurred in connection with defense of any (1) criminal or civil investigation, grand jury proceeding, or prosecution; (2) civil litigation; or (3) administrative proceedings such as suspension or debarment, or any combination of the foregoing, brought by the Government against a contractor, its agents or employees, are unallowable when the charges, which are the subject of the investigation, proceedings, or prosecution, involve fraud or similar offenses (including filing of a false certification) on the part of the contractor, its agents or employees, and result in conviction (including conviction entered on a plea of nolo contendere), judgment against the contractor, its agents or employees, or decision to debar or suspend, or are resolved by consent or compromise.

(The next page is 31-35.)

(c) In circumstances where the charges of fraud are resolved by consent or compromise, the parties may agree as to the extent of allowability of such costs as a part of such resolution.

(d) Costs which may be unallowable under 31.205-47, including directly associated costs, shall be differentiated and accounted for by the contractor so as to be separately identifiable. During the pendency of any proceeding or investigation covered by paragraph (b) of this subsection, the contracting officer should generally withhold payment of such costs. However, the contracting officer may in appropriate circumstances provide for conditional payment upon provision of adequate security, or other adequate assurance, and agreement by the contractor to repay all unallowable costs, plus interest, if a conviction or judgment is rendered against it.

#### 31.205-48 Deferred research and development costs.

"Research and development," as used in this subsection, means the type of technical effort which is described in 31.205-18 but which is sponsored by, or required in performance of, a contract or grant. Research and development costs (including amounts capitalized) that were incurred before the award of a particular contract are unallowable except when allowable as precontract costs. In addition, when costs are incurred in excess of either the price of a contract or amount of a grant for research and development effort, such excess may not be allocated as a cost to any other Government contract.

#### 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 Executive lobbying costs.

Costs incurred in attempting to improperly influence (see FAR 3.401), either directly or indirectly, an employee or officer of the executive branch of the Federal Government to give consideration or to act regarding a regulatory or contract matter are unallowable.

#### 31.205-51 Costs of alcoholic beverages.

Costs of alcoholic beverages are unallowable.

### SUBPART 31.3—CONTRACTS WITH EDUCATIONAL INSTITUTIONS

#### 31.301 Purpose.

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

#### 31.302 General.

Office of Management and Budget (OMB) Circular No. A-21, Cost Principles for Educational Institutions, revised, provides principles for determining the costs applicable to research and development, training, and other work performed by educational institutions under contracts with the Government.

#### 31.303 Requirements.

(a) Contracts that refer to this Subpart 31.3 for determining allowable costs under contracts with educational institutions shall be deemed to refer to, and shall have the allowability of costs determined by the contracting officer in accordance with, the revision of OMB Circular A-21 in effect on the date of the contract.

(b) Agencies are not expected to place additional restrictions on individual items of cost.

### SUBPART 31.4—RESERVED

### SUBPART 31.5—RESERVED

### SUBPART 31.6—CONTRACTS WITH STATE, LOCAL, AND FEDERALLY RECOGNIZED INDIAN TRIBAL GOVERNMENTS

#### 31.601 Purpose.

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

#### 31.602 General.

Office of Management and Budget (OMB) Circular No. A-87, Cost Principles for State and Local Governments, Revised, sets forth the principles for determining the allowable costs of contracts and subcontracts with State, local, and federally recognized Indian tribal governments. These principles are for cost determination and are not intended to identify the circumstances or dictate the extent of Federal and State or local participation in financing a particular contract.

#### 31.603 Requirements.

(a) Contracts that refer to this Subpart 31.6 for determining allowable costs under contracts with State, local and Indian tribal governments shall be deemed to refer to, and shall have the allowability of costs determined by the contracting officer in accordance with, the revision of OMB Circular A-87 which is in effect on the date of the contract.

(b) Agencies are not expected to place additional restrictions on individual items of cost.

### SUBPART 31.7—CONTRACTS WITH NONPROFIT ORGANIZATIONS

#### 31.701 Purpose.

This subpart provides the principles for determining the cost applicable to work performed by nonprofit organizations under contracts with the Government. A nonprofit organization, for purpose of identification, is defined as a business entity organized and operated



exclusively for charitable, scientific, or educational purposes, of which no part of the net earnings inure to the benefit of any private shareholder or individual, of which no substantial part of the activities is carrying on propaganda or otherwise attempting to influence legislation or participating in any political campaign on behalf of any candidate for public office, and which are exempt from federal income taxation under section 501 of the Internal Revenue Code.

**31.702 General.**

Office of Management and Budget (OMB) Circular No. A-122, Cost Principles for Nonprofit Organizations, sets forth principles for determining the costs

applicable to work performed by nonprofit organizations under contracts (also applies to grants and other agreements) with the Government.

**31.703 Requirements.**

(a) Contracts which refer to this Subpart 31.7 for determining allowable costs shall be deemed to refer to, and shall have the allowability of costs determined by the contracting officer in accordance with, the revision of OMB Circular A-122 in effect on the date of the contract.

(b) Agencies are not expected to place additional restrictions on individual items of cost.

**PART 15--CONTRACTING BY NEGOTIATION**  
**SUBPART 15.8--PRICE NEGOTIATION**

**15.802 Policy.**

(b)(2) (This prohibition neither prevents the negotiation of indirect costs and other rates applicable to several contracts nor prohibits FPRA's applicable to several contracts.)

**15.803 General.**

(b) When necessary, requirements and technical specialists should be consulted. The primary responsibility for the adequacy of specifications and for the delivery requirements must necessarily rest with requirements and technical groups. However, the contracting officer should be aware of the effect which these factors may have on prices and competition, and should, prior to award, inform requirements and technical groups of any unsatisfactory effect which their decisions have on prices or competition.

(d) When products are sold in the open market, costs are not necessarily the controlling factor in establishing a particular seller's price. Similarly, where competition may be ineffective or lacking, estimated costs plus estimated profit are not the only pricing criteria. In some cases, the price appropriately may represent only a part of the seller's cost and include no estimate for profit or fee, as in research and development projects where the contractor is willing to share part of the costs. In other cases, price may be controlled by competition. The objective of the contracting officer shall be to negotiate fair and reasonable prices in which due weight is given to all relevant factors. When negotiations indicate the need for using other than a firm fixed-price contract, there should be compatibility between the type of contract selected and the contractor's accounting system.

**15.804 Cost or Pricing Data.****15.804-2 Requiring Certified Cost or Pricing Data.**

(a)(1)(ii) The term "price adjustment" or "pricing adjustment" means the aggregate increases and/or decreases in costs plus applicable profits.

(2) Partial or limited data may be requested when less than complete cost analysis (e.g., analysis of only specific factors) will provide a reasonable pricing result on awards under \$100,000 without the submission of complete cost or pricing data. The contracting officer shall request only that data which the contracting officer considers adequate to support the limited extent of the cost analysis required and he will not require certification.

(b)(1) Cost or pricing data shall not be required merely in anticipation of postaward review of the contract.

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(2) If, after cost or pricing data were initially requested and received, it is determined that adequate price competition does exist, the data need not be certified.

**15.804-3 Exemption from or Waiver of Submission of Certified Cost or Pricing Data.**

(a)(1) When economic price adjustment provisions are included in competitive acquisitions, see FAR 16.203-2(b).

(b)(2)(ii) An example of a determinative advantage is where substantial costs, such as start-up or other nonrecurring expenses, have already been absorbed in connection with previous sales, thus placing the competitor in a preferential position.

(3) Examples of a price "based on" adequate price competition are: (i) exercise of an option in a contract for which there was adequate price competition if the option price has been determined to be reasonable in accordance with FAR 17.207(d); and (ii) an item normally is acquired competitively but in a particular situation only one offer is solicited or received, and the price clearly is reasonable in comparison with recent purchases of comparable quantities for which there was adequate price competition.

(c)(6) In addition, cost or pricing data may be requested, if necessary, where there is such a disparity between the quantity being acquired and the quantity for which there is such a catalog or market price that pricing cannot reasonably be accomplished by comparing the two.

(7) In determining exemptions, it is the item under consideration that must meet the test. The ultimate objective is to achieve fair and reasonable prices for items bought. Altered terms, minor configuration changes, extra inspection requirements, or quantity differences are adequate reasons for pricing items differently from catalog or market prices.

(e)(3) In anticipation of repetitive acquisitions of a catalog item, the contracting officer or the cognizant ACO may make special arrangements for submission of the exemption claim. The submission need not be on a Standard Form 1412, but shall include any data required by the form and include or incorporate by reference all the applicable definitions, representations and rights included in the form. Government approval of the exemption claim shall set forth the effective period, usually not more than one year, and require the contractor to furnish any later information that might raise a question as to the continuation of the exemption. Such approval may be extended to other Government contracting offices with their concurrence.

Note: A copy of each waiver shall be sent to the Deputy Assistant Secretary for Procurement, Office of Assistant Secretary of Defense, Acquisition and Logistics.

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(1) Set forth below is a format for the D&Fs to be made by the agency head with respect to waiving the requirement for submission of cost or pricing data and certification there f, as required by 10 U.S.C. 2306(f), and for waiving the inclusion of the clauses required by FAR 52.214-27 and 52.215-25. The format may be used also for the D&Fs for such waiver made by the Head of the Procuring Activity for contracts with foreign governments or agencies thereof.

(Military Department or Agency)

Determination and Findings

Authority to Waive Submission of Cost or Pricing Data and Certificate

Upon the basis of the following findings and determination which I hereby make as agency head, the requirement for submission of cost and pricing data and certificate described below may be waived pursuant to the authority of 10 U.S.C. 2306(f), as implemented by FAR 15.804-3(i).

Findings

1. The \_\_\_\_\_ (2) proposes to enter into a contract with \_\_\_\_\_ (3) for the acquisition of \_\_\_\_\_ (4).
2. Pursuant to FAR 15.804-2, the proposed contractor is required to submit certified cost or pricing data. However, waiver of submission of the certified cost or pricing data described below is justified for the reasons indicated: \_\_\_\_\_ (5).

Determination

1. The requirement for submission of cost or pricing data for the proposed contract action may be waived.

Date \_\_\_\_\_

- NOTES: (1) In the case of a contract with a foreign government or agency thereof, delete the words "agency head" and substitute therefor "head of a procuring activity."
- (2) Procuring or contracting activity.
  - (3) Name of supplier.
  - (4) Brief description of supplies or services.
  - (5) Describe the cost or pricing data requirements to be waived. (The waiver may be partial, i.e. limited to particular cost or pricing data.) Set forth the circumstances and conditions which make the proposed contract action an exceptional case and state the reasons which justify the proposed waiver.

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**15.804-4 Certificate of Current Cost or Pricing Data.**

(c) The data on numerous minor material items each of which by itself would be insignificant may be reasonably available only as of a cut-off date prior to agreement on price because the volume of transactions would make the use of any later data impracticable. Furthermore, except where a single item is used in substantial quantity, the net effect of any changes to the prices of such minor items would likely be insignificant.

**15.804-6 Procedural Requirements.**

(b)(2) The following may be used with the SF 1411:

(i) When Contract Cost Data Reports are required by the purchase request, the contractor shall be required to submit DD Forms 1921 and/or 1921-1 to support the SF 1411. The DD Forms 1921 shall be prepared in accordance with the Contractor Cost Data Reporting (CCDR) System (Army - AMCP 715-8, Navy - OASN(S&L), CBM-CPR, and Air Force - AFLCP/AFSCP 800-15). The contractor supporting data shall be prepared in such a manner as to support each cost element on the DD Form 1921-1.

(ii) Contract Pricing Proposal Supporting Schedules may be devised by contracting offices to require such supporting data to the foregoing forms as is considered necessary and reasonable through knowledge of industry, company or commodity practices.

(c) To the extent possible, the understanding should relate to the contractor's formal estimating system. Notwithstanding the foregoing, significant matters important to contractor management and to the Government and any related data within the contractor's organization or the organization of a subcontractor or prospective subcontractor would be expected to be current on the date of agreement on price and, therefore, will be treated as reasonably available as of that date. Although changes in the labor base or in prices of major material items are generally significant matters, no hard and fast rule can be laid down since what is significant can depend upon such circumstances as the size and nature of the acquisition.

(e) The referral to higher authority shall also include a complete statement of the attempts made to resolve the matter, including (1) steps taken to secure essential cost or pricing data, (2) efforts to secure the contractor's cooperation in the establishment of a satisfactory business relationship, and (3) any assurances offered, such as agreements to adequately safeguard information furnished.

(f) Since an offeror may propose a price which does not include all preproduction and startup or other nonrecurring costs for the purpose of obtaining the first production contract and for gaining an advantage over competitors in negotiations for future acquisitions, it is important to know whether the offeror intends to absorb any portion of these costs or whether the offeror plans to recover them in

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connection with subsequent pricing actions under the proposed or future contracts. This information is needed in evaluating competing proposals to determine which proposal is most likely to result in the lowest overall cost to the Government, particularly where the successful offeror is likely to become, in effect, a sole source for follow on acquisitions (including spare parts or other support items).

(g)(3) In addition to submitting cost or pricing data from the prospective subcontractor most likely to be awarded the subcontract, the contractor shall submit other data pertaining to subcontract costs, including other subcontractor quotations. Failure by the contractor to submit subcontract cost or pricing data may be cause for disqualification of the contractor from further consideration for award of the proposed contract.

#### **15.804-7 Defective Cost or Pricing Data.**

(b)(2) In the absence of evidence to the contrary, the natural and probable consequence of defective data is an increase in the contract price in the amount of the defect plus related burden and profit or fee; therefore, unless there is a clear indication that the defective data were not used, or were not relied upon, the contract price should be reduced in that amount. In establishing that the defective data caused an increase in the contract price, the contracting officer is not expected to reconstruct the negotiation by speculating as to what would have been the mental attitudes of the negotiating parties if the correct data had been submitted at the time of agreement on price.

(d) An auditor's advisory report of postaward reviews of cost and pricing data may result either from a specific request of a contracting officer or from audit action initiated independent of a contracting officer's request.

(e) In exercising the Government's rights in such cases, the contracting officer will consider the varying circumstances discussed below.

(e)(70) In some instances, the prime contractor may have reached agreement on price with a subcontractor before the prime contractor and the Government agree on a definitive price. This might occur, for example, if the prime contractor commenced performance under an unpriced action such as a letter contract. In such cases, the subcontractor's cost or pricing data must be submitted with the prime contractor's submission. If any such subcontractor data are subsequently found to be defective, the prime contract is subject to price adjustment in the same manner as would be the case if any other cost or pricing data submitted by the prime contractor proved to be defective.

(e)(71) The Government and the prime contractor will normally agree on the price of a contract prior to final agreement on price

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between the prime contractor and his subcontractor. In such cases, the prime contract price will be based, in part, on subcontract cost estimates. The prime contractor will be expected to support the subcontract cost estimates with subcontractor cost or pricing data. The prime contract price will be subject to adjustment on the basis of defective subcontractor cost or pricing data submitted prior to agreement on the prime contract price if:

(i) such subcontractor data were not accurate, complete, or current as of the date certified in the prime contractor's Certificate of Cost or Pricing Data, or in some cases were not accurate as submitted by the subcontractor, and

(ii) the prime contract price was increased by a significant sum because of such defective subcontractor data.

(f) Conditions may be prescribed by: the Office of the Assistant Secretary of the Army (Research, Development and Acquisition), for the Army; Office of the Assistant Secretary of the Navy (Shipbuilding & Logistics), DCBM, for the Navy; the Director of Contracting and Manufacturing Policy, Headquarters, USAF (AF/RDC), for the Air Force; and the Executive Director, Contracting, for the Defense Logistics Agency.

(2) Although the action is taken under those price reduction clauses rather than under Part 31 as a practical matter the result is the same, i.e., the increased costs will be disallowed under cost-type contracts or not considered as actual costs for final pricing of redeterminable or incentive-type contracts. The action is taken under the price reduction clauses because not only will the increased costs be disallowed or not considered as actual costs but also the fixed-fee or target profit included in the initial price may be subject to reduction in accordance with (1) and (2) of 15.804-7(e) above.

**15.804-8 Contract Clauses.** The requirement for inclusion of the specified clauses in contracts with foreign governments or agencies may be waived in exceptional cases by the Agency head (see FAR 15.804-3(1)). The contracting officer shall also include the clause at FAR 52.215-22 when obtaining partial cost or pricing data in accordance with 15.804-2(a)(2).

(70) The clause at 52.215-7000, Aggregate Pricing Adjustment, shall be included in all solicitations and contracts which include a clause at FAR 52.215-23, FAR 52.215-24, or at FAR 52.215-25. The Contracting Officer may insert a lesser dollar amount, if appropriate.

#### **15.805 Proposal Analysis.**

##### **15.805-1 General.**

(a) The contracting officer should also note the following:

(a)(70) Each contracting officer is responsible for performing or having performed all administrative actions necessary for effective contracting.

(a)(71) For certain acquisitions, it may be necessary to convene a formal "Should Cost" (see FAR 15.810) team of specialists to evaluate the contractor's cost projections, supporting standards, and other in-plant management, operational and performance practices, on which cost projections are based.

(a)(72) Contract auditors are professional accountants who, although organizationally independent, are the principal advisors to contracting officers on contractor accounting and contract audit matters. Contract audit services are available in two forms:

(i) Audit reports setting forth the results of auditors' reviews and analyses of cost data submitted by contractors as part of pricing proposals, reviews of contractors' accounting systems, estimating methods, and other related matters; and

(ii) "On-the-spot" personal consultation and advice to contracting and contract administration personnel in connection with analyses of contractors' cost representations and related matters by liaison auditors stationed at contracting and contract administration offices. (DCAA provides procurement liaison auditors (PLAs) at most major contracting and contract administration offices to facilitate the receipt and use of audit service and to provide accounting and audit advice as to whether or not audit review of a price proposal should be waived.)

(b) Some form of price or cost analysis is required in connection with every negotiated contract action. The method and degree of analysis, however, is dependent on the facts surrounding the particular acquisition and pricing situation. The extent of cost analysis should be that necessary to assure reasonableness of the pricing result, taking into consideration the amount and complexity of the proposed contract. Normally, a sound conclusion as to value cannot be made on the basis of cost analysis alone. Depending on the information available, a price arrived at by cost analysis should be corroborated through price analysis techniques.

#### **15.805-2 Price Analysis.**

(b) To provide a suitable basis for comparison, appropriate allowances must be made for differences in such factors as time of prior acquisitions, specifications, quantities ordered, time for delivery, Government-furnished materials, and experienced trends of improvement in production efficiency. It must also be recognized that such comparison may not detect an unreasonable current quotation unless the reasonableness of the prior prices was established and unless changes in the general level of business and prices have been considered.



**15.805-4 Technical Analysis.** Technical analyses by the Plant Rep/ACO and the team members shall be based on their knowledge of such factors as production, quality assurance, engineering and manufacturing practices and techniques, and information as to plant capacity, scheduling, engineering and production "know-how," Government property, make-or-buy considerations, and industrial security, particularly as these relate to practices of the specific prospective contractor.

**15.805-5 Field Pricing Support.**

(a)(1) Contracting officers shall request field pricing reports for contracts and modifications resulting from a proposal in excess of \$100,000 for a firm fixed-price contract, \$250,000 for a fixed-price incentive contract, and \$500,000 for a cost type contract. The requirement for subject reports may be waived, with adequate justification, at one level above the contracting officer. Requests for field pricing support should be tailored to ask for minimum essential information needed to ensure a fair and reasonable price is achieved. Information of the type described in (i) through (vi) below, which is often available to the contracting officer from the Plant Rep/ACO or from the Procurement Liaison Auditor (PLA), should be useful in determining the extent of any field pricing support that is needed.

(i) In-house engineering determination of level of effort required in connection with research and development or study contracts.

(ii) Audited cost information from contract awards in process, or recently negotiated contracts.

(iii) Adequately reviewed data on proposed subcontract items which constitute the major portion of the prime contract price proposal.

(iv) Prices of standard commercial items which constitute the major portion of the prime contract price proposal.

(v) Special forward pricing formulas or rates such as for support items, or forecast overhead rates, prescribed in an existing advance agreement.

(vi) Current labor rates, overhead rates, loading factors, per diem rates, and lot data based upon actual costs and labor hours. It should be borne in mind that no single category of information is necessarily sufficient by itself; for example, information as to rates for labor and overhead would normally require data concerning the base elements--labor hours, material costs, etc.--to which the rates apply.

(2) The Plant Rep/ACO, as well as the contract auditor, will be responsible for providing a complete and accurate field pricing report to the contracting officer. To accomplish this end, the Plant Rep/ACO must:

(i) In concert with the auditor and in consideration of the auditor's workload, establish a deadline for the auditor's input, subject to date adjustments when considered necessary (adjustments will be coordinated by the Plant Rep/ACO with the contracting officer and the contract auditor);

(ii) Identify areas for special consideration (these are areas in addition to those specified by the contracting officer);

(iii) Arrange for exchanges of technical and audit information; and

(iv) Be fully responsive to a request for technical information from the auditor.

(a)(70) If an audit review will not be required, either as a separate report or as part of a field pricing report, before negotiating any contract or modification for which a proposal is submitted in excess of \$500,000, approval shall be obtained at a level above the contracting officer.

(c)(1)(70) When field pricing reviews are required, contracting officers should note the following:

(A) The Plant Representative/Administrative Contracting Officer (Plant Rep/ACO) is the team manager for all contracting officer requests for field pricing support. The contracting officer shall send all requests for field pricing support to the cognizant field contract administration activity; generally, the Plant Rep for the Services and the ACO for DCAS(DLA). To expedite the pricing review process, these requests shall be marked in bold letters on the mailing envelope "**FIELD PRICING REQUEST.**" On urgent requests, provide facsimile numbers in the requests to facilitate sending the complete report. A copy of the request will also be sent to the cognizant audit activity.

(B) When the contracting officer knows in advance that field pricing support will be required, the contracting officer shall provide the cognizant Plant Rep/ACO and auditor a copy of the solicitation. If the contracting officer requires the contractor to provide copies of the proposal directly to the Plant Rep/ACO and auditor, a field pricing request shall be issued along with the solicitation. In this event, the contracting officer shall include in the field pricing request, the approximate date the proposal will be provided by the contractor, and identify those specific areas for which field pricing support is required.

(C) Where audit reports are received on contracting actions that are subsequently canceled or unsuccessful, the cognizant auditor shall be notified in writing.

(c)(1)(71) When field pricing reports are requested for acquisition of parts or support equipment, the reports shall as a minimum include, but will normally be limited to, the following:

(A) A detailed analysis of each line item where the quoted price exceeds by 25 percent or more the lowest price to the Government of the item at any time within the most recent 12-month period. These items will be specified in the request for field pricing support.

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(B) The results of a review of the description and the price of each line item in the proposal made to assist in identifying any obvious overpricing. Those items, so identified, will be subjected to further analysis.

(C) An analysis of the significant high-dollar-value items. If there are no obvious high-dollar-value items (i.e., the majority of line items are of approximate equal value), a random sampling technique should be used.

(D) An analysis of a random sample of the remaining low-dollar-value line items. Sample size may be determined by subjective judgment, e.g., experience with the contractor, reliability of contractor's estimating/accounting systems, credibility of proposals, etc.

(c)(1)(72) When field pricing reports are to be requested for spare parts proposals that have been identified as Spares Acquisition integrated with Production (SAIP) items (see DoD Instruction 4245.12), the contracting officer shall--

(A) Include a copy of the data entitled "Contractor's Procurement Schedule for SAIP" (Data Item DI-V-7200), or equivalent, in the request so that the benefits of combining new and in-process quantities can be assured (this data is delivered by the contractor on contracts that include SAIP requirements); or

(B) Require the contractor to include this data in its proposal.

(d) The efforts of all field pricing support team members are complementary, advisory and also offer an excellent check and balance of the various analyses imperative to the contracting officer's final pricing decision. Therefore, it is essential that there be close understanding, cooperation and communication to ensure the exchange of information of mutual interest during the period of analysis. While they shall review the data concurrently when possible, each shall render services within the individual area of responsibility. For example, on quantitative factors (such as labor hours), the auditor may find it necessary to compare proposed hours with hours actually expended on the same or similar products in the past as reflected on the cost records of the contractor. From this information the auditor can often project trend data. The technical specialist may also analyze the proposed hours on the basis of knowledge of such things as shop practices, industrial engineering, time and motion factors, and the contractor's plant organization and capabilities. The interchange of this information will not only prevent duplication but will assure adequate and complementary analysis.

(e) The terms "audit review" and "audit" refer to examinations by contract auditors of contractors' statements of actual or estimated costs to the extent deemed appropriate by the auditors in the light of their experience with contractors and relying upon their appraisals of the effectiveness of contractors' policies, procedures, controls, and practices. Such audit reviews or audits may consist of desk reviews,

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test checks of a limited number of transactions, or examinations in depth, at the discretion of the auditor. The contract auditor is responsible for submission of information and advice, based on analysis of the contractor's books and accounting records or other related data, as to the acceptability of the contractor's incurred and estimated costs.

(e)(6) Reports of technical analysis and review should be furnished to the auditor at the earliest possible date and at least five days prior to the due date of the audit report to enable the auditor to include the financial effect of technical findings in the audit report (for example, the necessary computations of dollar amounts arising from changes in proposed kinds and quantities of materials, labor hours, etc.). In the event the technical analyses are not available in time to be reflected in the audit report, the audit report shall so state, and this shall be made known to the Plant Rep/ACO so that comments may be incorporated in the submission to the contracting officer. If technical analyses are received later by the auditor, the auditor shall issue a supplemental report if the status of the negotiation is such that a report would serve a useful purpose. The original of all technical reports received by the auditor shall be made a part of the audit report submitted to the Plant Rep/ACO.

(e)(7) When the contracting officer determines that deficiencies in the contractor's accounting system or estimating methods are such that the proposed contract cannot be adequately priced or administered, the contracting officer shall, with the advice of the contract auditor and the Plant Rep/ACO, assure that necessary corrective action is initiated prior to the award of such contract. The auditor is responsible for performing that part of reviews and cost analyses which requires access to the contractor's books and financial records supporting proposed cost or pricing data, regardless of the dollar amount involved.

(e)(8) During the course of the examination, the Plant Rep/ACO and the auditor shall each confer with the contractor to fully understand the basis for each item in the contractor's proposal and to remove any doubts as to the validity and accuracy of their conclusions and findings.

(g) The Plant Rep/ACO (price analyst or negotiator) shall query the auditor or technical personnel about matters in audit or technical reports which appear to need clarification. When developing the Plant Rep/ACO statement to the contracting officer transmitting audit and technical reports, comments or observations shall be added about pertinent matters whether or not covered in the audit or technical reports. However, it is not contemplated, for example, that the price analyst or negotiator should attempt an examination of the contractor's accounting records for this purpose since the contract auditor has this responsibility.

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(i) If in the opinion of the contracting officer, Plant Rep/ACO, or auditor, the review of a prime contractor's proposal requires further review of subcontractors' cost estimates at the subcontractors' plants (after due consideration of reviews performed by the prime contractor), such reviews should be fully coordinated with the Plant Rep/ACO having cognizance of the prime contractor before being initiated. If a review is required of a subcontract proposal, the prime Plant Rep/ACO shall forward the request to the subcontract ACO with an information copy to the subcontract auditor. In the event a lower tier subcontract proposal requires review, the request should be coordinated in sequence with the Plant Rep/ACO's at higher tiers in the subcontract chain. The resulting pricing reports, including any audit reports, shall be forwarded by the subcontract Plant Rep/ACO to the prime Plant Rep/ACO with an information copy to the prime auditor. If the review is of a lower tier subcontract proposal, the report shall be transmitted through the Plant Rep/ACO's in the subcontract chain.

(j) The appropriate contract administration activities will be notified by the HCA when review and evaluation of subcontractors' proposals will require extensive field pricing assistance in connection with the acquisition of a major new weapon system, or require special or expedited action by field pricing personnel and such action is being, or has been, delayed.

#### 15.806 Subcontract Pricing Considerations.

(70) Other subcontract pricing considerations include:

(1) Subcontract costs and pricing arrangements are significant elements to be considered during negotiation of prime contracts and during contract administration.

(2) Basic responsibility rests with the prime contractor for decisions to make or buy, for selection of subcontractors, for subcontract prices, and for subcontract performance. The contracting officer who is responsible for negotiating the contract price with the prime contractor must have adequate knowledge of these elements as they affect prime contract prices.

(3) Contractors' "make-or-buy" programs and proposed subcontracts must be reviewed in accordance with FAR 15.7 and with FAR Part 44. Information from these reviews should be used in evaluating subcontract costs when negotiating prime contract prices. The contracting officer, when appropriate, should secure from the contractor information concerning:

- (i) the prime contractor's purchasing practices; and
- (ii) the principal components to be subcontracted and the prospective or actual subcontractors, including (A) the extent of competition obtained or to be obtained, (B) the basis for the

subcontract costs included in the contract pricing proposal (SF 1411), (C) any contractor cost or price analyses of subcontract proposals, including the cost or pricing data submitted by subcontractors, (D) the pricing arrangement contemplated or negotiated, and (E) the extent of subcontract supervision.

(4) The contracting officer is responsible for the reasonableness of the prime contract price which includes self-satisfaction as to the reasonableness of the subcontract costs included in the prime contract price. Field pricing support from the Plant Rep/ACO cognizant of the prime contractor is generally required in determining reasonableness of the prime contract price. In some instances, it may be necessary to obtain field pricing support of proposed subcontracts. On the basis of a request from the contracting officer and/or advice from members of the field pricing team, the ACO cognizant of the prime contractor may request field pricing support from the ACO cognizant of the prospective subcontractor. These actions will be taken in accordance with 15.805-5.

(5) If the prime contractor's analysis is not considered adequate, the ACO will return the analysis package to the contractor for re-accomplishment indicating areas of inadequacy. In this case, the prime contractor will accomplish or cause the accomplishment of the additional review and resubmit the package to the ACO.

(6) When subcontracts have been placed on a price redetermination or fixed-price incentive basis and the prime contract is to be repriced, it may be appropriate to negotiate a firm prime contract price, even though the contractor has not yet established final subcontract prices. The contracting officer may do this when convinced the amount included for subcontracting is reasonable, e.g., where realistic cost or pricing data on subcontract efforts are available. However, even though the available cost data are highly indefinite and there is a distinct chance that one or more of the subcontracts eventually may be redetermined at prices that are lower than those predicted in redetermining the prime contract price, other circumstances may require the prompt negotiation of the final contract price. In such a case, the contract modification which evidences the revised contract prices should provide for adjustment of the total amount paid or to be paid under the contract on account of subsequent redetermination of the specified subcontracts. This may be done by including in the contract modification a statement substantially as follows:

Promptly upon the establishment of firm prices for each of the subcontracts listed below, the Contractor shall submit, in such form and detail as the Contracting Officer may reasonably require, a statement of costs incurred in the performance of such subcontract and the

firm price established therefor. Thereupon, notwithstanding any other provisions of this contract as amended by this modification, the Contractor and the Contracting Officer shall negotiate an equitable adjustment in the total amount paid or to be paid under this contract to reflect such subcontract price revision. The equitable adjustment shall be evidenced by a modification to this contract.

(List Subcontracts)

(7) In considering cost-plus-fee subcontracts, the contracting officer shall make every effort to insure that fees under such subcontracts never exceed the fee limitations identified in 15.903(d).

(8) The prime contractor may submit subcontractor claims for exemption at any time to the contracting officer for an advance review of their acceptability, but otherwise the prime contractor shall submit them with its proposal or request for subcontract consent; or other action by the contracting officer, whichever comes first.

#### **15.807 Prenegotiation Objectives.**

(b) Prenegotiation objectives will be documented in accordance with Departmental procedures.

(70) When contract audit review of the offeror's proposal has been requested, the contracting officer shall keep the auditor informed of planned prenegotiation and negotiation activities, including related fact-finding sessions and/or discussions with the offeror, and invite contract audit participation where the contracting officer and auditor agree that a significant contribution can be made.

#### **15.808 Price Negotiation Memorandum.**

(a)(4) Comments should also be included on the current status of their contractor systems (e.g., estimating, accounting, compensation, etc.) to the extent that they impacted and were considered in the negotiation.

(a)(10) The following applies to documentation of profit or fee negotiated:

(i) Since the profit objective is the contracting officer's pre-negotiation evaluation of the total estimated profit under the proposed contract, the amounts set forth for each category of cost will probably change in the course of negotiation. Furthermore, the negotiated profit will probably vary from the profit objective, and from a detailed application of the weighted guidelines method to each element of the Contractor's Input to Total Performance as anticipated prior to negotiation. Since the profit objective is viewed as a whole rather than as its component parts, insignificant variations from the pre-negotiation profit objective, as a result of changes of the Contractor's Input to Total Performance, need not be documented in

detail. Conversely, significant deviations from the profit objective necessary to reach a final agreement on profit or fee shall be explained. The profit earned as a result of contract performance will generally vary from that anticipated at the time of negotiation.

(ii) When the weighted guidelines method is not used because of unusual pricing situations (see 15.9), the contract file shall be documented to support the exceptions.

(iii) DD Form 1547 (see 15.9) may be used in the Price Negotiation Memorandum, Provided that the rationale used in assigning the various rates is fully documented.

(iv) See also FAR 15.807(c).

#### 15.809 Forward Pricing Rate Agreements.

(e) Indirect costs commonly known as overhead are defined and described in FAR 31.203. Criteria for treatment and application of indirect costs to contracts are also set forth in FAR 31.203. To assure a reasonable approximation and allocation of indirect costs on an equitable basis to individual contracts, negotiators shall utilize audited indirect cost data or negotiated indirect cost rates, when available, in connection with negotiation of contracts and shall not, unless authorized by the head of the contracting activity, seek preferential indirect cost rates. If there is any question with respect to audited indirect cost data or negotiated indirect cost rates, or if such are not available, the negotiator should normally use the advisory services of the cognizant Department of Defense auditor.

(e)(2) In assessing changed conditions, the ACO will consider: (i) the type of contract contemplated; (ii) whether the dollar amount of the proposed contract action would significantly change the rates in the agreement; (iii) whether the performance period of the proposed contract action is significantly different from the period to which the rate agreement applies; and (iv) any new data or other information that may raise a question as to the acceptability of the rates.

(f) When contracting representatives have received notice that changed conditions negate FPRA's, individual contracting actions should not be delayed.

#### 15.810 Should-Cost Analysis.

(b)(70)(i) Should-cost analyses shall be performed prior to award of definitive major systems contracts in excess of \$100 million for major systems if each of the following conditions are met:

(A) a production contract for the system is to be awarded on a sole-source basis;

(B) initial production of the system has already taken place;

(C) the current plans for the Department of Defense include production of substantial quantities of identical or similar items;



(D) the work to be performed under the contract is sufficiently defined to permit an effective analysis of what production of the system by the contractor should cost; and

(E) major changes in the program are unlikely.

(ii) After an initial should-cost analysis has been performed under (i) above, subsequent should-cost analyses need not be performed annually, but must be accomplished at least every four years on contracts meeting the requirements of (i) above.

(iii) Waiver of a should-cost analysis shall be made in accordance with Service procedures, but in no event at a level lower than a general/flag officer or civilian equivalent.

(e) The content of the should-cost analysis team report shall be prescribed by Service procedure. Team leaders should ensure that activities are coordinated to avoid duplication of effort.

#### **15.811 Estimating Systems.**

(a)(70) The establishment, maintenance, and consistent use of formal cost estimating systems by contractors is to the mutual benefit of the Government and industry, particularly where a large portion of the contractor's business is defense work and there are a number of significant proposals requiring review. Contracting activities and contract administration activities are required to furnish full support to a program of encouraging major defense contractors to formalize and follow good estimating procedures. It is recognized that estimating procedures will vary among contractors, and may vary between plants or divisions of a contractor due to differences in products, size and methods of operations, production vs. research, and other factors. While formal systems do not eliminate the need for judgmental factors to be applied by contractors in developing cost proposals, they do provide a sound foundation for the systematic and orderly application of these judgment factors to specific proposals.

(a)(71) Reviews and reports shall be accomplished as a joint contract audit and contract administration office team effort, with the contract auditor designated as its head. Reviews shall be tailored to take full advantage of the day-to-day work done as an integral part of both the contract audit and contract administration activities. The program established by the contract audit activity shall be coordinated with the appropriate contract administration activity to assure that team membership includes qualified technical specialists, and that adequate personnel resources are made available to accomplish the program.

#### **15.870 Procedures for Identifying Contractors' Unallowable Costs.**

(a) The establishment, maintenance, and consistent use of procedures for identifying and segregating unallowable costs, which will assure compliance with CAS 405 and FAR Part 31 will benefit both the Government and contractors. Such procedures may vary between

plants or divisions of a contractor due to size, mix of business and complexity of organization. Some of the advantages of sound procedures are that:

- (1) A greater degree of confidence can be placed on the accuracy and reliability of contractors' proposals, billings and claims;
- (2) They expedite the negotiation process; and
- (3) They may reduce the scope of reviews performed by audit and other technical and contracting personnel.

(b) The responsible Federal Contract Audit organization shall review contractors' procedures and practices in conjunction with other contract audit activities. Deficiencies shall be reported to the cognizant ACO, and, as appropriate, contracting officers having substantial business with the contractor. Among the matters to be considered in determining the adequacy of a contractor's procedures are its policy, practices and techniques for:

- (1) Assignment of responsibilities within the contractor's organization for reviewing and approving claims against the Government;
  - (2) Identification of unallowable costs (expressly unallowable, mutually agreed to be unallowable or specifically designated as unallowable by written decision of the contracting officer) together with the individual employees incurring such costs;
  - (3) Identification and computation of directly associated costs;
  - (4) Assurance that unallowable and directly associated costs are not included in estimated costs proposed, or incurred amounts claimed by the contractor;
  - (5) Coordination and communication between the elements of the contractor's organization that prepare proposals and claims and those responsible for identifying unallowable and directly associated costs; and
  - (6) Assuring the adequacy of the documentation maintained by the contractor identifying the unallowable costs together with directly associated costs.
- (c) Documentation in support of the contractor's procedures shall be made available to authorized Government personnel.

#### 15.871 Estimated Data Prices (DD Form 1423).

(a) The Department of Defense requires estimates of the prices of data in order to evaluate the cost to the Government of data items in terms of their management, product or engineering value.

(b) When data are required to be delivered under a contract, the solicitation will include DD Form 1423, Contract Data Requirements List. The form and the provision included in the solicitation request the offeror to state what portion of the total price is estimated to be attributable to the production or development of the listed data

for the Government (not to the sale of rights in the data). However, offerors' estimated prices may not reflect all such costs; and different offerors may reflect these costs in a different manner, for the following reasons:

- (1) differences in business practices in competitive situations;
- (2) differences in accounting systems among offerors;
- (3) use of factors or rates on some portions of the data;
- (4) application of common effort to two or more data items;
- (5) differences in data preparation methods among offerors.

For these and other reasons, data price estimates should not be used for contract pricing purposes without further analysis.

(c) The contracting officer shall assure that the contract does not include a requirement for data which the contractor has delivered or is obligated to deliver to the Government under another contract or subcontract, and that the successful offeror furnishes any certification required by the solicitation. However, where duplicate data are desired, the contract price shall include the costs of duplication, but not of preparation, of such data.

(d) In the case of acquisitions of \$100,000 or over, the contracting officer, after agreeing upon a negotiated contract price, will adjust the estimated prices in Blocks 26 of the original DD Form 1423 for the data items listed thereon to equal the amount included in the related priced contract line or subline item(s) for the data item(s). Adjusted DD Form 1423 will be maintained so as to be available at each contracting activity. The detachable portion of the DD Form 1423 (Blocks 17-26) with the estimated or adjusted prices shall not appear in the contract.

(e) When printing is to be acquired as an integral part of a contract for other supplies or services, each requirement in the contract for printing shall be listed as a separate line item on DD Form 1423; and the approval or waiver obtained pursuant to Subpart 8.8 shall be appropriately identified.

#### 15.872 Capital Investment Incentives.

(a) Policy. Although DoD profit and competition policies are intended to provide adequate incentives to the contractor for capital investment and productivity, it is also recognized that individual cases will arise when additional incentives may be appropriate. In these individual cases, it is the policy of DoD that industrial modernization incentives may be negotiated and included in contracts for research, development, and/or production of weapons systems, major components, or material. The purpose is to motivate the contractor to invest in facilities modernization and to undertake related productivity improvement efforts it would not have otherwise undertaken or to invest earlier than it otherwise would have done.

(b) General. Any industrial modernization incentives program (IMIP) shall be accomplished in accordance with this coverage and with DoD Directive 5000.44 and DoD Guide 5000.44-G. Sufficient flexibility is provided in the directive and guide to allow the IMIP to be tailored to the requirements of an individual situation. The incentives may be in the form of productivity savings rewards, contractor investment protection, and/or other appropriate forms. They may be used separately or in combination, as addressed in subparagraphs (b)(1), (2) and (3) of this subsection. However, in no event, shall an IMIP agreement be made between DoD and a contractor until careful analyses have been conducted and reduced acquisition costs or equivalent benefits (such as improved quality, as a result of the application of the IMIP) are clearly evident. It may be generally desirable to initially negotiate a memorandum of understanding (MOU) to establish guidelines and criteria against which to analyze and negotiate a specific IMIP.

(1) Productivity Savings Reward (PSR). This incentive shares the savings achieved from facilities modernization and related productivity improvement efforts. This incentive may be used to encourage productivity improvements in all facets of the production process including major cost driving areas such as labor, materials, overhead, support systems (including software), and organizations. In order for these to be considered viable projects that are beneficial for both the Government and the contractor, the contractor must show that PSR is required for project implementation and that these projects are over and above requirements to meet normal contractual obligations. The scope and limitation of productivity savings rewards are as follows:

(i) Productivity savings rewards in conjunction with contractor capital investment will be based on an internal rate of return (IRR) analysis. The productivity savings rewards should be sufficient to allow the contractor to obtain an equitable return on the investment. Nonseverable plant equipment and property may be included on a limited basis as part of the contractor's investment basis for calculating the appropriate return on investment. The effect of any Government funding provided in conjunction with modernization efforts must be included in the contractor's IRR, and no contractor costs or expenses otherwise allocable and allowable to any specific DoD contract may be included.

(ii) Productivity savings rewards providing the contractor a reward for productivity improvements other than through capital investment will be based on an economic analysis of the benefits to the Government and the contractor. The negotiated sharing amount or percentage shall be based on benefits and risks to both parties. It will be paid only for savings that are validated, and will be

negotiated for a period normally no longer than five years after the date of implementation.

(iii) Productivity savings rewards shall not constitute fee within the meaning of the limitations imposed by 10 U.S.C. 2306(d).

(2) Contractor Investment Protection. If formally agreed to by the parties, this incentive would become operative in the event that the contract or program is terminated or funds are not provided in subsequent fiscal years for the planned acquisition upon which the investment decision was based. This incentive may permit the Government to acquire specific capital investments at no more than the undepreciated value. This value may be determined by considering a combination of investment incentives, income tax credits or incentives, and allowable depreciation costs pursuant to cost principles established in FAR Part 31. The scope and limitations are as follows:

(i) This technique is designed to transfer to the Government some of the risk associated with acquisition of certain capital assets by contractors. Its purpose is to cover only specifically identified cost-effective capital assets. It is not to be used to override the general policy that all facilities needed for the performance of Government contracts will be provided by the contractor as set forth in FAR Part 45.

(ii) This investment incentive is designed primarily for the situation when one program dominates the business base and the contractor may bear unacceptable monetary risk from the modernization effort. The program must provide for a sufficient buy to allow for amortization of the planned investment.

(iii) Capital assets which may be covered by such an investment incentive include only severable industrial plant equipment, and other types of severable plant equipment with a unit value in excess of \$10,000, including associated accessories which would be capitalized in accordance with the contractor's disclosed accounting practices, but excluding real property.

(iv) The exact value and nomenclature of each piece of capital equipment must be included in the contract documents.

(v) The fiscal authority who commits funds to the resultant contract must certify that the approval authority has approved by fiscal year the amount of contingent Government liability and that the approval authority has notified the Congress in advance that the technique will be used on contracts for a specific weapon system or material program element. Unless there are unusual circumstances, this notification will be included in the justification material submitted to the Congress in support of authorization and appropriation requests. A copy of the notification shall be retained in the contract file.

(vi) Approval for use of this investment incentive must be obtained from the Secretary of the Military Departments, the Director of DLA, or the Director, Strategic Defense Initiative Organization. Authority up to \$50 million may be delegated no lower than the Commander, AFSC, AFLC, or AMC.

(vii) In the event that it becomes apparent that the contingent liability resulting from the use of this technique will become an actual obligation, the approval authority shall be notified and immediate steps shall be taken to obtain sufficient funds to cover the obligation.

(3) Other Appropriate Incentives. Other incentives such as award fees and direct Government funding, based on IMIP methodologies, may be provided under IMIP when appropriate.

(c) Contracting Officer Evaluation. The contracting officer must evaluate the proposed IMIP agreement to determine that benefits to the U.S. Government can be expected. A contractor statement that the investments or actions would not be undertaken without, or will be accelerated with, the use of the incentive may be required. The evaluation should include the following elements:

(1) A cost/benefit analysis of the investment or action and the overall cost savings or other benefits to the Government, including the payback quantities and payback periods and how the savings will be reflected in the pricing of individual contracts.

(2) An analysis of the contractor's past investments and capital investment profiles, and the relationship of specific projects to the contractor's factory analysis.

(3) Other considerations such as:

(i) Interaction with other incentives provided on the contract.

(ii) Effects of variations in procurement quantities on the incentives.

(iii) How the incentive techniques are integrated with the overall acquisition strategy, including items such as second sourcing plans and multiyear procurement.

(iv) Effects on overhead and indirect costs.

(d) Negotiation.

(1) The Government objective should be to provide only those incentives sufficient to motivate the contractor to implement the desired investment or action. Ceiling should normally be provided to establish a maximum incentive amount.

(2) Emphasis should be placed on flowing down requirements or involvement to subcontractors and vendors where appropriate.

(3) Provisions should be provided establishing the extent to which the contractor may use equipment for commercial purposes. This should be reflected in the amount of incentive provided.

(4) The extent of disclosure or dissemination of technologies or processes contained in the IMIP are subject to negotiation and agreement.

(e) Contractual Requirements.

(1) Specific contract requirements should be structured to match the circumstances of the individual acquisition.

(2) Measurement and verification requirements should be addressed contractually, and systems established that match the incentives used and the needs in this area. Contractors should be required to develop, maintain, and provide data supporting any measurement of savings achieved until three years after final payment under the contract.

(f) Contract Clause. The contracting officer shall include the clause at 52.215-7001, "IMIP Productivity Savings Reward", in all solicitations and contracts for which certified cost or pricing data were obtained involving the acquisition of supplies (i.e., weapon systems, equipment, and material) expected to result in contracts or contract modifications greater than \$1 million. The clause is discretionary for inclusion in solicitations less than \$1 million. Inclusion of the clause does not in itself result in the payment of any productivity savings reward amounts to the contractor - the clause becomes operable only when an IMIP business agreement has been executed establishing all the terms and conditions for payment of the productivity savings rewards.

**15.873 Reserved.**

**15.874 Follow-Up on Contract Audit Reports.** It is the policy of the Department of Defense for contracting officers to make the best possible use of contract audit advice. The DoD policy on contract audit follow-up is contained in Department of Defense Directive 7640.2, "Policy for Follow-Up on Contract Audit Reports."

**15.875 Availability of Contractor Records.** In accordance with 10 U.S.C. 2406, the contracting officer shall include the clause at 52.215-7002, "Availability of Contractor Records", in solicitations and contracts which--

(a) Require the submission and certification of cost or pricing data; and

(b) Are for the manufacture of end items for a major defense acquisition program, as defined in 10 U.S.C. 2432a.

**PART 31--CONTRACT COST PRINCIPLES AND PROCEDURES**  
**SUBPART 31.2--CONTRACTS WITH COMMERCIAL ORGANIZATIONS**

**31.201 General.** The contracting officer shall insert the clause at 52.231-7000, Supplemental Cost Principles, in all solicitations and contracts, except acquisitions made under the small purchase procedures in FAR Part 13.

**31.205-10 Cost of Money.**

(a)(2)(i) The contractor's capital investment must also be measured, allocated to contracts, and costed in accordance with 30.70.

(ii) The contractor must also maintain records to demonstrate compliance with (i) above.

(b)(2)(i)(A) The cost of money must be calculated, allocated to contracts, and costed in accordance with 30.70.

(B) The contractor must also maintain records to demonstrate compliance with (A) above.

**31.205-18 Independent Research and Development and Bid and Proposal Costs.**

(c)(1)(vii) The total amount of IR&D/B&P costs allocated to DoD contracts shall not exceed the total of expenditures for IR&D/B&P projects with a potential relationship to a military function or operation. For contracts which do not provide for cost determinations on a historical basis, the requirement will be considered to have been met if the estimated IR&D/B&P costs allocated to the contract do not exceed its proportionate share of the total estimated costs of IR&D/B&P with a potential relationship to a military function or operation. IR&D/B&P costs will be considered to satisfy the potential relationship requirement when the contractor can demonstrate that the effort under a proposed contract or grant would have a potential relationship to a military function or operation. The potential relationship of IR&D/B&P will be determined by the contracting officer, and the results of the determination will be made available to the contractor. For additional allowability requirements affecting Foreign Military Sales (FMS) contracts, see 25.7304.

**31.205-38 Selling Costs.** Additional allowability requirements for Foreign Military Sales (FMS) contracts are contained in 25.7304 and 25.7305.



NOTES

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## CHAPTER E

### Production Management

This block of instruction is designed to permit open discussion concerning the following topics -- Preaward Surveys, Post award conferences, resolving delinquencies and surveillance actions. Experience has proved we are doing many of the right things in administering contracts. However, our attention is focused on the things we don't do so well. We encourage you to share your or your agencies positive accomplishments as they relate to problems surfaced by fellow students.

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SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION (PPM 304)

SUBJECT: Production Management

TIME: 10.5 Hrs

OBJECTIVE: Comprehend the concepts and techniques of determining, evaluating and improving contractor progress toward contract performance.

SAMPLES OF BEHAVIOR:

- a. List the responsibilities of Production and Engineering Personnel and the impact of their workload on surveillance efforts.
- b. Describe the Preaward Survey process, ways to provide better Preaward Survey service to the contracting officer, and ways to improve Preaward survey communication among contracting activities, surveying activities and offerors.
- c. Explain the purpose of Post award Orientation Conferences and identify ways to make them more effective.
- d. Describe how the production section determines the degree of surveillance for each contract.
- e. Understand the Defense Priorities Allocation System (DPAS) in determining performance priorities.
- f. Identify ways to predict when delinquency problems may occur and ways to handle delinquency once it occurs.
- g. Describe ways to improve the effectiveness of admin. activity delinquency reporting and contracting activity response.
- h. Describe various methods of monitoring contractor progress such as critical path, line of balance and cost/schedule control systems criteria, when they are appropriate and advantages of each.
- i. Describe value engineering and work measurement and their use within Defense contracting.

**Describe the circumstances under which a preaward survey is performed and identify the factors considered in the survey.**

The preaward survey (PAS) is an evaluation by a contract administration office of a prospective contractor's capability to perform under the terms of a proposed contract. It covers those aspects of the contractor's management, finances, and facility resources that are significant to the purchasing office in determining whether a contractor would be considered responsible. The evaluation may be accomplished by use of data on hand, data from another government agency or commercial source, an on-site inspection of plant and facilities to be used on the proposed contract, or any combination of these.

**Circumstances Under Which Performed.** A preaward survey will be requested when the information available to the contracting office is not sufficient for it to make a determination regarding the responsibility of a prospective contractor. As the recognized and established method for determining capability, the preaward survey is requested early in the procurement cycle whenever there is any doubt of the potential supplier's ability to perform. These surveys are particularly effective as an indicator of possible performance failure on the part of a new contractor, and they are also quite effective in detecting changes in performance capability of established sources.

For procurements that are significant in dollar value or are critical by the nature of the requirement, consideration is given to requesting the CAO to verify information regarding current workload and financial capability. Normally, however, a preaward survey will not be requested for a procurement valued at \$25,000 or less.

In requesting the survey, the purchasing office calls attention to any factors which should receive special emphasis. If a CAO knows unfavorable information exists and no preaward survey has been requested, it should immediately notify the purchasing office. The purchasing office shall consider such advice before award is made.

Generally, surveys are requested only on those prospective contractors that are within range for an award. Requests are expected to be processed promptly after bid opening or receipt of proposals.

In addition to the request for a Preaward Survey SF 1403, there are forms for technical SF 1404, production SF 1405, quality assurance SF 1406, financial capability SF 1407, and accounting system SF 1408. The additional parts of the form go into substantial detail in their individual area of coverage, and are used by members of the survey team as a guide in the conduct of the investigation and reporting findings to the Preaward Survey Review Board.

**Scope of Survey.** Generally, the purchasing office will request a preaward survey in the detail commensurate with the dollar value and complexity of the proposed procurement. In the absence of specific instructions from the purchasing office, the scope of the survey will be determined by the CAO. Seven working days, after receipt of the request, are allowed for conducting the survey and submitting the report.

The following is a list of factors included in Section III. Factors requiring emphasis, but not included in this list should be identified under "other":

- . technical capability
- . production capability
- . quality assurance capability
- . financial capability
- . accounting system
- . government property control
- . transportation
- . packaging
- . security
- . plant safety
- . environmental/energy considerations

Purchasing offices will forward the request for preaward survey to the cognizant CAO.

Unless previously furnished, a copy of the solicitation and such drawings and specifications as deemed necessary by the purchasing office, are supplied with the preaward survey request. The purchasing office will also forward any information indicating previous unsatisfactory performance.

Data obtained from a preaward survey for the purpose of determining the responsibility of a prospective contractor will not be released outside the government and shall not be made available for inspection by individuals, firms, or trade organizations. Such data may be disclosed to, or summarized for, other elements within the government on their request. Prior to making a determination of responsibility, such data may be discussed with the appropriate contractor as determined necessary by the purchasing office. After an award has been made, the contracting office or the head of the CAO, or the designee, may discuss the preaward survey results with the contractor surveyed, if that contractor was an unsuccessful offeror.

## **Performing Preaward Surveys**

**Describe the procedures for performing preaward surveys and preparing and reviewing the survey report.**

Preaward surveys are conducted by the CAO within the normal time frame of seven working days after receipt of request. If the survey cannot be accomplished within the time allowed, the purchasing office is so notified. If the date is not extended, the CAO will supply a definite recommendation to the PCO by the date required, based on the material at hand or developed by that time. The basis for the recommendation and the factors for which no data or only partial data could be obtained, are indicated. The accomplishment of a preaward requires many individual's involvement in investigating many aspects of contractor capabilities; therefore, it is a team effort. The primary responsibility of performing the preaward survey normally lies with the industrial specialist familiar with the contractor's operations, procedures, policy, and facilities. To tie together the survey effort, certain designations of authority, responsibility, and prescribed flow of documents have been established. Some of these are discussed in the following paragraphs.

**Preaward Survey Monitor.** An individual within each CAO is designated as the preaward survey monitor. The monitor administers the preaward survey from the receipt of the request through the issuance of the final report.

The monitor shall:

- a. Receive all incoming preaward survey requests.
- b. Ascertain whether the prospective contractor is included on the Consolidated List of Debarred, Suspended, and Ineligible Contractors. If the prospective contractor is so listed, the purchasing office is promptly advised; and the preaward survey will not be completed unless specifically requested by the purchasing office.
- c. Compare the survey request with the requirements of the solicitation.
- d. Determine the need for an on-site survey after reviewing the type and quantity of items or services involved in previous experience with the firm, technical and schedule requirements, and the extent of other information currently available.

e. Advise the organizational segments of the CAO (Production, Quality Assurance, and Contract Administration) that will furnish team members and coordinate the appointment of the PAS Team Leader.

f. Provide information and guidance to team members.

g. Arrange for required audit and other external assistance.

h. Coordinate any purchasing office participation in the preaward survey.

i. Receive and review reports of the individual team members for completeness and adequate substantiation.

j. Resolve questions regarding technical details with responsible specialists.

k. Assemble all necessary survey data into a report and forward the report to the requesting agency if the recommendation is positive. If any team member recommends a negative report the Preaward Survey Monitor will convene a review board.

**Preaward Survey Review Board.** A Preaward Review Board is formally established to review negative aspects of survey reports prior to transmittal to the purchasing office. The Board is normally chaired as stated by Department Directives and is usually chaired by the Chief of the production or Chief of the Contract Management Elements. The board is composed of senior specialists from each of the major organizational segments of the contract administration office normally concerned with preaward surveys. These include representatives from or chief of Contract Management, Small Business, quality, pricing, Production/Engineering and the ACO elements.

**Preparation and Review of Report.** When the required information has been gathered, each specialist analyzes it and evaluates the prospective contractor's capability to perform with respect to the functional elements investigated. Each participant then provides his findings to the monitor on his appropriate standard form format. Where a negative reply is recorded, or where doubt exists, an explanation must substantiate the entry. If a detailed analysis is needed or additional significant information is pertinent, the form is then supplemented by a narrative report.

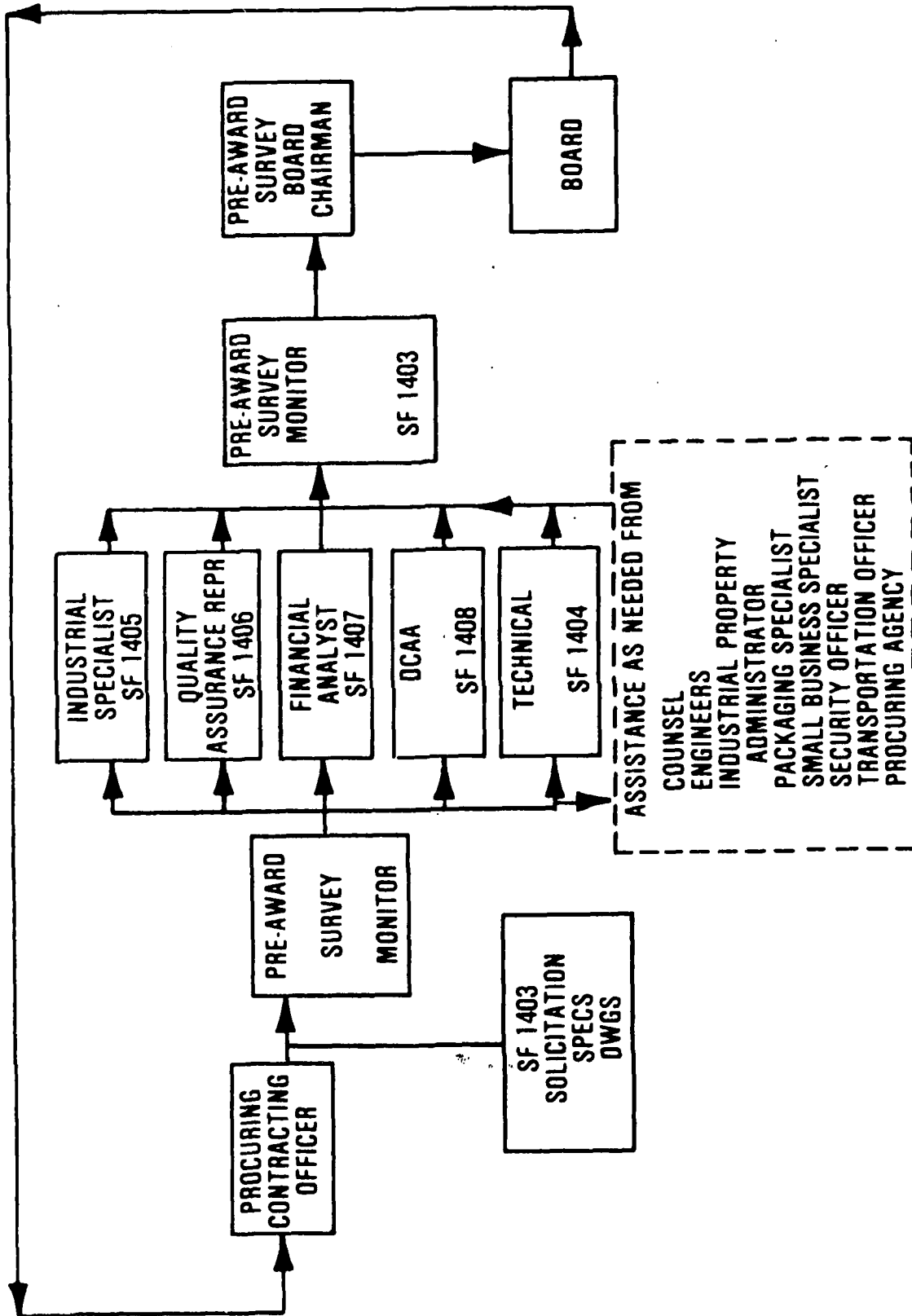
Based on all the information received from the team members, the monitor thoroughly evaluates the findings and recommendations concerning award. The monitor insures a recommendation for partial or no award is supported by a statement of justification. Where the prospective contractor is a small business concern, the monitor coordinates with the small business specialist at the CAO.

The fact that a prospective contractor is known to be a sole source should not influence the findings and recommendations of the individuals preparing the report. Realistic reporting alerts

purchasing offices to seek alternate sources early when conditions warrant such action. When the Review Board overrides the recommendation of the team, the justification supporting the reversal is then forwarded as part of the report to the purchasing office. Following the action by the board, the monitor forwards the report directly to the purchasing office. The decision to award or not award is then up to the PCO.



# CONTRACTOR EVALUATION A PRE-AWARD SURVEY



**9.106 Preaward surveys.****9.106-1 Conditions for preaward surveys.**

(a) A preaward survey is normally required when the information on hand or readily available to the contracting officer is not sufficient to make a determination regarding responsibility. However, if the contemplated contract (1) will be for \$25,000 or less or (2) will have a fixed price of less than \$100,000 and will involve commercial products (see 11.001) only, the contracting officer should *not* request a preaward survey unless circumstances justify its cost.

(b) When a cognizant contract administration office becomes aware of a prospective award to a contractor about which unfavorable information exists and no preaward survey has been requested, it shall promptly obtain and transmit details to the contracting officer.

(c) Before beginning a preaward survey, the surveying activity shall ascertain whether the prospective contractor is debarred, suspended, or ineligible (see Subpart 9.4). If the prospective contractor is debarred, suspended, or ineligible, the surveying activity shall advise the contracting officer promptly and not proceed with the preaward survey unless specifically requested to do so by the contracting officer.

**9.106-2 Requests for preaward surveys.**

The contracting officer's request to the surveying activity (Preaward Survey of Prospective Contractor (General), SF 1403) shall—

(a) Identify additional factors about which information is needed;

(b) Include the complete solicitation package (unless it has previously been furnished), and any information indicating prior unsatisfactory performance by the prospective contractor;

(c) State whether the contracting office will participate in the survey;

(d) Specify the date by which the report is required. This date should be consistent with the scope of the survey requested and normally shall allow at least 7 working days to conduct the survey; and

## 9.106-3

(e) When appropriate, limit the scope of the survey.

**9.106-3 Interagency preaward surveys.**

When the contracting office and the surveying activity are in different agencies, the procedures of this section 9.106 and Subpart 42.1 shall be followed along with the regulations of the agency in which the surveying activity is located, except that reasonable special requests by the contracting office shall be accommodated.

**9.106-4 Reports.**

(a) The surveying activity shall complete the applicable parts of SF 1403, Preaward Survey of Prospective Contractor (General); SF 1404, Preaward Survey of Prospective Contractor—Technical; SF 1405, Preaward Survey of Prospective Contractor—Production; SF 1406, Preaward Survey of Prospective Contractor—Quality Assurance; SF 1407, Preaward Survey of Prospective Contractor—Financial Capability; and SF 1408, Preaward Survey of Prospective Contractor—Accounting System; and provide a narrative discussion sufficient to support both the evaluation ratings and the recommendations.

(b) When the contractor surveyed is a small business that has received preferential treatment on an ongoing contract under Section 8(a) of the Small Business Act (15 U.S.C. 637) or has received a Certificate of Competency during the last 12 months, the surveying activity shall consult the appropriate Small Business Administration field office before making an affirmative recommendation regarding the contractor's responsibility or nonresponsibility.

(c) When a preaward survey discloses previous unsatisfactory performance, the surveying activity shall specify the extent to which the prospective contractor plans, or has taken, corrective action. Lack of evidence that past failure to meet contractual requirements was the prospective contractor's fault does not necessarily indicate satisfactory performance. The narrative shall report any persistent pattern of need for costly and burdensome Government assistance (e.g., engineering, inspection, or testing) provided in the Government's interest but not contractually required.

(d) When the surveying activity possesses information that supports a recommendation of complete award without an on-site survey and no special areas for investigation have been requested, the surveying activity may provide a short-form preaward survey report. The short-form report shall consist solely of the Preaward Survey of Prospective Contractor (General), SF 1403. Sections III and IV of this form shall be completed and block 21 shall be checked to show that the report is a short-form preaward report.

**PART 9--CONTRACTOR QUALIFICATIONS**  
**SUBPART 9.1--RESPONSIBLE PROSPECTIVE CONTRACTORS**

**9.103 Policy.****(70) Acquisition from Concerns in Qualifying Countries.**

(1) Awards to concerns in qualifying countries are subject to this subpart and other sections of this Supplement concerning NATO participating country sources.

(2) A Canadian firm proposed by the Canadian Commercial Corporation (CCC) as its subcontractor generally shall be accepted by the contracting officer under the provisions of FAR 9.104-4 as the basis for his determination under FAR 9.103.

**9.104 Standards.****9.104-3 Application of Standards.****(c) Satisfactory Performance Record.**

(c)(2) Quality is a significant consideration in determining satisfactory performance. Quality defects of a critical or repetitive nature without adequate and timely corrective action, including repair or replacement of items, shall also be presumptive of inability to meet this requirement. DoD components shall assure that contracts are not awarded to contractors with a history of providing supplies or services of an unsatisfactory quality.

(70) In cases where the firm proposed by CCC is so accepted, pre-award survey forms need not be completed. When the CCC proposal is not consistent with other information which may be available to the contracting officer, the contracting officer shall request from CCC and any other sources whatever additional information or plant surveys the contracting officer may deem necessary to make the determination of responsibility of sources proposed by CCC. Such additional data may be requested on the preaward survey forms or on any other forms. Upon request, CCC shall be furnished an explanation of the reasons for rejection of its proposed firm.

**9.105 Procedures.****9.105-70 Current Information.**

(a) Maximum practicable use shall be made of currently valid information on file or within the knowledge of personnel in the Department of Defense. Each Department, shall at such level and manner as it deems appropriate, maintain useful records and experience data for the guidance of contracting officers in the placement of new procurement, and shall inform its contracting officers and the other Departments of the means of access thereto. Notwithstanding this direction contract administration offices shall maintain files of

information reflecting upon the ability of contractors to perform Government contracts successfully.

(b) Any contracting office becoming aware of circumstances which, for any reason, casts doubt upon the ability of a contractor to perform contracts successfully, shall immediately advise the cognizant contract administration office. A contract administration office, upon being notified by a contracting office of unfavorable information affecting a contractor under its cognizance, or upon developing unfavorable information during the course of contract administration activities, shall advise the contracting offices of the other Departments. When a contract administration office is requested to perform a preaward survey and it has been notified of the existence of unfavorable information relative to the contractor, it shall obtain the details including full supporting information. Careful and full consideration shall be given such information.

(c) For preaward survey assistance for contracts requiring performance of Contract Administration Services (CAS) on military installations, see 42.270.

#### **9.106 Preaward Surveys.**

##### **9.106-2 Requests for Preaward Surveys.**

(70) Procedure for Requesting Preaward Survey.

(1) Preaward surveys will be accomplished by the cognizant Contract Administration Office as listed in DoD Directory of Contract Administration Services Components, DoD 4105.59-H. The contracting officer shall request a preaward survey on Standard Form (SF) 1403, Preaward Survey of Prospective Contractor (General), indicating in Section III thereof, the scope of the survey desired. An original and 3 copies of the SF 1403 requesting a preaward survey will be provided along with a copy of the solicitation and such drawings and specifications as deemed necessary by the purchasing office.

(2) Factors requiring emphasis not enumerated in Section III should be listed by the contracting officer under item "G" of that Section and explained in block 23, Remarks.

(3) The "Walsh-Healey Public Contracts Act" block of Section I is for information purposes only. If information is needed on the offeror's eligibility under the Walsh-Healey Act, it must be specifically requested in block "G" of Section III and explained in block 23, Remarks.

(4) A survey may be requested by telegraphic communication containing the data required by Sections I, II, and III of the form. A survey may be requested by telephone but shall be immediately confirmed by transmittal of completed SF 1403.

(5) The SF 1403 lists five major factors and seven other factors to be evaluated. One or more of these factors can be checked

depending on the contracting officer's concerns regarding the offeror's responsibility. Following is a brief explanation of the factors:

SECTION III, Block 19, MAJOR FACTORS

FACTOR A - Technical Capability - An assessment of the prospective contractor's key management personnel to determine if they have the basic technical knowledge, experience, and understanding of the requirements necessary to produce the required product or provide the required service.

FACTOR B - Production Capability - An evaluation of the prospective contractor's ability to plan, control, and integrate manpower, facilities, and other resources necessary for successful contract completion. This includes (1) an assessment of the prospective contractor's possession of, or the ability to acquire, the necessary facilities, material, equipment and labor; (2) a determination that the prospective contractor's system provides for timely placement of orders and for vendor follow-up and control.

FACTOR C - Quality Assurance Capability - An assessment of the prospective contractor's capability to comply with the quality assurance requirements of the proposed contract. It may involve an evaluation of the prospective contractor's quality assurance system, personnel, facilities and equipment.

FACTOR D - Financial Capability - A determination that the prospective contractor has adequate financial resources, or access to them, to acquire needed facilities, equipment, materials, etc.

FACTOR E - Accounting System - An assessment by the Defense Contract Audit Agency (DCAA) of the adequacy of the prospective contractor's accounting system. Normally, an accounting system review will be requested when conditions such as progress payment, or a cost or incentive type contract is contemplated.

SECTION III, Block 20, OTHER FACTORS

FACTOR A - Government Property Control - An assessment of the prospective contractor's capability to manage and control Government property.

FACTOR B - Transportation - An assessment of the prospective contractor's capability to comply with the laws and regulations applicable to the movement of Government material, or overweight, oversized, hazardous cargo, etc.

FACTOR C - Packaging - An assessment of the prospective contractor's ability to meet all contractual packaging requirements including preservation, unit pack, packing, marking and unitizing for shipment.

FACTOR D - Security Clearance - A determination that the prospective contractor's facility security clearance is adequate and current. (When checked, this factor will be referred to the Defense Investigation Service (DIS) by the surveying activity.)

FACTOR E - Plant Safety - An assessment of the prospective contractor's ability to comply with safety requirements specified in the solicitation.

FACTOR F - Environmental/Energy Considerations - An evaluation of the prospective contractor's ability to meet specific environmental/energy requirements contained in the solicitation.

FACTOR G - Other - This factor is checked when an assessment of other than Major Factors A-E and Other Factors A-F is desired. When Factor G is checked, the desired information will be explained in the Remarks sections. An example of an item that may be included under this factor is Walsh-Healey eligibility.

(6) Factors checked on the SF 1403 will be limited to those essential to the contracting officer's determination of responsibility.

(7) Block 10 of the SF 1403 will show the date preaward survey results are required by the purchasing office. This date will be determined by the contracting officer after due consideration of the urgency of the acquisition, and the scope and complexity of the preaward survey. In particular, consideration must be given to the more time-consuming aspects of a preaward survey such as secondary survey requirements, accounting system review, financial capability analysis, and purchasing office participation in the survey. Routine preaward surveys, with established DoD contractors, are normally accomplished by the Contract Administration Office within 7 workdays after receipt of the request. Preaward survey requests for particularly complex items, or those involving aspects as mentioned above, will usually require more time and should be allowed for by the contracting officer.

**9.106-70 Steps for Survey Performance.** The three steps in performing a preaward survey are the preliminary analysis, the development and evaluation of information, and the preparation and review of the survey report.

(a) Preliminary Analysis. The request (SF 1403, Sections I, II, and III) shall be reviewed to establish basic administrative

information and the factors to be evaluated. The solicitation shall then be reviewed to ascertain those general and special requirements which have a significant bearing on determining contractor responsibility. Examples are the nature of the product, applicable specifications, delivery schedule, documentation requirements, property control requirements, and financing aspects.

(b) Development of Information.

(1) Review of Available Data. The information already available in the contract administration office pertaining to the prospective contractor and his past performance shall be reviewed. Prior preaward survey reports shall be examined and considered in support of preaward survey recommendations. If the prospective contractor has current or contemplated Government contracts, the files should be checked for information regarding similarity of product, current status of contracts, quality control experience, and financial status.

(2) Development of Additional Data.

(i) When appropriate, the contract administration office shall supplement the data on hand with any additional information required from other Government sources and from commercial sources, such as banks, business associates, and credit rating and reporting agencies.

(ii) When a prospective contractor proposes to acquire additional resources essential to performance of the proposed contract, the CAO shall as a minimum obtain and evaluate:

(A) an itemized list of the required resources;

(B) a planned method of acquisition; and

(C) a schedule for acquisition of resources.

Failure to meet commitments on previous contracts shall be documented in the current preaward survey report and considered in the final recommendation.

(c) On-Site Surveys.

(1) Interview, Evaluation, and Review.

(i) General. An on-site survey will consist of an interview with representatives of the prospective contractor and, normally, an evaluation of his resources and procedures.

(ii) Interview with Management. Management officials of the appropriate level authorized to represent the prospective contractor should be interviewed. The prospective contractor's background shall be reviewed and as much history recorded as necessary to reflect the soundness and reputation of the firm's operation.

(A) The organizational structure of the facility is the basis for management's control and must be reviewed. Assignment of definite tasks and responsibilities should be checked.

(B) Lack of understanding or misinterpretation of the solicitation often results in delinquent contracts and leads to default actions. Therefore, the solicitation shall be discussed with prospective contractors to assure that they understand its



requirements, including its technical aspects such as drawings, specifications, prototype, technical data and provisioning technical documentation (including automated data processing requirements when appropriate), testing, packaging, and Government's right to use technical data in accordance with the terms of the solicitation. Any misinterpretations of the requirements of the solicitation which could adversely affect performance, or refusal by the prospective contractor to furnish required data, should be brought to the immediate attention of the official approving the survey by the team coordinator. The official approving the survey shall, in turn, promptly advise the purchasing office.

(iii) Evaluation of Resources and Review of Procedures. The resources which the prospective contractor intends to utilize shall be inspected, analyzed, and compared with his overall plans for performing. His procedures relating to performance of the proposed contract shall be reviewed for adequacy.

(iv) Specific Factors to be Considered. In the course of developing information, those factors described in 9.106-70(c)(2) through 9.106-70(c)(4) below and all others needed to provide the report and recommendations in the detail and to the extent required by the purchasing office shall be considered.

(2) Production.

(i) General. The production portion of the on-site survey consists of an evaluation of the prospective contractor's ability to manufacture the product(s) in accordance with the specifications and delivery schedule of the proposed contract. To achieve the objectives of this portion of the on-site survey, the production plan shall be reviewed, production resources ascertained, and the plan related to such resources.

(ii) Obtaining the Production Plan. The prospective contractor's production plan for meeting the delivery schedule specified in the proposed contract shall be ascertained. The principal milestones within the production plan shall be established, along with target dates for achievement. These target dates must support the delivery schedule of the proposed contract. The controls which will be utilized in order to gear and hold the manufacturing effort to the target dates for the principal milestones shall be analyzed for suitability.

(iii) Ascertaining Production Resources. The information necessary to prepare SF 1405 shall be obtained by discussion with appropriate management personnel of the prospective contractor. This information shall be verified, when necessary, by physical inspection of the manufacturing plant and evaluated in terms of suitability to manufacture the required item(s).

(iv) Relating Production Plans to Production Resources. When necessary, representatives of the prospective contractor shall be

requested to advise how the production resources will be allocated and utilized in order to achieve the target dates for the principal milestones. This shall include both in-house and subcontractor production resources. Pertinent to this is an analysis of projects and contracts which will compete for utilization of those resources within the same time frame as that specified by the prospective contractor's production plan. The information developed as a result of equating the production plan and production resources of the prospective contractor should enable the contract administration office to:

- (A) conclude whether the resources which the prospective contractor is planning to use are suitable for the job;
- (B) determine whether the prospective contractor will be capable of properly controlling, maintaining, protecting and using Government property;
- (C) determine whether the planning and scheduling of effort will result in timely accomplishment of the principal milestones;
- (D) conclude whether achievement of the principal milestones will result in timely delivery.

(3) Quality Assurance (SF 1406).

(i) The standing of the quality assurance organization in the prospective contractor's overall organization must be evaluated. An inspection or quality control function which reports to some other organizational segment (such as Production) instead of top management may be undesirable. The experience of the company inspection or quality control personnel with the same or similar items shall be evaluated.

(ii) To evaluate the prospective contractor's ability to comply with quality control or inspection requirements, the following areas shall be reviewed:

- (A) methods currently utilized to control product quality as reflected by a documented or verifiable inspection system or quality program plan;
- (B) personnel on hand and available (report both trained and untrained);
- (C) inspection and test equipment on hand and available;
- (D) quality, identification, and storage of materials;
- (E) physical arrangement of plant;
- (F) tool and gauge control; and
- (G) test and inspection records.

(4) Financial (SF 1407).

(i) General. The normal procedure for determining a prospective contractor's financial capability shall be initial presurvey planning, followed by verification of financial data as required. The extent of the review and analysis of financial matters shall be governed by the nature of the proposed contract. In certain instances, a sound

decision may be possible after a relatively simple review of a company's financial position and production commitments. Under other circumstances, a more comprehensive review and analysis will be required. The approach to financial analysis shall be consistent with the basic policies and regulations outlines in FAR 32.172, 32.173 and 32.174.

(ii) Procedure. Aspects to be considered in determining the prospective contractor's financial capability include the following:

(A) The latest balance sheet and profit and loss statement shall be reviewed. The following are indicative of the soundness of the prospective contractor's financial structure:

1. rates and ratios;
2. working capital as represented by current assets over current liabilities; and
3. financial trends such as net worth, sales and profit.

(B) The method of financing the contract shall be evaluated. Where sources of outside financing, other than the Government, are indicated, their availability should be verified.

(C) When financial aid from the Government is to be obtained, the necessity should be verified. Review shall be made concerning the applicability of such financing as progress payments or guaranteed loans.

(d) Evaluating Data and Preparing the Report.

(1) Findings of Team Members. When the required information has been gathered, each individual participant shall analyze it and evaluate the prospective contractor's capability to perform with respect to the functional element(s) evaluated. Each participant shall then provide his findings to the official approving the survey. When a negative reply is recorded, or when doubt exists, an explanation must substantiate such action. If a detailed analysis is needed or additional significant information is pertinent, a narrative report shall be supplied.

(2) Evaluation and Recommendation. Based on all the information received from the team members, the official approving the survey shall thoroughly review and evaluate the findings and recommendations, and forward the report direct to the purchasing office. When advance reports are made by telegraphic communication or telephone, they shall be confirmed by mail without delay. The official approving the survey shall follow up on any requirements for the submission of supplemental reports.

#### **9.106-71 Audit Responsibilities for Preaward Surveys and Reviews.**

Preaward surveys of potential contractors' competence to perform proposed contracts shall be managed and conducted by the contract administration office. When information is required on the adequacy of the contractor's accounting system or its suitability for

administration of the proposed type of contract, such information shall always be obtained by the ACO from the auditor. The contract administration office shall be responsible for advising the contracting officer on matters concerning the contractor's financial competence or credit needs.

(d) Maximum benefits will be realized when orientation is conducted promptly after award.

**42.502 Selecting contracts for postaward orientation.**

When deciding whether postaward orientation is necessary and, if so, what form it shall take, the contracting officer shall consider, as a minimum, the—

- (a) Nature and extent of the preaward survey and any other prior discussions with the contractor;
- (b) Type, value, and complexity of the contract;
- (c) Complexity and acquisition history of the product or service;
- (d) Requirements for spare parts and related equipment;
- (e) Urgency of the delivery schedule and relationship of the product or service to critical programs;
- (f) Length of the planned production cycle;
- (g) Extent of subcontracting;
- (h) Contractor's performance history and experience with the product or service;
- (i) Contractor's status, if any, as a small business or small disadvantaged business concern;
- (j) Contractor's performance history with small business and small disadvantaged business subcontracting programs;
- (k) Safety precautions required for hazardous materials or operations; and
- (l) Complex financing arrangements, such as progress payments, advance payments, or guaranteed loans.

**42.503 Postaward conferences.**

**42.503-1 Postaward conference arrangements.**

(a) The contracting officer who decides that a conference is needed is responsible for—

- (1) Establishing the time and place of the conference;
- (2) Preparing the agenda, when necessary;
- (3) Notifying appropriate Government representatives (e.g., contracting/contract administration office) and the contractor;
- (4) Designating or acting as the chairperson;
- (5) Conducting a preliminary meeting of Government personnel; and
- (6) Preparing a summary report of the conference.

(b) When the contracting office initiates a conference, the arrangements may be made by that office or, at its request, by the contract administration office.

**42.503-2 Postaward conference procedure.**

The chairperson of the conference shall conduct the meeting. Unless a contract change is contemplated, the chairperson shall emphasize that it is not the purpose of the meeting to change the contract. The contracting officer may make commitments or give directions within the scope of the contracting officer's authority and shall put in writing and sign any commitment or direction, whether or not it changes the contract. Any change to the contract that results from the postaward conference shall be made only by a contract modifica-

**SUBPART 42.5—POSTAWARD ORIENTATION**

**42.500 Scope of subpart.**

This subpart prescribes policies and procedures for the postaward orientation of contractors and subcontractors through (a) a conference or (b) a letter or other form of written communication.

**42.501 General.**

(a) A postaward orientation aids both Government and contractor personnel to (1) achieve a clear and mutual understanding of all contract requirements and (2) identify and resolve potential problems. However, it is not a substitute for the contractor's fully understanding the work requirements at the time offers are submitted, nor is it to be used to alter the final agreement arrived at in any negotiations leading to contract award.

(b) Postaward orientation is encouraged to assist small business and small disadvantaged business concerns (see Part 19).

(c) While cognizant Government or contractor personnel may request the contracting officer to arrange for orientation, it is up to the contracting officer to decide whether a postaward orientation in any form is necessary.

tion (see 42.503-2) referencing the applicable terms of the contract. Participants without authority to bind the Government shall not take action that in any way alters the contract. The chairperson shall include in the summary report (see 42.503-3 below) all information and guidance provided to the contractor.

**42.503-3 Postaward conference report.**

The chairperson shall prepare and sign a report of the postaward conference. The report shall cover all items discussed, including areas requiring resolution, controversial matters, the names of the participants assigned responsibility for further actions, and the due dates for the actions. The chairperson shall furnish copies of the report to the contracting office, the contract administration office, the contractor, and others who require the information.

**42.504 Postaward letters.**

In some circumstances, a letter or other written form of communication to the contractor may be adequate postaward orientation (in lieu of a conference). The letter should identify the Government representative responsible for administering the contract and cite any unusual or significant contract requirements. The rules on changes to the contract in 42.503-2 also apply here.

**42.505 Postaward subcontractor conferences.**

(a) The prime contractor is generally responsible for conducting postaward conferences with subcontractors. However, the prime contractor may invite Government representatives to a conference with subcontractors, or the Government may request that the prime contractor initiate a conference with subcontractors. The prime contractor should ensure that representatives from involved contract administration offices are invited.

(b) Government representatives (1) must recognize the lack of privity of contract between the Government and subcontractors, (2) shall not take action that is inconsistent with or alters subcontracts, and (3) shall ensure that any changes in direction or commitment affecting the prime contract or contractor resulting from a subcontractor conference are made by written direction of the contracting officer to the prime contractor in the same manner as described in 42.503-2.

**PART 42--CONTRACT ADMINISTRATION  
SUBPART 42.5--POSTAWARD ORIENTATION**

**42.501 General.**

The need for a postaward orientation conference normally will be established as a result of substantive review and analysis of the contract by the Contract Administration Office. However, the contracting officer or technical representative of the purchasing office may initiate the request for a conference. A conference of Government personnel normally shall be held prior to notifying and conferring with the contractor to assure that the Government position on all matters is established.

**42.503-1 Postaward Conference Arrangements.**

(a)(2) The agenda of the postaward conference may include such matters as are indicated on DD Form 1484.

**42.503-2 Postaward Conference Procedure.**

The chairperson shall use the DD Form 1484 in conducting the conference to assure that all significant matters are covered.

**42.503-3 Postaward Conference Report.**

The chairperson may use the DD Form 1484 as the summary report where appropriate.

## PRODUCTION

Once a contract is awarded, the contractor is responsible for timely delivery. The government, however, will maintain surveillance of contractor performance as necessary to protect its interests. This chapter discusses three separate but interrelated topics: production surveillance; the priorities and allocations system and the role of the industrial specialist.

### Production Surveillance

It is the policy of the DOD that the Government perform production monitoring functions necessary to provide the production or performance information required to protect the interests of the government. As used in this chapter, criticality and delinquency have the following meanings. Criticality refers to the degree of importance to the Government of supplies or services under contract. Delinquency includes actual failure by the contractor, regardless of reason, to meet the contract delivery or performance schedule; and potential failure by the contractor, regardless of reason, to maintain such progress in contract performance as is required to meet his contract delivery or performance schedule. This will also include those items beyond contractor's control such as, excusable delays. Timely delivery or performance ordinarily requires realistic planning and action on the part of the purchasing office, the contractor and the contract administration office. The functions of the purchasing office and the CAO are complementary and are discussed below.

The purchasing office after considering the governments essential schedule requirements, establishes the delivery/performance schedule with the contractor and formalizes this agreement as part of the contract.

The Uniform Contract Format, required by the FAR specifies that delivery/performance information be in section F of the contract. Further, after assessing such factors as the complexity of the task and the seriousness of any impact of contractor failure/delay, on the government, the purchasing office assigns a Criticality Designator which is used by CAO when determining the level of surveillance to be provided.

Criticality Designator's (CD) are codified as A, B or C and conditionally annotated on the face page of the contract. Specifically, a CD of A is reserved for the most critical requirements. If the assignment is one of higher criticality, they must annotate the face page of the contract with the appropriate CD, an "A" or "B." If the Criticality Designator is "C", the contract is not annotated.

**CAO Priority.** Current guidance requires contracts with criticality designator A or B to be assigned to



production surveillance category 1 or 2. Contracts with criticality designator C will be assigned category 2 or 3.

Table 1 depicts this decision scheme as well as the general translation from buying activity to CAO priority. Within these guidelines the final decision is normally a CAO production element function. Factors considered while making this decision include:

- . type of contract.
- . the production processes.
- . contractor production plan.
- . personnel resources of the CAO.
- . contract performance schedule.
- . contractor production plan.
- . provisions for contractor performance and progress reports.

#### **Production Surveillance Categories.**

**Category 1.** Contracts are normally limited to those requiring continued on-site assessment and will be surveilled by an Engineer or Industrial Specialist (IS). Although the complexity of the items under contract, as well as other factors, have a direct bearing on the actual conduct of surveillance, there are basic techniques which are followed to assure the required objectives are met. First the contract, and the contractor's performance history, are reviewed; second, an initial visit to determine the contractor's plan for production or performance; third and last, a surveillance plan is developed and executed.

**Category 2.** This category is normally accomplished by Production Control Clerks (PCC) with technical assistance by the Industrial Specialist (IS) or engineer, as required. The degree to which the IS, PCC and engineer teamwork is required is a function of several factors including: contract characteristics, contractor capability and past performance, and the experience, expertise and judgment of CAO Production Management Personnel. The PCC is required to provide telephonic or mailed status inquiries or a reminder notice prior to scheduled delivery. The contracts assigned to this production surveillance category will not have milestones or pacing events; therefore, the establishment of a suspense date will be the extent of surveillance planning. If and when the PCC experiences problems with contractor responsiveness or the reliability of contractor furnished information, details are provided to the IS/engineer for further action.

**Category 3.** This category of surveillance is conducted on the "exception" basis. Specifically, the PCC takes action only if requested to expedite or when the contract is already delinquent. Under these exceptional circumstances, Category 3 Surveillance is afforded Category 2 treatment.

TABLE 1 .

PRODUCTION SURVEILLANCE LEVELS

CRITICALITY DESIGNATOR	PRODUCTION SURVEILLANCE CATEGORY
(Assigned by Procuring Contracting Office)	(Assigned by Contract Administration Office)
<p>A</p> <ul style="list-style-type: none"> <li>• Defense Priority System rating of DX</li> <li>• DOD or service directed critical program</li> <li>• Public Exigency (emergency contracts)</li> </ul>	<p><u>Industrial Specialist/Engineer</u></p> <ul style="list-style-type: none"> <li>• Contract with production or performance lead time of several months <u>and</u> identifiable milestones <u>and is</u></li> <li>• CD "A" contract <u>or is</u> with</li> <li>• Contractor with history of poor production performance in general or on the item purchased</li> </ul> <p>1</p>
<p>B</p> <ul style="list-style-type: none"> <li>• Contracts for items needed to maintain a Government or Contractor production or repair line</li> </ul>	<p><u>Clerk/Industrial Specialist</u></p> <ul style="list-style-type: none"> <li>• CD "A" contracts not Cat 1</li> <li>• All CD "B" contracts</li> <li>• CD "C" contracts with poor performers</li> </ul> <p>Clerk evaluates contractor supplied information and makes <u>advance reminder</u> to contractor by telephone or letter</p> <p>2</p>
<p>C</p> <ul style="list-style-type: none"> <li>• All other contracts</li> </ul>	<p><u>Clerk or Equivalent</u></p> <ul style="list-style-type: none"> <li>• All other CD "C" contracts</li> </ul> <p>Clerk expedites delivery <u>after</u> delinquency with Industrial Specialist Assistance</p> <p>3</p>

**Reporting.** Production progress reports may be required by contract; in those cases, the contractor's reports are routed through the production element for comment enroute to the contracting officer(s). In addition the CAO should originate reports upon the detection of anticipated or actual delinquency.

The form, whether a preprinted form, letter, or message is directed by the departmental regulations and procedures. The content of the report(s) should contain a concise summary of the discrepancy, actions taken by the IS/Engineer and contractor to mitigate the impact and recommended action. Such reports are provided through channels to the cognizant ACO who determines what action is to be taken, such as, ACO letter to the contractor, or notification of the PCO. Follow-up action is taken/monitored by the IS/Engineer until the contract requirements are fulfilled.

### **Defense Priority and Allocation System (DPAS)**

The Defense Priority and Allocation System (DPAS) has the Defense Production Act of 1950 as its statutory origin. The current DPAS is the latest revision of a regulatory system that has been in existence for over 30 years and was previously known by the acronyms DMS (Defense Material System) and (DPS) Defense Priority System. The DPAS, like its predecessor, ensures preferential treatment to certain government contracts in markets with scarce resources that are essential to support national defense initiatives. The Federal Emergency Management Agency specifies which defense programs are authorized the highest degree of preference after which the Department of Commerce Administers the DPAS. The two areas covered by DPAS are priority rated orders and controlled materials. Each is discussed below.

**Priority Ratings and Rated Orders.** Rated orders are identified by a priority rating consisting of the rating DX or DO and a program identification symbol. Rated orders take preference over all unrated orders as necessary to meet required delivery dates.

Among rated orders, delivery on DX rated orders take preference over DO rated orders. Program identification symbols indicate which authorized program is involved with the rated

order. For example, A1 identifies defense aircraft programs and A7 signifies defense electronic programs. The program identification symbols do not connote any priority.

Persons receiving rated orders must give preferential treatment as required by DPAS. This means a contractor must accept and fill a rated order for items that it normally supplies. The existence of previously accepted unrated or lower rated orders is not sufficient reason for rejecting a rated order. The contractor is required to reschedule unrated orders if it conflicts with performance against a rated order. Similarly, it must reschedule DO rated orders if it conflicts with performance against a DX rated order. In other words, All rated orders must be scheduled to the extent possible to ensure delivery by the required delivery date.

Contractors receiving rated orders must in turn place rated orders with suppliers for the items needed to fill the orders. This provision ensures that suppliers will give priority treatment to rated orders from contractor to subcontractors and suppliers throughout the procurement chain.

Contractors may place a priority rating on orders only when in receipt of a rated order, having been explicitly authorized to do so by the Department of Commerce or of a delegate agency, such as DOD.

**Controlled Materials.** Federal central management of certain key materials, designated "controlled materials", has been essential in the past to effective industrial mobilizations. Accordingly, special rules are maintained in peacetime to provide an operating mechanism that can be rapidly expanded during a national emergency to meet increased defense and other essential needs. Currently, the controlled materials are steel, copper, aluminum, and nickel alloys.

Under the controlled materials program, the Department of Commerce requires suppliers of controlled materials to accept rated orders up to a specified quantity of material during a given period of time. This quantity is called a "set-aside". This provision ensures that the material will be available when rated orders are placed. In addition, the system ensures that controlled materials producers are treated equitably, for after the set-aside quantity levels have been reached, controlled materials producers may generally reject additional rated orders. These orders would then be filled by other controlled materials producers who had not exhausted their set-aside requirement.

In time of national emergency, the level and scope of the controlled materials program may be greatly expanded to ensure the necessary allocation of materials and in order to direct general industrial activity toward supporting the requirements of the emergency. If items become scarce or critical and the requirements of the national defense cannot be met without creating a significant dislocation in the civilian market place so as to create appreciable hardship, special rules may be established under section 101(b) of the Defense Production Act to control the general distribution of such items in the civilian market.

**Special Priorities Assistance.** The DPAS is designed to be largely self-executing. However, from time to time production or delivery problems will arise. In this event, special priorities assistance is available from Commerce and from the delegate agencies. Special priorities assistance is available for any reason consistent with DPAS. Generally, special priorities assistance is provided to expedite deliveries, resolve delivery conflicts, place rated orders, locate suppliers, or to verify information supplied by customers and vendors. Special priorities assistance may also be used to request rating authority for items not automatically ratable.

**Official Actions.** When necessary, the Department of Commerce takes specific official actions to implement or enforce the provisions of DPAS and to provide special priorities assistance. Such actions may include the issuance of: rating authorizations, directives, letters of understanding, set-asides, and compliance documents such as administrative subpoenas, demands for information, and inspection authorizations.

**Compliance.** Compliance with the provisions of DPAS and official actions is required by the Defense Production Act. Violators are subject to criminal penalties. Contractors placing or receiving a rated order should be thoroughly familiar with, and must comply with, the provisions of DPAS.

#### **Role of the Industrial Specialist**

The industrial specialist's major responsibilities are to assist, advise, and make recommendations to the ACO and the buying organization regarding production aspects of assigned contracts and insure delivery of all items in the contract in a timely and economical manner.

The industrial specialist is expected to anticipate production problems and recommend preventive action to the ACO for correction or improvement. Identifying these deficiencies in a timely manner contributes to the prevention of difficulties that could delay deliveries.

The industrial specialists also perform in many other areas of the acquisition process by assisting the buying activity, the ACOs, and the contractor.

Familiarity with the other areas will help you recognize the relationship between the functions of the industrial specialist and those of the ACO. Generally the industrial specialist will:

a. Serve as team coordinator for preaward surveys and perform production surveys.

b. Monitor submission of and validity of contractor prepared monthly production progress reports.

c. Support buying agencies in the provisioning cycle and monitor the sequence of provisioning actions.

d. Evaluate engineering change proposals to determine impact on schedules.

e. Monitor and control the amended shipping instruction system.

f. Conduct studies to determine the production impact of strikes.

g. Obtain necessary concurrences, support, and approval when parts and materials must be removed from facilities affected by strike conditions.

h. Provide field surveillance and guidance to contractors in preparation of plans for operation during emergencies - Disaster Preparedness Planning.

i. Serve as Armed Services Procurement Planning Officer in coordinating Industrial Readiness Planning.

j. Perform liaison between the contractor and other agencies when required to assist the contractor in obtaining timely delivery of equipment or property to be furnished by the government.

k. Evaluate and validate the contractor's facilities expansion proposals and make recommendations to the cognizant PCO.

l. Review and substantiate the contractor's equipment modernization and replacement proposals under facilities contracts

m. Perform reporting requirements and monitor contractor's management of Government-owned plants and real estate.

n. Perform annual inspection of Departmental and National Industrial Reserve Plants.

o. Provide surveillance of active industrial plant equipment and perform utilization surveys of this equipment.

p. Insure that adequate procedures are established and maintained for the control of excessive generation of scrap in the contractor's plant for cost type contracts or terminations of contracts.

q. Evaluate plant clearance inventories for allowability, allocability, and reasonableness.

r. Perform technical evaluation of cost proposals for labor and material amounts and kinds.

s. Review contractor requests for progress payments for satisfactory progress.

(b) Contracts of values less than the small purchase threshold should not normally require production surveillance.

(c) In planning and conducting surveillance, contract administration offices shall make maximum use of any reliable contractor production control or data management systems.

(d) In performing surveillance, contract administration office personnel shall avoid any action that may (1) be inconsistent with any contract requirement or (2) result in claims of waivers, of changes, or of other contract modifications.

**42.1105 Assignment of criticality designator.**

Contracting officers shall assign a criticality designator to each contract in the space for designating the contract administration office, as follows:

**SUBPART 42.11—PRODUCTION SURVEILLANCE AND REPORTING**

**42.1101 General.**

Production surveillance is a function of contract administration used to determine contractor progress and to identify any factors that may delay performance. Production surveillance involves Government review and analysis of (a) contractor performance plans, schedules, controls, and industrial processes and (b) the contractor's actual performance under them.

**42.1102 Applicability.**

This subpart applies to all contracts for supplies or services other than facilities, construction contracts, and Federal Supply Schedule contracts.

**42.1103 Policy.**

The contractor is responsible for timely contract performance. The Government will maintain surveillance of contractor performance as necessary to protect its interests. When the contracting office retains a contract for administration, the contracting officer administering the contract shall determine the extent of surveillance.

**42.1104 Surveillance requirements.**

(a) The contract administration office determines the extent of production surveillance on the basis of (1) the criticality (degree of importance to the Government) assigned by the contracting officer (see 42.1105) to the supplies or services and (2) consideration of the following factors:

- (i) Contract requirements for reporting production progress and performance.
- (ii) The contract performance schedule.
- (iii) The contractor's production plan.
- (iv) The contractor's history of contract performance.
- (v) The contractor's experience with the contract supplies or services.
- (vi) The contractor's financial capability.
- (vii) Any supplementary written instructions from the contracting office.

*Criticality Designator*

*Criterion*

A	Critical contracts, including DX-rated contracts (see Subpart 12.3), contracts citing the authority in 6.302-2 (unusual and compelling urgency), and contracts for major systems.
B	Contracts (other than those designated "A") for items needed to maintain a Government or contractor production or repair line, to preclude out-of-stock conditions or to meet user needs for non-stock items.
C	All contracts other than those designated "A" or "B."

**42.1106 Reporting requirements.**

(a) When information on contract performance status is needed, contracting officers may require contractors to submit production progress reports (see 42.1107(a)). Reporting requirements shall be limited to that information essential to Government needs and shall take maximum advantage of data output generated by contractor management systems.

(b) Contract administration offices shall review and verify the accuracy of contractor reports and advise the contracting officer of any required action. The accuracy of contractor-prepared reports shall be verified either by a program of continuous surveillance of the contractor's report-preparation system or by individual review of each report.

(c) The contract administration office may at any time initiate a report to advise the contracting officer (and the inventory manager, if one is designated in the contract) of any potential or actual delay in performance. This advice shall (1) be in writing, (2) be provided in sufficient time for the contracting officer to take necessary action, and (3) provide a definite recommendation, if action is appropriate.

**42.1107 Contract clause.**

(a) The contracting officer shall insert the clause at 52.242-2, Production Progress Reports, in solicitations



and contracts when production progress reporting is required; unless a facilities contract, a construction contract, or a Federal Supply Schedule contract is contemplated.

(b) When the clause at 52.242-2 is used, the contracting officer shall specify appropriate reporting instructions in the Schedule (see 42.1106(a)).

**PART 42--CONTRACT ADMINISTRATION**  
**SUBPART 42.11--PRODUCTION SURVEILLANCE AND REPORTING**

**42.1101 General.**

Delinquency includes--

(a) actual failure by the contractor, that is, his failure, regardless of reason, to meet the contract delivery or performance schedule; and

(b) potential failure by the contractor, that is, his failure, regardless of reason, to maintain such progress in contract performance as is required to meet his contract delivery or performance schedule.

**42.1104 Surveillance Requirements.**

(a)(70) Initial Contract Review.

(i) The contract administration office shall, during initial contract review, assign contracts to production surveillance or review categories as follows:

(A) Category 1 is conducted by an industrial specialist or other person qualified to assess the contractor's plan for production and evaluate progress toward the successful accomplishment of that plan. This type of effort is adaptable to contracts which have a production/performance lead time of at least several months, and which entail identifiable milestone or pacing events against which progress may be measured. Contracts assigned this category should include those contracts which are of the complexity described under FAR 42.1104(a) and have a Criticality Designator A or are with a contractor which has either a history of generally poor production performance or a poor performance history on the same or similar supplies or services as those on the current contract.

(B) Category 2 is conducted by personnel qualified to assess information provided by the contractor in terms of delivery probability. They may be assisted by industrial specialists or other technically qualified personnel who will visit the production facility when there is probability of failure by the contractor to deliver or perform according to schedule, or when contractor-furnished information is questionable, or in other occasions when the assistance of technical personnel may contribute to the avoidance or minimizing of a delinquency. This category of surveillance entails, as a minimum, a written or telephonic reminder to the contractor in advance of the required delivery or performance date(s) including inquiry as to whether he will perform on schedule or as to the cause and duration of any anticipated delay, and periodic followup and expediting of supplies or services not delivered or performed on time. This category is adaptable to contracts which warrant surveillance effort by the Government in advance of the required due date. Any contract with a Criticality Designator A not assigned to Category 1 shall be assigned to Category 2. All Criticality Designator B contracts and those Criticality Designator C contracts placed with contractors

**DOD FAR SUPPLEMENT**

having a history of generally poor production performance also shall also be assigned to this category.

(C) Category 3 is conducted by the same personnel assigned Category 2 contracts. This category of surveillance entails inquiry and expediting effort after a failure to deliver or perform within the contract schedule has occurred, and periodic followup. It may involve assistance by technical personnel.

(ii) Regardless of assigned category, if a contract is reported by DD Form 375, Production Progress Report, as delinquent or anticipated to become delinquent, the surveillance efforts will provide continuous knowledge of the status of the problems causing the delinquency and of the corrective efforts being taken.

(iii) If Category 1 is assigned to a contract, the contract administration office shall also:

(A) review the contract in conjunction with any preaward survey (see FAR 9.1) to ascertain what contract performance difficulties may be expected.

(B) determine the extent of postaward orientation required in the production area (see FAR 42.5).

(C) determine any special procedures to be followed.

(b) The contract administration office shall determine, in accordance with FAR 42.1104(a), the extent of production surveillance required regardless of dollar value.

(d) After delinquency has occurred, and before the PCO has determined the action to be taken, it is particularly important that surveillance be limited to fact finding to avoid waiver of the contract delivery and performance schedules.

#### **42.1105 Assignment of Criticality Designator.**

(a) The assigned designator may be changed only by the purchasing office. Ordinarily, unilateral purchase orders shall be assigned Criticality Designator C.

(b) DoD contract items on which a priority 01, 02, 03, or 06 (if emergency supply of clothing) has been assigned based on DoDD 4410.6, Uniform Material Movement and Issue Priority System and nonstocked items which otherwise meet the criteria for Force Activity Designator 1 and Urgency or Need Designator A thereunder shall fall under Criticality Designator A.

#### **42.1106 Reporting Requirements.**

(b)(1) If the contractor's report indicates that the contract schedule will be met and the contract administration office concurs, no further report by the contract administration office is required.

(2) If, on the other hand, either the contractor forecasts delivery or performance failure, or the contract administration office does not concur in the contractor's no failure report, and in either case the delay is expected to be for more than 30 days, or purchasing

office action, in any case, is deemed necessary, the contract administration office shall add an endorsement and forward a copy to the purchasing office and to the inventory control manager unless otherwise specified in the contract, within 4 working days after receipt of the contractor's report. The endorsement shall include:

- (i) comments as to nonconcurrency, if applicable;
- (ii) action taken by the contractor and by the Government to overcome the anticipated or actual delinquency.
- (iii) action required - a positive recommendation to the purchasing office of the action necessary to correct the delinquency, including any realistic schedule revision which can be met by the contractor and the extent to which the contractor may have excusable cause of delay. When other actions are indicated, such as those leading to default termination, the contract administration office shall indicate specific dates by which Government action should be taken to preserve the Government's rights.

(c) Reports Initiated by Contract Administration Offices.

Reports may be furnished by use of:

- (1) DD Form 375-2, or DLA Form 1654 (Test), Delay in Delivery (Flash Notices); or
- (2) DD Form 375, Production Progress Report and DD Form 375c (continuation).

**42.1107 Contract Clause.**

(b)(1) Contract schedule provisions supporting the clause at FAR 52.242-2 shall contain but not be limited to instructions relative to:

- (i) the frequency and timing (normally 5 working days after each reporting period of reporting);
- (ii) the contract line items, exhibits, or exhibit line items for which reporting is required;
- (iii) offices and mailing addresses to which reports shall be sent including the purchasing office, the contract administration office (3 copies), status control activities and inventory managers, if appropriate; special requirements as to codes and formats.

(2) When reporting an actual or potential delinquency, the contractor-prepared DD Form 375c shall, as a minimum, contain the following data:

- (i) problem - a statement of the difficulty, the reasons therefor, and whether caused by the Government or the contractor;
- (ii) items and quantities affected;
- (iii) date of commencement of the anticipated or actual delinquency;
- (iv) action taken by the contractor to overcome the anticipated or actual delinquency.
- (v) estimated recovery date based upon evaluation of the factors contributing to the delinquency; and
- (vi) a realistic schedule revision which can be met by the contractor. In the absence of an actual or potential delinquency, the DD Form 375c may be used to provide any information which the contractor deems appropriate.

**DOD FAR SUPPLEMENT**

“Authorized program,” as used in this subpart, means a program approved by the Federal Emergency Management Agency (FEMA) for priorities and allocations support under the Defense Production Act of 1950, as amended (50 U.S.C. app. 2061, et seq.), to promote the national defense. Schedule I of the DPAS lists currently authorized programs.

“Controlled materials,” as used in this subpart, means the various shapes and forms of steel, copper, aluminum, and nickel alloys specified in Schedule II, and defined in Schedule III, of the DPAS.

“Delegate Agency,” as used in this subpart, means an agency of the U.S. Government authorized by delegation from DOC to place priority ratings on contracts that support authorized programs. Schedule I of the DPAS lists the Delegate Agencies.

“Rated order” means a prime contract for any product, service, or material (including controlled materials) placed by a Delegate Agency under the provisions of the DPAS in support of an authorized program and which requires preferential treatment, and includes subcontracts and purchase orders resulting under such contracts.

#### 12.302 General.

(a) Under Title I of the Defense Production Act of 1950, as amended (50 U.S.C. app. 2061, et seq.), the President is authorized (1) to require that contracts in support of the national defense be accepted and performed on a preferential or priority basis over all other contracts, and (2) to allocate materials and facilities in such a manner as to promote the national defense.

(b) The Office of Industrial Resource Administration (OIRA), DOC, is responsible for administering and enforcing a system of priorities and allocations to carry out Title I of the Defense Production Act for industrial items. The DPAS has been established to promote the timely availability of the necessary industrial resources to meet current national defense requirements and to provide a framework to facilitate rapid industrial mobilization in case of national emergency.

(c) The Delegate Agencies (see Schedule I of the DPAS) have been given authority by DOC to place rated orders in support of authorized programs. Other government agencies, Canada, and other friendly foreign nations may apply for special rating authority in support of authorized programs (see 15 CFR 350.55).

(d) Rated orders shall be placed in accordance with the procedures in the DPAS. Contracting officers responsible for acquisitions in support of authorized programs shall be familiar with the DPAS and should provide guidance on the DPAS to contractors and suppliers receiving rated orders. Agency heads shall ensure compliance with the DPAS by contracting activities within their agencies.

(e) Under the Defense Production Act, any willful violation of the Act, the DPAS, or any official action

### SUBPART 12.3—PRIORITIES AND ALLOCATIONS

#### 12.300 Scope of subpart.

This subpart implements the Defense Priorities and Allocations System (DPAS), a Department of Commerce (DOC) regulation in support of authorized national defense programs (see 15 CFR 350).

#### 12.301 Definitions.

taken by DOC under the DPAS, is a crime punishable by a maximum fine of \$10,000, one year in prison, or both (see 15 CFR 350.70 and 15 CFR 350.74).

#### 12.303 Procedures.

(a) There are two levels of priority for rated orders established by the DPAS, identified by the rating symbols "DO" and "DX." All DO rated orders have equal priority with each other and take preference over unrated orders. All DX rated orders have equal priority with each other and take preference over DO rated and unrated orders. DX ratings are used for special defense programs designated by the President to be of the highest national priority.

(b) DOC may issue a Directive to compel a contractor or supplier to accept a rated order, to rearrange production or delivery schedules, or to improve shipments against particular rated orders. Directives issued by DOC take precedence over all rated and unrated orders as stated in the Directive.

(c) In addition to any other contractual requirements, a valid rated order must contain (see 15 CFR 350.12) the following:

(1) A priority rating consisting of the appropriate DO or DX rating symbol and a program identification symbol to indicate the authorized program (see Schedule I of the DPAS).

(2) A required delivery date or delivery dates.

(3) The signature of an individual authorized by the agency to sign rated orders.

(d) The DPAS has the following three basic elements which are essential to the operation of the system:

(1) *Mandatory acceptance of rated orders.* A rated order shall be accepted by a contractor or supplier unless rejected for the reasons provided for mandatory rejection in 15 CFR 350.13(b), or for optional rejection in 15 CFR 350.13(c).

(2) *Mandatory extension of priority ratings throughout the acquisition chain.* Contractors and suppliers receiving rated orders shall extend priority ratings to subcontractors or vendors when acquiring items to fill the rated orders (see 15 CFR 350.15).

(3) *Priority scheduling of production and delivery.* Contractors and suppliers receiving rated orders shall give the rated orders priority over other contracts as needed to meet delivery requirements (see 15 CFR 350.14).

(e) Agencies shall provide contracting activities with specific guidance on the issuance of rated orders in support of agency programs.

(f) Contracting officers shall follow agency procedural instructions concerning the use of rated orders in support of agency programs.

(g) Contracting officers, contractors, or subcontractors at any tier, that experience difficulty placing rated orders, obtaining timely delivery under rated orders, locating a contractor or supplier to fill a rated order, ensuring that rated orders receive preferential treatment by

contractors or suppliers, or require rating authority for items not automatically ratable under the DPAS, should promptly seek special priorities assistance in accordance with agency procedures (see 15 CFR 350.50-55).

(h) Contracting officers shall report promptly any violations of the DPAS to DOC in accordance with agency procedures.

#### 12.304 Solicitation provision and contract clause.

(a) Contracting officers shall insert the provision at 52.212-7, Notice of Priority Rating for National Defense Use, in solicitations when the contract to be awarded will be a rated order.

(b) Contracting officers shall insert the clause at 52.212-8, Defense Priority and Allocation Requirements, in contracts that are rated orders.

## PROGRESS EVALUATION

It is the Department of Defense policy that the Government perform production management functions necessary to provide production or performance progress information. This protects the interest of the Government and fulfills the Government's contract obligations.

### Monitoring Contractor Progress

The contractor is responsible for timely and satisfactory contract performance. However, the Government cannot always rely on the contractor to make sure that the contract work is progressing as scheduled. Poor performance or late deliveries may cause costly delays in the program of which the contract is a part. Thus, the Government monitors contract performance closely to insure that desired end items are delivered on time. The method of monitoring used depends on several factors; such as, the contract performance period, complexity of the item, and urgency of need for the item.

Monitoring supports many objectives. It may identify potential delinquencies. It may help to isolate specific performance problems. It may permit the Government to allocate government property to various programs. Monitoring information is used to support contractor requests for progress payments. Monitoring may point out the need for government assistance. It may supplement but not supplant the contractor's own efforts to solve performance problems.

Monitoring may reveal more than just performance difficulty. It may reveal actual or anticipated default. The Government must then act promptly and carefully to fulfill its requirements and preserve its rights.

Each type of contract requires its own approach to monitorship and measurement. For example, the R & D Contract presents unique surveillance challenges. Normally the status of a study, experiment, test, evaluation, and design is often hard to gauge before completion. Objective scheduling criteria seldom exist since the statements of work are usually broad and flexible. Researchers may encounter breakthroughs or setbacks which negate earlier progress data. In research contracts, therefore, the customary monitoring criteria such as costs, schedule and progress are not easily applied. Monitoring is more a matter of technical evaluation, controls over costs incurred, and estimating the contractor's level of effort.

Monitoring becomes easier as the program matures from R & D through the development phase to production. Though the work is not yet repetitive and detailed specifications are still lacking, much of the uncertainty may be gone. The experience gained on earlier contracts should provide some standard for comparison.

However, the work still depends on the contractor's ability to cope with obstacles he has not met before. Thus, technical evaluation is still very important in determining the status of development work.

On production contracts, the end-item design should be firm. Production processes are defined and a production schedule is established at the outset of the contract. Use of customary monitoring criteria permits measurement of progress against the contract schedule causing the emphasis to shift from technical evaluation to production specialists (Industrial Specialists) evaluation.

### **Sources of Progress Information**

In evaluating a contractor's progress, the Government is primarily interested in actual progress toward completing the work. Data about progress may be obtained from production progress conferences held by the contract administration office, field representatives at the work site, or periodic progress reports by the contractor to the ACO or CO.

**Conferences and Reviews.** The contract administration office and the procuring activity may hold regularly scheduled meetings and reviews to evaluate the overall status of the contract and to resolve problems that may be affecting contractor performance. Progress reports submitted to the Government provide the basis for many of the resulting decisions made by the procurement team.

Periodic meetings between cognizant technical personnel and the contractor may also be held to discuss technical questions important to both. Generally, these meetings take place before scheduled contract administration team meetings. This permits the administration team to consider problems that cannot be completely settled at the technical level.

The industrial specialist's contribution to these progress evaluation conferences and reviews is significant. The industrial specialist is often located at or near the contractor's plant. At the very least, the industrial specialist should report to the ACO any special information concerning the contractor's performance.

**Production Schedules.** In some instances the contractor is required by terms of the contract to submit a phased production schedule for review by the Government. This requirement must appear as a special provision in the contract schedule. There is



no standard format for such schedules; however, they usually show the time required to perform the production cycle, to include planning, purchasing, plant rearrangements, tooling, component manufacture, subassembly and final assembly, testing, and shipping.

**Production Progress Reports.** The CO can insert into the contract a requirement to obtain production progress information normally on a monthly basis from the contractor. Usually this report is prepared on DD Form 375 Production Progress Report. The contractor shows the actual and forecast deliveries as compared with the contract schedule, as well as delay factors, if any. The report provides narrative sections which the contractor uses to explain any difficulties, delay factors, action taken or proposed to overcome these difficulties, and any assistance required from the Government.

This report, when contractor prepared is normally submitted to the CAO. The industrial specialist reviews the report and provides comments for ACO consideration. The ACO, in turn, comments to the CO and other interested parties.

In some cases, the DD Fm 375 report is supplemented by additional information. For example, the procuring activity may require special production graphic submissions for some contracts to show detailed schedules and to provide a convenient method for reporting progress. The graphs supplement the progress information contained on the DD Fm 375; they also further insure its accuracy. Such graphic techniques, including line of balance, are discussed later.

The fact that a monthly production progress report is or is not required by the contract does not relieve the production element of its obligation to report anticipated or actual delays to the ACO as soon as such delays are recognized. In most cases this is done by executing a DD Fm 375-2, Delay in Delivery or Flash Notice, or by other authorized means such as letter or message.

Such reports need not repeat the previous analysis made of the same problem, but should reference previous reports. However, when there is a change to a previous delinquency forecast, such as deletion of current or anticipated delinquent line items, or a change in the causes of a production delay, the previous analysis must be updated. The ACO takes action and reports to the CO.

Where the DD Fm 375 is not appropriate, for example, construction, shipbuilding, and maintenance and overhaul, special progress reports may be required. Here, physical progress is often reported and measured by the stage or percentage of completion of the work.

## Techniques for Measuring Progress

In evaluating a contractor's delivery schedule, a graphic display of the accumulated data can be helpful. The forcefulness that a visual presentation enjoys over the narrative is not the only advantage; most graphic studies can be updated more economically. The selection of the best method is important. It is DOD policy that maximum use shall be made of the contractor's progress management procedures. The Government must avoid imposing a technique intended for surveillance of a complex procurement if the procurement involved is comparatively simple and only an isolated administrative or production phase warrants monitoring.

There are many graphic techniques for analyzing contractor planning and for monitoring progress toward completion. Also, many contractors have developed graphic techniques for portraying production progress. Some of the more common techniques that have received acceptance are identified and described below.

**Phase Planning Chart.** This is a technique in which lead times and target dates are projected for the principal resources and steps in the manufacturing process of a contract. The lead time is the length of time before an end item delivery in which an operation must be completed in order to meet the delivery schedule. The target date is the specific date for completion of an operation. Progress, if any, is displayed by annotating actual times (dates) for events on the same chart containing "planned" times (dates). See Figure 1.

**Delivery Forecasting.** This is another production planning technique by which lead times and target dates are projected for principal resources and steps in the manufacturing process. It is similar to phase planning. Delivery forecasting differs from phase planning in that it consists of determining the lead time and target dates for only those major components in the first end item. It is not concerned with lead time and target dates for all items in the contract. It is concerned with the production of the first end item because it was designed for use on contracts in which the assembly time for the end items is negligible compared to the overall lead time for the end item, The time required to manufacture the total number of components for all items is little more than the time required to manufacture the components for the first item.

After delivery forecasting data has been initially compiled, it is reviewed and updated periodically to determine how actual production progress on the first end item compares with the contractor's original production plan. The theory of delivery forecasting is that the total number of items on a contract, as

# GANTT CHART

1. ADMINISTRATIVE		DEF COMPANY		PROJECTED LEAD TIME AND/OR TARGET DATE (ENTER MONTHS)												DATE PREPARED:	
CONTRACTOR'S NAME:		CONTRACT NUMBER:		SYSTEM: F-104												1 MAR 70	
FACTORS NOT APPLICABLE MARK "N/A."		CONTROL DATA		JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB
Design		15 FEB															
Drawings and Plans																	
Bills of Material																	
Specifications																	
Instruction Books																	
Shop Orders and Drawings																	
Provisioning/Stock Numbers		N/A															
Sub-Orders																	
2. MANUFACTURING																	
Manpower		N/A															
Manufacturing Space		N/A															
Production Equipment		N/A															
GFM/OFE																	
Raw Material																	
Sub-Assemblies																	
Components																	
Prototype or Pilot Lot																	
Spare Parts																	
Start of Production																	
Assembly of End Item																	
3. SHIPMENT																	
Test and Inspection																	
Preservation, Packaging & Packing																	
Shipment																	
PREPARED BY:		DATE:		REVIEWED BY:												DATE:	

FIGURE 1

### DELIVERY FORECASTING

CONTRACT/ORDER NO. F0406-70-C-XXXX CONTRACTOR/MANUFACTURER ABC COMPANY LINE 1 - PLANNED SCHEDULE  
 ITEM R-2800 SERIES ENGINE CONTRACTOR/ORDER DELIVERY SCHEDULE 10 EACH/30 APR LINE 2 - ACTUAL SCHEDULE

- |  |  |  |
|--|--|--|
| ▷ PLAN SUBMISSION<br>◊ PLAN APPROVAL<br>↗ PURCHASE ORDER ENTERED | △ SHOP ORDER ENTERED<br>○ NOT REQUIRED ON SHOWN CRITICAL DATE<br>○ COMPLETION POSTED | □ CONTRACTOR TEST<br>◼ GOVERNMENT TEST<br>⊕ SHIPMENT |
|--|--|--|

COMPONENT	PURCHASE ORDER OR SHOP NO.	VENDOR	MARCH				APRIL						
			1st WEEK	2nd WEEK	3rd WEEK	4th WEEK	1st WEEK	2nd WEEK	3rd WEEK	4th WEEK			
NOSE SECTION	1		△	◇	△								
	2		△	◇	△								
CRANK CASE	1		△	◇	△					○			
	2		△	◇	△								
CYLINDERS	1		△	◇	△					○			
	2		△	◇	△								
ACCESSORIES	1		△	◇	△					○			
	2		△	◇	△								

FIGURE 2

described above, is relatively small and the first item can be produced on schedule, then the remaining items should follow without difficulty. Delivery forecasting is not generally useful for long production lead time contracts which involve a small number of complex, high dollar value items. The information generated by delivery forecasting is more detailed than the information generated by phase planning.

In delivery forecasting, the major components of the first end item, called "pacing item" govern the delivery schedule and are selected for plotting on the delivery forecasting chart. As actual production progresses and production difficulties or delays occur for certain items, the pacing items may be changed when the original delivery forecasting chart is reviewed and updated. The major stages in the production cycle against which the pacing item is plotted will vary with each individual contract. In general, such stages will include engineering or design, purchasing, assembly, test, packaging, and shipment. See Figure 2.

**Milestone Variance Chart.** When a more condensed graphic presentation than either phase planning or delivery forecasting is needed, a milestone variance chart can be used. It, like delivery forecasting, is primarily a tool for monitoring a contract after the contractor's production schedules have been established.

The milestone variance chart presents the planned target date for the major steps in producing the end item from planning to shipment. Revisions to such target dates and the actual performance achieved by the contractor are also portrayed. The production plan and production progress on the contract are highlighted for quick evaluation. The information to be included in the chart is obtained at meetings with the contractor just as for phase planning and delivery forecasting.

This technique is especially useful on contracts with long lead time end items being manufactured by contractors with some proven ability to produce. While the importance of such end items requires an evaluation of the contractor's production plans and closer production surveillance than other contracts, the proven ability of the contractor may show that only summary information need be charted. See Figure 3.

### **Program Evaluation and Review Technique (PERT)**

# MILESTONE VARIANCE CHART

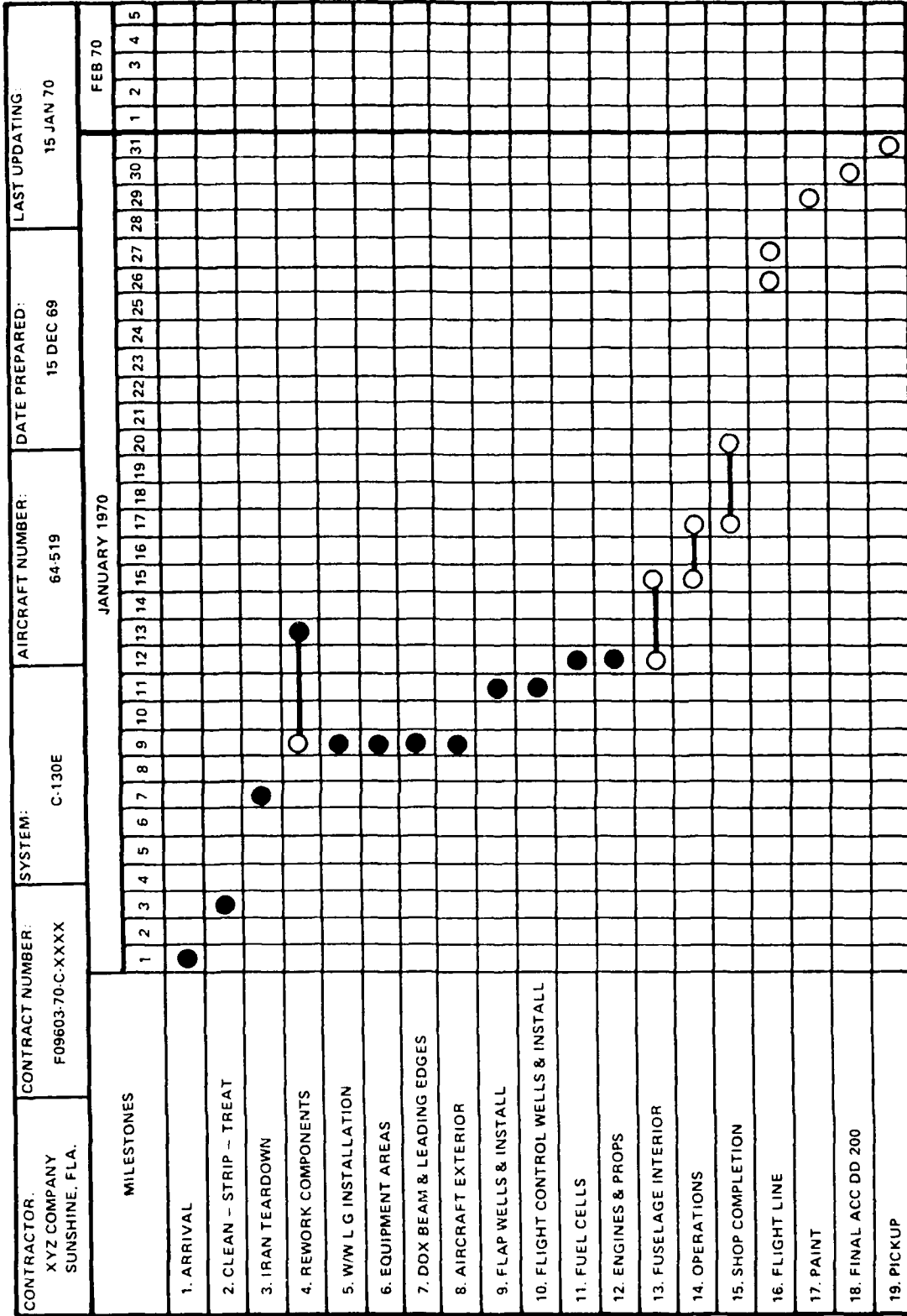


FIGURE 3

- | KEY EVENTS |                                      |
|------------|--------------------------------------|
| (1)        | Receive program go-ahead             |
| (2)        | Initiate procurement of engine       |
| (3)        | Complete final fuselage drawings     |
| (4)        | Complete plans and specs             |
| (5)        | Submit GFAE requirements             |
| (6)        | Complete manufacture of fuselage     |
| (7)        | Award subcontract for tail assembly. |
| (8)        | Complete assembly fuselage-engine    |
| (9)        | Receive wings from subcontractor     |
| (10)       | Receive GFAE                         |
| (11)       | Receive tail assembly                |
| (12)       | Roll out aircraft                    |

FIGURE 4 Tasks to build an aircraft.

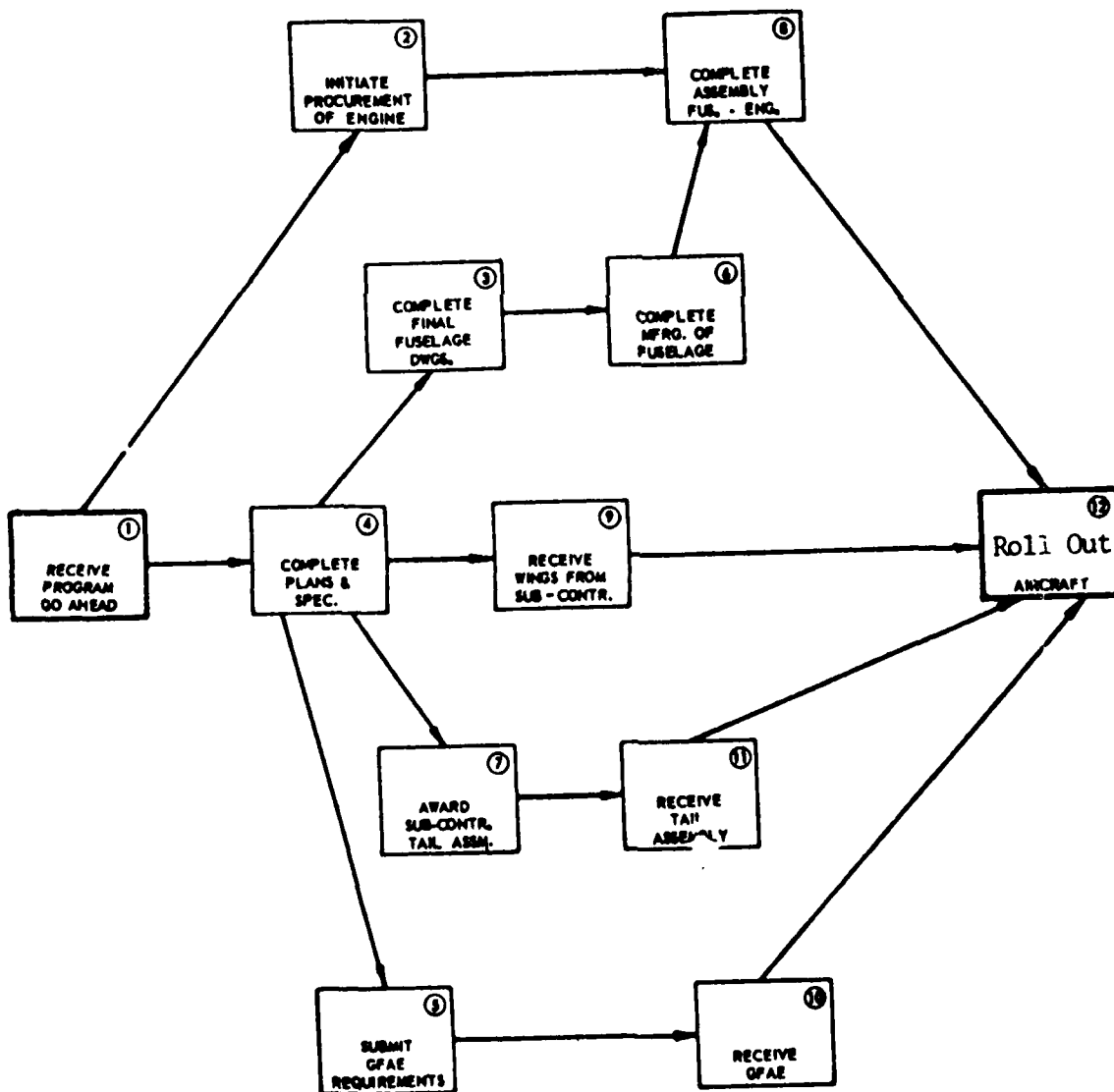


FIGURE 5 Drawing a network (event oriented).

Program evaluation review technique is a management tool that can be applied to construction projects, research and development projects, or projects of a one-time nature justifying the relatively high cost of PERT. It is a management technique designed to help the manager plan and schedule both large and small projects in terms of time and cost. PERT can provide the basis for decision making. PERT quantifies knowledge about uncertainties faced by the activities responsible for meeting a predetermined time schedule. The very process of analyzing these uncertainties focuses management's attention on the critical areas.

It uses networks to show time and dependency relationships between the factors contributing to completing a system, project, or task. Using PERT data, management can evaluate possible "trade-offs" in order to improve the chances of meeting the time schedule. This technique can quickly give the results of alternate courses of action, thus making a range of alternatives available.

**Characteristics of a Network.** A PERT network is actually a sequential flow chart showing the significant events and activities which must be completed in the orderly progress of the plan. These events and activities are diagrammed in a time relationship to each other to show the complete system, project, or task.

A network chart shows two types of accomplishment: events and activities. Events are instantaneous happenings, they do not consume time or resources. Some examples of events are program go-ahead, design start, design completion, fabrication start, and fabrication completion. On a network diagram events are shown by boxes or circles.

An activity is a discrete, identifiable task in a program which consumes time. Activities, shown as arrows, must start and end in an event. The event at the tail of the arrow indicates the beginning of an activity, the event of the point of the arrow, its completion. In a graphic representation, arrows point to the right, up, or down; thereby, the flow from project beginning to end flows from left to right on the graphic.

Activity time ( $t_e$ ) is the elapsed time required to complete an activity in a specified manner. Estimating "activity time" is the most difficult feature of the PERT process. Any future activity involves uncertainty. Therefore, responsible organizations are reluctant to make a single time estimate. Time estimates must be made by the people familiar with each activity to insure accuracy. These estimates are made independently. The intent is to get a realistic appraisal of the time required to accomplish each activity.

PERT uses three estimates of the time required to complete activity; the optimistic time, the most likely time, and the pessimistic time. These are defined as follows:

(1) The optimistic time ( $a$ ) is the estimated completion time if everything goes better than expected.



(2) The most likely time (m) is that time which the estimator really thinks will be required for the job.

(3) The pessimistic time (b) is that which would be required if practically everything went wrong.

(4) The activity time (te) is then calculated by using the equation:

$$t_e = \frac{a + 4m + b}{6}$$

**Constructing the Network.** Figure 4 lists the events in a task - the task of building an aircraft. This is a simple example of a PERT network.

Before these major events in the manufacture of an aircraft can come about, it is evident that many other events must take place. What are these events? How are they scheduled so that the major events can be accomplished by the appointed time?

In building an aircraft, as in this example, there are actually thousands of events programmed into many networks. PERT diagrams include all these events and the ultimate activities. The diagrams become the basis for computations.

Figure 5 diagrams the twelve events listed in Figure 4. Each is shown as a numbered and labeled rectangle.

Selecting the events is the first step in building a network. The second step is to connect the events with arrows showing the activity, or activities that must take place between events. These arrows emphasize graphically that an event cannot occur until all activities leading to it have been completed. Furthermore, an activity cannot begin until the preceding event has occurred. For example, Event 2 is constrained by Event 1 because engine procurement cannot be initiated until after the program "go-ahead" has been received. Event 4 must also follow event 1. Events 3, 5, and 7 are logical steps after event 4. Four events - 8, 9, 10, and 11 - culminate in event 12, unveiling the aircraft. This is a greatly simplified illustration of a master network for an aircraft construction plan.

As pointed out previously, numerous additional events would be necessary for a true network. Events in a master network could actually be the end events or objectives of the other networks.

The third step in constructing the PERT network is to calculate the te for each activity. Figure 6 illustrates the time estimates used for this example. The te for the activity between event 1 and event 2 is calculated as follows:

$$\begin{array}{l} a = 8 \\ m = 16 \\ b = 32 \end{array} \quad \begin{array}{l} t_e = \frac{a+4m+b}{6} \\ t_e = \frac{8+4(16)+32}{6} = \frac{8+64+32}{6} = \\ \frac{104}{6} = t_e = 17.3 \end{array}$$

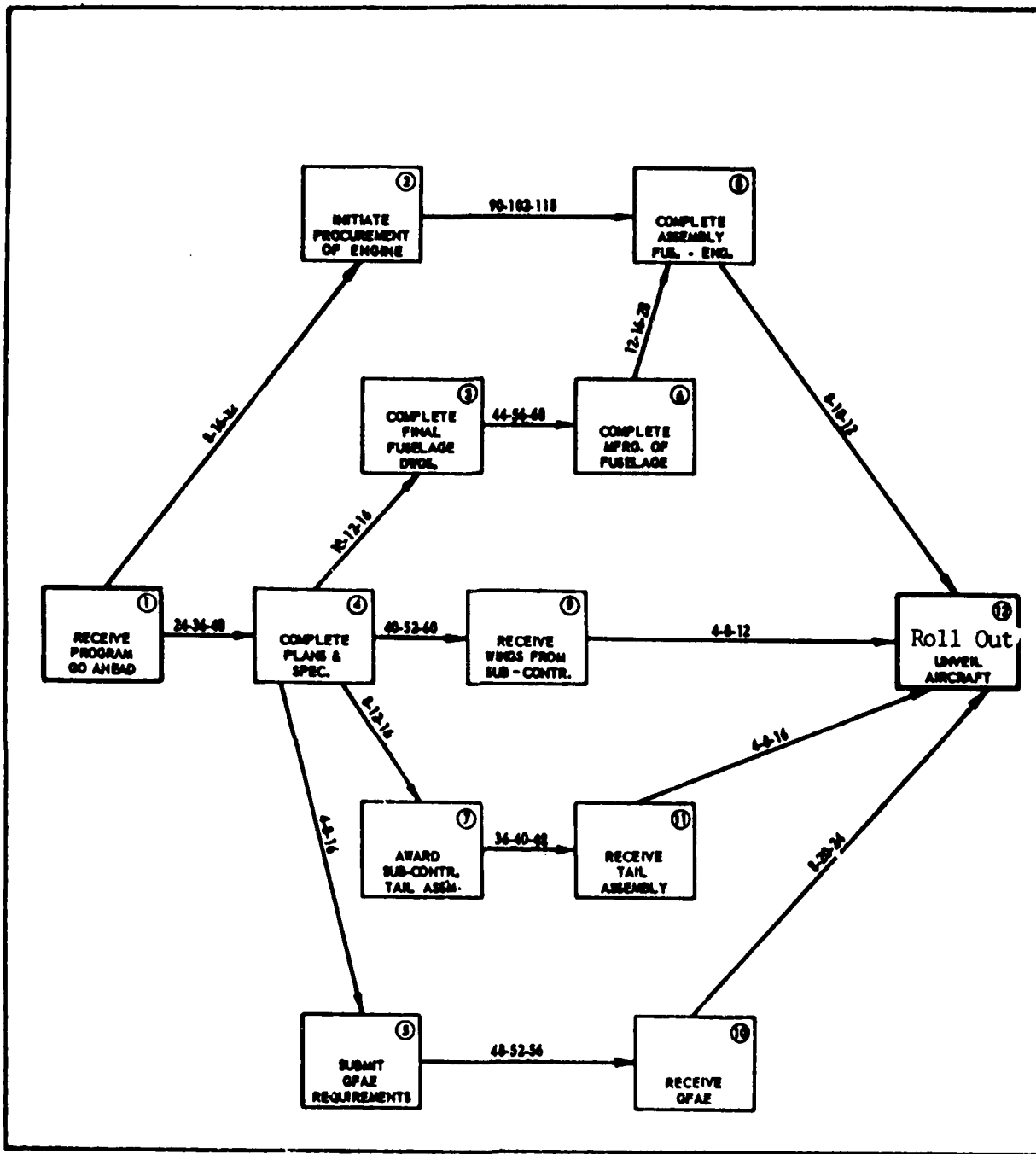
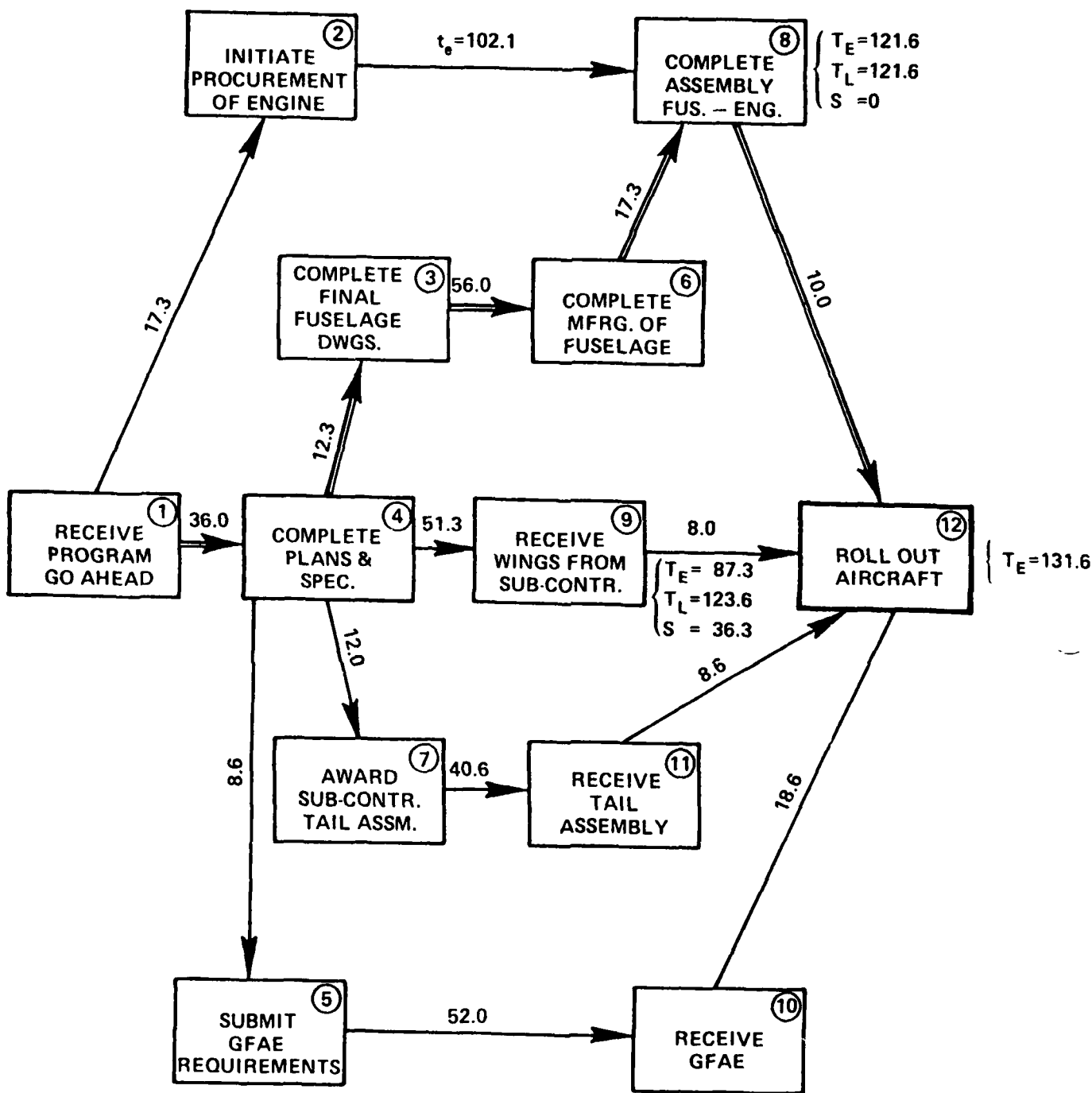


FIGURE 6 Adding time estimates.



$t_e$  - CALCULATED ACTIVITY TIME (WEEKS)  
 $T_L$  - LATEST TIME  
 $S$  - SLACK  
 $T_E$  - EXPECTED TIME, PROJECTED COMPLETION  
 ==> - CRITICAL PATH

FIGURE 7  
E-48

The activity time ( $t_e$ ) is calculated for other activities in the same manner. The results of those calculations are shown in Figure 7. The  $t_e$  for each activity then becomes the baseline for generating useful management data. Refer to Figure 7.

**Processing the Baseline Data.** Although computers perform this function in "real world" PERT applications, a brief explanation, will provide an understanding of this process.

The Event Expected Completion Date (TE) is calculated for each event by adding the estimated activity times ( $t_e$ ) for each activity preceding that event in the network. Note that the individual completion date is designated by a small  $t_e$  and the addition of small  $t_e = TE$ . When more than one path constrains the event, the TE for the event is equal to the time over the path which consumes the most time. For example (see Figure 7), event 8 is constrained by paths including events 1, 2, 8 and 1, 4, 3, 6, 8 since the time consumed over paths 1, 4, 3, 6, 8 (121.6) is greater than the time consumed over path 1, 2, 8 (119.1) the TE for event 8 is 121.6. The TE for the end event, in our example - event 12, represents the time required to complete all the activities in the network. The most time consuming path through the entire network, in our example the path containing events 1, 4, 3, 6, 8 and 12, is called the Critical Path. The time consumed over the Critical Path is the time estimated to complete the entire task, as such it is particularly important to the user's of the PERT technique because any additional time required (in excess of the  $t_e$ ) for completion of activities on the Critical Path will delay completion of the project. Management can then allocate resources to minimize potential delays by monitoring progress along the Critical Path.

Another useful management technique is to examine the network using the "Event Latest Allowable Completion Date (TL)" criteria. TL is the time after program start on which an event must occur to avoid a delay in the project completion. TL is calculated on a "backward" or "right to left" pass through the network. In our example TL for the last event (Event 12) is arbitrary assigned a value of 131.6. The TL (Event Latest Allowable Completion Date) for each activity between the event and event 12, when two or more paths from event 12 to that activity exists, TL for the event is the time over the most time consuming path. For example (see Figure 10-7) the TL for event 4 could be calculated by subtracting from TL event 12 (131.6) the TE for each event over the following paths; 12, 8, 6, 3, 4 or 12, 9, 4 or 12, 11, 7, 4 or 12, 10, 5, 4. In this example, the most time consuming path is path 13, 8, 6, 3, 4 therefore TL for event 4 is 131.6 minus 95.6 or 36.

Having now computed both the TE and TL for each event in the network the concept of "slack time" can be developed and used by the management. Slack time is the difference between TL and TE. If the calculated slack time is positive for a particular event, a schedule slippage up to the value of slack time can be tolerated without a delay in the completion of the end event. If the slack time is zero, any slippage will cause a day for day slip in the completion of the end event, further, if slack time

is negative, the program is behind the schedule and unless corrected will result in a day for day delay in the completion of the end event. In our example, slack time is zero along the critical path and positive on all others. This slack provides the planner with leeway in reallocating resources to improve the situation on the critical path.

When a network is completed, the required time and the critical path can be examined in detail. At this time various simulated situations can be computed by adjusting times to see what effect these changes might have on the end event. This simulation produces alternate courses of action and gives a choice of decisions.

### **Line-of-Balance Technique**

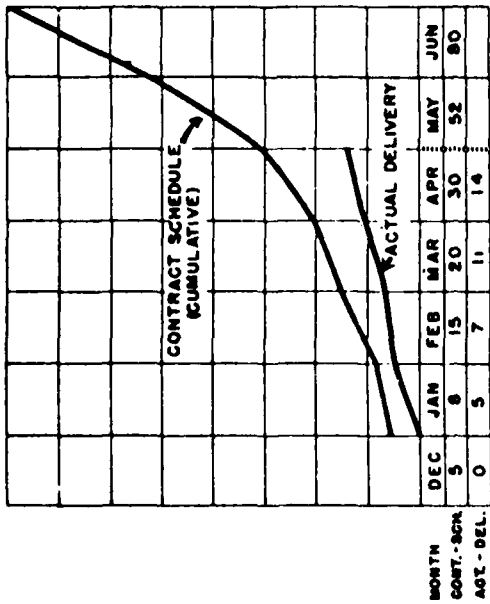
Line-of-balance (LOB) is a technique for assembling, selecting, and interpreting in graphic form the essential factors involved in a production process from raw material to completion of the end product, against a background of time. It is a management tool, utilizing the principle of exception to show only the most important facts to its audience. This is a means of integrating the flow of materials and components into the manufacture of end items in accordance with phased delivery requirements.

Elements of a production program are related to planned progress. Those elements that are lagging are identified. Time relationships between various elements in the manufacturing process are set forth and deficiencies pointed out in the availability of material, parts, and assemblies at selected control points along the production line.

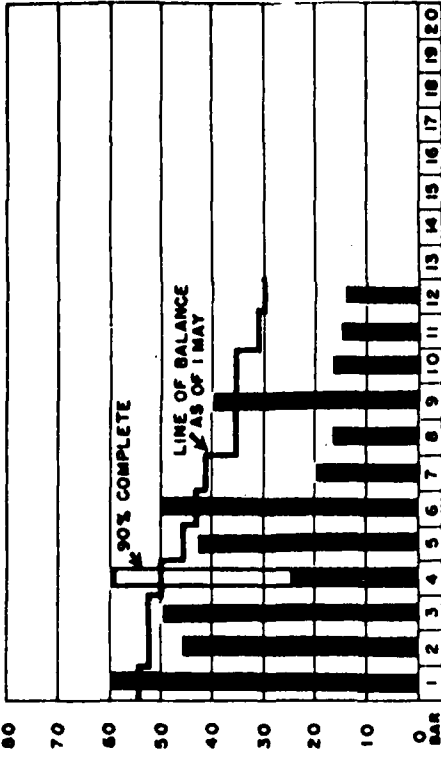
LOB is used to measure the current relationship of actual production progress to scheduled progress and predict the feasibility of accomplishing timely deliveries. It is a means for determining problem areas of the manufacturing or development process which need corrective action. Updated studies provide checks on the effectiveness of remedial action. Another use is the scheduling of purchase orders and shop orders. A contractor can use it as a reporting medium or as a means of communication. It might also be used to substantiate progress payments. The LOB Chart contains an Objective Chart, a Production Plan, and a Progress Chart. Each is described below.

**Objective Chart.** The objective chart (see Figure 8) is the required contract delivery schedule. In Figure 8, the

### THE OBJECTIVE



### PROGRESS CHART



### PASS THRU QUANTITIES

Control Point No. Quantities

1	60
2	46
3	50
4	25 (+ 35 partial)
5	42
6	50
7	20
8	16
9	40
10	16
11	15
12	14

### PRODUCTION PLAN

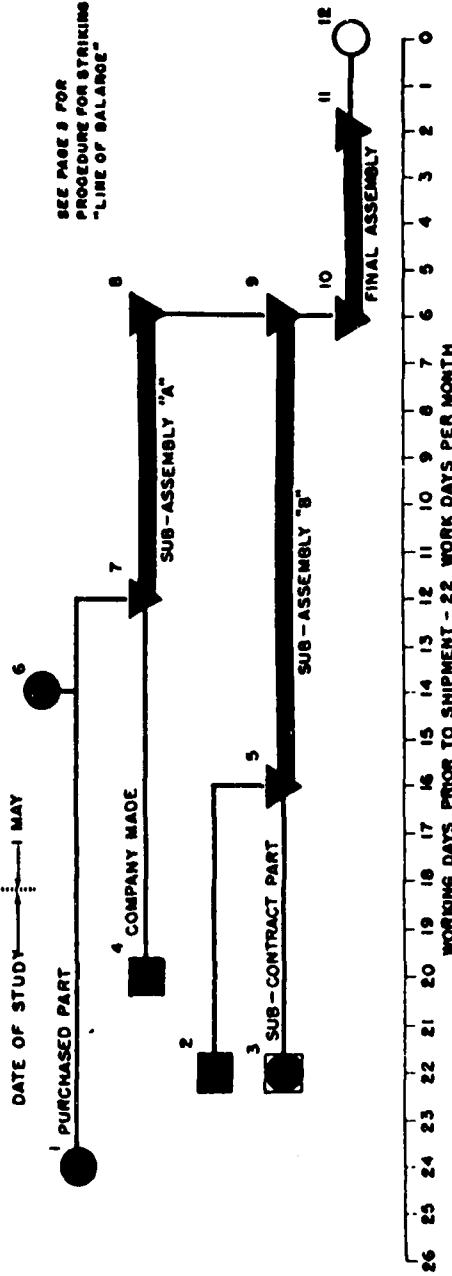


FIGURE 8 A sample line-of-balance chart.

graph reflects the delivery schedule of a contract which requires delivery of a varied number of units per month starting Dec through 30 Jun.

The schedule must be determined from the contract and converted to cumulative end items per unit of time. In addition, the contract and amendments should be checked for revisions or changes to the schedule. If the line-of-balance study is to include production of identical end items for more than one contract, the objective should be the overall cumulative delivery requirements of all contracts.

**Production Plan.** Following the setting down of the objective, the second important step in an LOB study is to chart the production plan. As used here, this is defined as the producer's planned process of production. Deriving the production plan or "assembly tree", in terms of key plant operation or assembly points and their lead-time relationship to final completion, is the most vital stage in a line-of-balance study. Lead time is defined as the time interval between the required availability of a raw material, a purchase part, a manufactured part, or a subassembly and the date of shipment of the completed end item. These operational points are steps in the manufacturing cycle, the completion of which can be used to monitor intermediate progress of production.

In our example LOB (See Figure 8), the numbers 1 through 11 indicate the intermediate control points whereas number 12 indicates that the end item is available for delivery. As items pass through these control points they are "counted". As the production plan depicts, items at control point #1 must be in place 24 days prior to delivery of the end item, during these 24 days, item one is combined with item #6 this assembly is then combined with the assembly of item 4 and the resulting end item is available 12 days prior to delivery. Charting of the Production plan results from detailed study by plant management, the process engineering staff, and other representatives responsible for conducting line-of-balance analysis.

The plan should cover the span of operation peculiar to the particular manufacturing process, from work on raw materials through assembly to shipment. Prior to any detailed examination or gathering and categorizing of data supplied by the contractor, a tour should be made of the plant to observe the physical layout. The actual processes involved should be observed as well as the physical attributes of the operations. This trip should be made "in reverse", beginning at the shipping room and ending in the stock room where incoming materials are received. This unusual approach will enable the observer to obtain a more accurate concept of lead time for operations and materials.

**Progress Chart.** The progress chart is used to display and compare the required progress versus actual progress. Actual production progress is depicted in terms of quantities of materials, parts, and subassemblies which have passed through the individual check points or control points of the production plan, including those contained in end items already completed. This

information is reported to management by a physical inventory for each control point and is graphically represented by bar graph inserts. Progress counts must not include defective or rejected quantities which will not add to the usable inventory.

On the progress chart the same quantity scale is used on the vertical axis as was used for the objective chart. The horizontal axis corresponds to the numbered control points depicted in the production plan. Numbering and coloring of the status or quantity bars are keyed to correspond with the duplicate of the numbered control points of the production plan. Scale numbering in this instance proceeds from left to right progressively.

If it is desired to show that an appreciable quantity has been nearly completed in addition to that already completed at a given control point, the bar for that control point may be extended upward to the appropriate amount but left uncolored. If this is done, an appropriate explanation should be made on the chart. Such bars are called ghost bars, or shadow bars.

Development of the objective chart, the production plan and progress chart completes the accumulation of physical information. There remains the task of relating the intelligence already gathered. This is accomplished by striking a "line-of-balance" which is the basis to be used for determining the required progress to assure timely delivery.

To plot the line-of-balance quantity for a control point, start at the study date (1 May) on the horizontal axis of the objective chart and mark off to the right the number of working days, or weeks as appropriate, of lead time for that control point. This lead time information is obtained from the production plan. Erect a vertical line from that point on the horizontal axis to intercept the cumulative delivery schedule line. From that intercept point draw a horizontal line to the corresponding bar on the progress chart. This is the LOB quantity for that bar. Join the LOB quantities to form one staircase-type line across the face of the progress chart. (See Figure 8).

The balance line quantity depicts the quantities of end item sets for each control point which must be available as of the date of the study to support the delivery schedule. In other words, it specifies the quantities of end item sets for each control point which must be available in order for progress on the program to remain in phase with the objectives. In our example, the study date is 1 May, on that date, thirty end items are required to be delivered (see objective chart); therefore, the number of items at or through inventory control point 12 must be thirty or more to be on schedule. Similarly, fifty-two assemblies each at control points 2 and 3 and are required, etc. Comparing of the quantities depicted by the LOB with the bar graphs depicting the actual progress make analysis very simple. Specifically, when the bar graph does not reach or exceed the LOB quantity, future deliveries will be delayed unless remedial action is initiated.



## **Cost/Schedule Control Systems Criteria**

**Performance Measurement.** Performance measurement involves the design and use of systematic procedures for managing and controlling cost, schedules and technical progress within a contractor's operations. Such a system of measurement should provide information concerning technical, schedule and cost problems. This will alert the contractor and the Government to early identification of problems and provide assistance in identifying the alternatives available for the future.

Both the contractor and the Government should have an understanding of how the information derived from such a system can be used intelligently to improve the value of output over the long run. To be effective, as a minimum the Performance Measurement System should:

- a. Define the work required to meet contract objectives and organizational elements responsible for accomplishing the work.
- b. Determine the costs accrued to date.
- c. Determine what portion of the initial estimates are associated with the specific job accomplished to date.
- d. Provide comparison of established plans with actual performances and determine the estimates for the work remaining and the amount funds available to be spent.

Performance measurement permits a rapid appraisal of contract cost and the ability to isolate and quantify problems. This visibility gives assurance that the contractor is properly managing the work. However, this is dependent on: the contractor's internal systems functioning as they are purported to be working and data for external reporting is derived from these same systems, and that actual costs are reported in a manner that will permit variance analysis from planning estimates traceable to successively lower levels within a contractor's operations.

**Criteria Requirements.** C/SCSC is not a system, but a set of criteria which contractors are required to meet with their internal planning and control system based on an integrated budgeting and scheduling discipline designed to support efficient, effective management of quality, schedule and cost. treated in the same manner.

Briefly stated, it requires the contractor to define the work required to meet contract objectives, assign the work to specifically identified organizational elements, establish internal schedules and budgets and periodically compare actual quality, cost and schedule performance against the plans, budgets and schedules projected. The sum of the internal budgets (plus or minus any management reserve) must always equal the total contract target cost plus the estimate for authorized but not yet negotiated work. This insures that all authorized work is treated in the same manner.

Each month the contractor totals the budgets for all work scheduled to have been completed. He also totals the budgets for the work actually accomplished and compares the two. The difference provides an indication of schedule conditions by relating the amount of work completed to the amount of work scheduled to be accomplished for the resources utilized. By summarizing these data elements up through the work breakdown structure, overall contract performance can be evaluated with respect to cost and schedule. By summarizing these data elements through the organization structure, performance of each functional organizations can be assessed. Either structure can be used by management to track back to the individual work packages or organizational units that are not performing according to plan.

The Department of Defense Instruction 7000.2, "Performance Measurement for Selected Acquisitions", specifies the use of cost/schedule control system criteria (C/SCSC) in contracts for the development and production of weapon and support systems. This approach to cost, schedule, and technical performance is intended to help industry and Government reach a mutual understanding of the criteria to be applied to the management of defense contracts. C/SCSC is used on multi-million dollar contracts. Exceptions can be made on an individual basis.

The criteria approach does not impose a standard system on contractors. Rather it specifies the capabilities that a contractor's internal planning and control systems must possess to be acceptable to the Department of Defense.

# *If the Pharaoh Had Only Used An Earned Value System in Building the Pyramids*

*Lieutenant Colonel William J. Niemann, USAF*

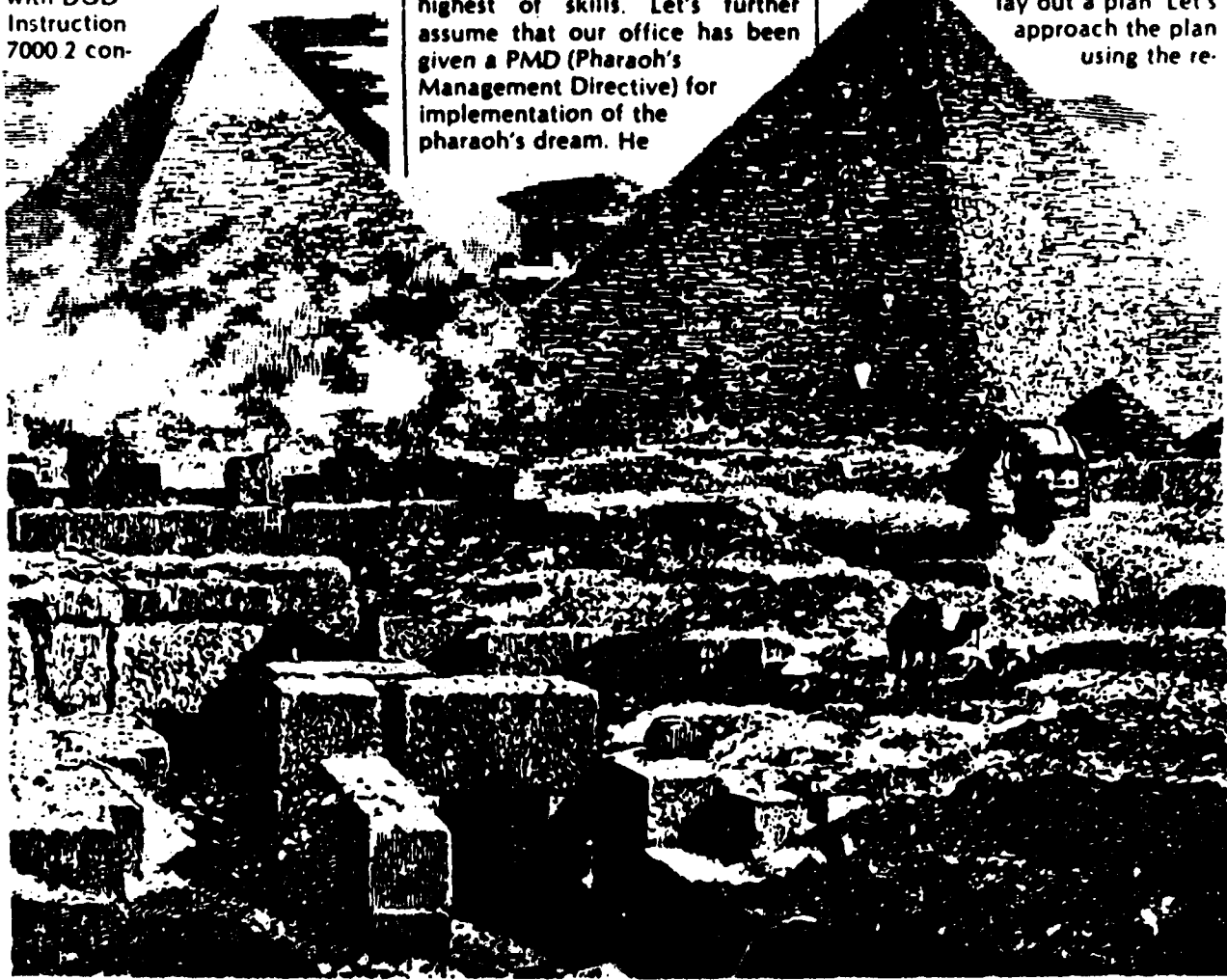
**T**he developer of the great pyramid of Egypt might be looked upon as the father of program management. He had one of the first programs in recorded history that required a great deal of integration and coordination (i.e., program management). He did not, however, have the relatively new concept of "earned value" to assist in the management of this ambitious program. An "earned value" concept is the heart of a defense contractor management information systems which comply with DOD Instruction 7000.2 con-

cerning the cost schedule control systems criteria (C/SCSC). But let's go back nearly 5,000 years to the construction of the pyramids to see if "earned value" would have been of any utility in managing that program.

Let's assume we are all members of the pharaoh's air force and work in a program management office. We are competing for resources with the Icarus, Pegasus, and Sphinx programs, so we must manage our technical, schedule, and cost performance with the highest of skills. Let's further assume that our office has been given a PMD (Pharaoh's Management Directive) for implementation of the pharaoh's dream. He

wants to build a tomb to keep out the barbarians, last forever, etc. We have been given 20 years and a budget of \$22 million (\$ is the symbol for shekel) to accomplish the task. The pharaoh also wants us to report the status of the program to him on a quarterly basis using the PAR (Pharaoh's Acquisition Report) format.

Now that we have our marching orders, what's the first thing we should do? As a military organization, experience would tell us that we need to lay out a plan. Let's approach the plan using the re-

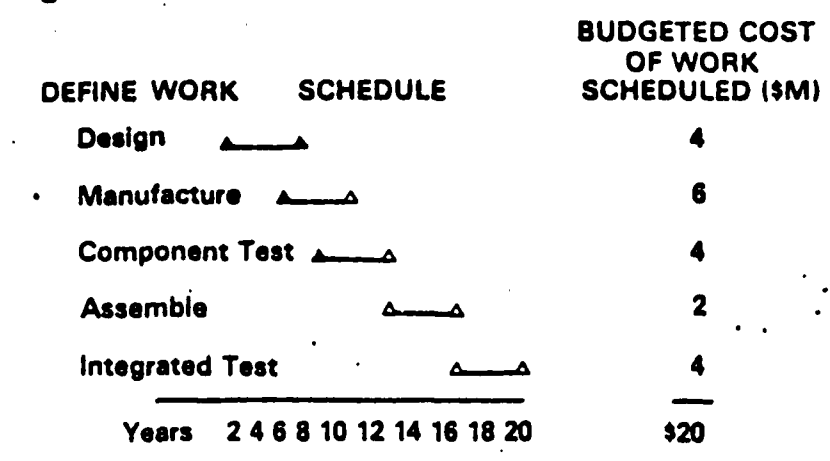


requirements and available resources. To convert the pharaoh's requirements into brick and mortar, we need to break down the work into its component tasks and distribute the responsibilities within the office. We could break down the work into either product-oriented or functionally oriented categories. For our purposes, let's break the work down into the functional categories shown in Figure 1. We could, of course, discuss whether this is the correct functional breakdown, but for our purposes, let's assume this breakdown of the work is adequate.

What next? We must look at the resources available for the completion of the program. One of those resources is time. In conjunction with the individuals responsible for each functional area, we determine the amount of time required for each task and the interrelationships of the tasks. Figure 1 shows the agreed-to times for accomplishing the individual tasks and the overall program. We have not shown the interrelationship of the tasks on our chart.

Lastly, for our plan to be complete, we must determine the expected cost of each work task. Since we are still in the planning stage, the cost we are referring to is budgeted cost. But cost of what? The answer is, of course, cost of the work we have just scheduled, or budgeted cost of work scheduled (BCWS). Cost in our definition will include both direct and indirect costs, but not profit or fee. For the design task we have to budget for wages of the astrologers, alchemists, and engineers, as well as any material required in this task. We also have to budget for other direct charges (ODC) that may occur (i.e., abacus time, or travel to headquarters at Cairo). Finally, we must include an estimate of the overhead (indirect) charges which will be incurred. When all of these anticipated costs are added up, we see that Budgeted Cost for the Work Scheduled (BCWS) in the design

Figure 1. THE PROGRAM PLAN

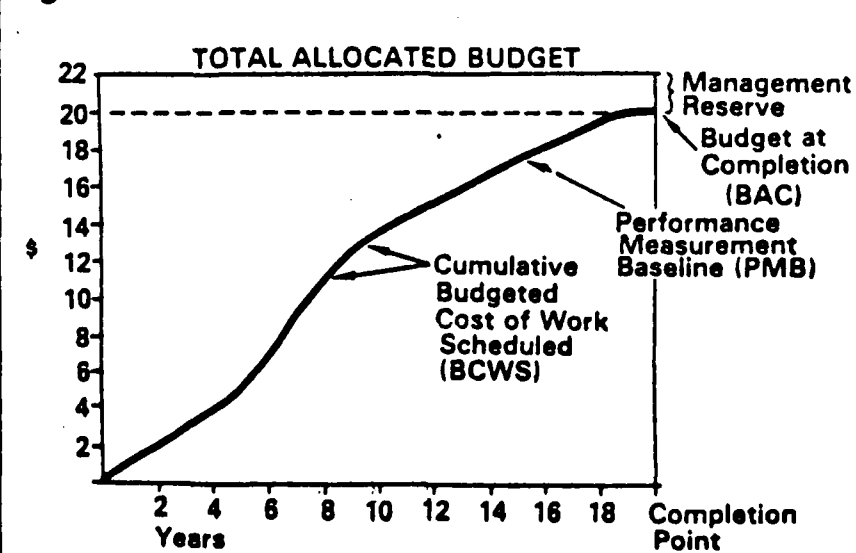


task is \$4 million. The manufacturing task is beyond our in-house capability and we plan to subcontract this to the Phoenicians, who are known to be shrewd negotiators, so we budget this task at \$6 million. For the component test, we will need to get the astrologers, alchemists, and abacus operators back together, and this is estimated to cost us \$4 million. For the assembly task, we intend to use slave labor, so the cost is relatively low at \$2 million. For the last task of integrated test, we expect the cost to be \$4 million. Note that when all the costs of all the tasks are added, the total is \$20 million, leaving \$2 million in

management reserve which the prudent program manager is setting aside for future problems (i.e., those infamous unk-unks).

In summary, we know the pharaoh likes to see a chart depicting shekels (\$) on the ordinate and time on the abscissa. This will result in a spend plan showing planned use of shekels over time. Taking the total amount of shekels expected to be expended over time, and then adding them cumulatively, results in a line in Figure 2 called the performance measurement baseline (PMB). This baseline is the result of adding together the BCWS for all tasks to be accomplished over certain time

Figure 2. THE TIME-PHASED SPEND PLAN



periods in the program. Management reserve (MR) is the difference between the total allocated budget and the budget at completion (BAC) of the performance measurement baseline (PMB). Clearly, management reserve lies outside of the PMB.

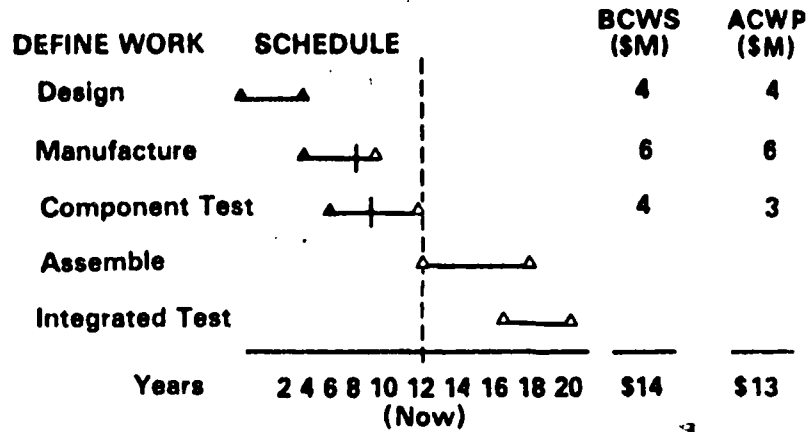
We now have laid out our basic program plan, and after developing several of the areas in a little more depth, we are ready to take our plan to the pharaoh for his approval. Let's assume the pharaoh is satisfied with our plan and gives us the program go-ahead, while reminding us that he wants us to report program progress on a quarterly basis.

Twelve years have now passed since program initiation. Like most programs we have had some success and some failures. It is now time to prepare another of our quarterly PAR reports to the pharaoh. What can we include in our reports? Let's look at our current status (Figure 3) and determine what we can tell the boss.

In our discussion with the manager of the design task, we found that he started his task on time and completed it on time by year 4. We know he had planned to spend \$4 million to do the task. We can also now collect some actual cost data. Using the bill of material, labor hours, and overhead rates, we can calculate the total amount of money actually spent to accomplish the design task. We find that \$4 million is the actual cost of work performed (ACWP). So far, so good. We spent exactly what we had projected to accomplish the design task.

Our discussion with the manager of the manufacturing task reveals that we are having a problem with our subcontractor, the Phoenicians. They are getting behind on their deliveries, and we only have 657 of the 1,000 granite cubes needed for the program. We had planned to spend (BCWS) \$6 million for this task and we have already spent (ACWP) \$6 million. The task is only two-thirds complete.

**Figure 3. CURRENT STATUS**



***“So far we have been out-prioritized by the Sphinx program for the use of the wind tunnel and have not been able to do the second test.”***



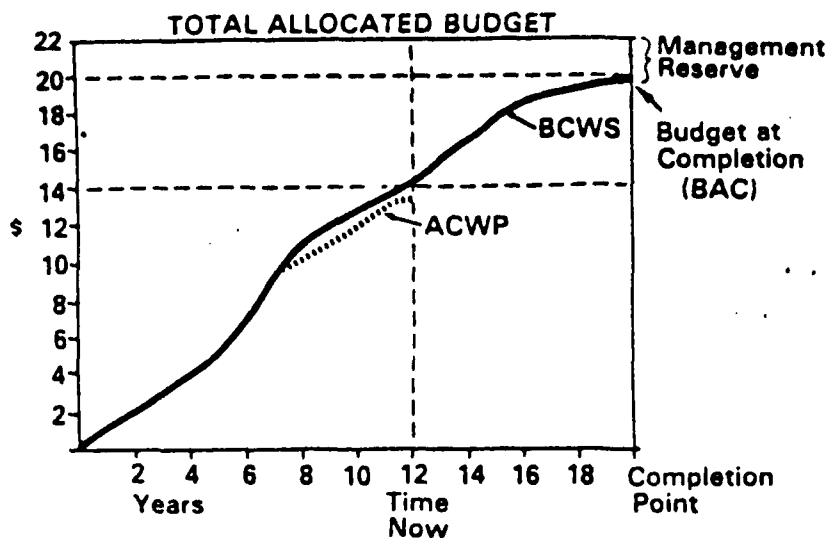
The component test area consists of two tests: a wind tunnel test and an environmental chamber test. Both tests are of equal cost. We have completed the environmental test, but have been out-prioritized by the Sphinx program for the use of the wind tunnel and unable to do the second test. We planned to spend \$4 million for the component test task and have spent \$3 million so far. The test effort is only one-half complete.

Let's again turn our attention to the spend plan (Figure 4), but let's include an indication of current status. We are at "time now" in year 12 and we had planned to spend (BCWS) a total of \$14 million by this time. We may also plot the actual cost of the work that was performed (ACWP), which totals \$13 million. We could have determined ACWP in previous reporting periods and plotted these points. These points also define a line which is an analog representation of the ACWP over time.

**W**hat could we tell the pharaoh from this information? By examining the current status chart we can determine that:

- we have spent less than we planned to spend at this point in time (planned to spend \$14 million, actually spent \$13 million);
- we still have \$2 million in management reserve;

**Figure 4. CURRENT STATUS IMPOSED ON THE SPEND PLAN**



— we have spent 65 percent of the money (ACWP \$13 million)

(BAC \$20 million); and

— we have done less work than we planned. We can tell this from looking at the schedule

The last time we briefed the pharaoh he asked some difficult questions. For example:

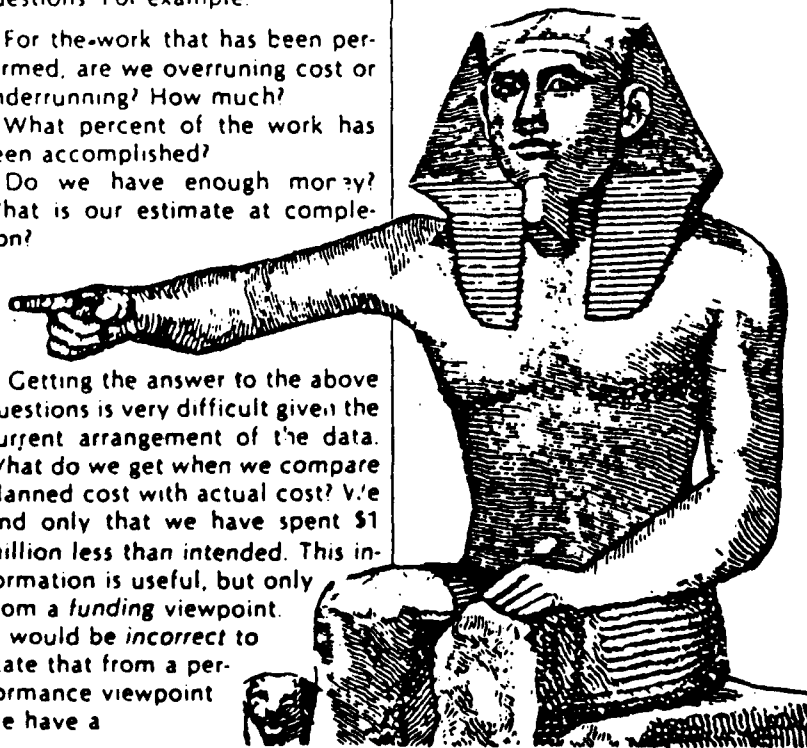
— For the work that has been performed, are we overrunning cost or underrunning? How much?

— What percent of the work has been accomplished?

— Do we have enough money? What is our estimate at completion?

Getting the answer to the above questions is very difficult given the current arrangement of the data. What do we get when we compare planned cost with actual cost? We find only that we have spent \$1 million less than intended. This information is useful, but only from a funding viewpoint. It would be *incorrect* to state that from a performance viewpoint we have a

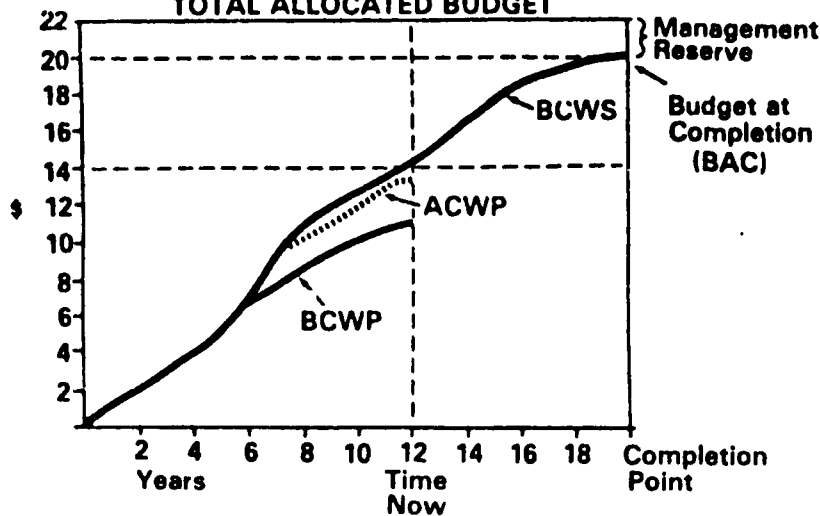
**“... a tomb that will keep out the barbarians, last forever... 20 years and a budget of \$22M... ”**



cost variance of +\$1 million. What we need is a measure of performance that takes into account what really has been accomplished. We could measure this accomplishment or work performed in terms of budgeted cost. This measurement of work performed is designated as “earned value” in C/SCSC terminology. The budgeted cost of work (BCWP) is a measurement of work accomplished in terms of the cost budgeted for that work and is the heart of a good cost performance reporting system. If we now subtract the actual cost of the work performed from the budgeted cost of work performed, we get a measurement, in \$, of the difference between planned cost and actual cost, for the same amount of work performed. Likewise, if we subtract the BCWS from the BCWP, we see in \$ the difference between the work scheduled and the work performed. Note that this \$ difference represents accomplishment of more or less work than originally planned. No consideration is given to the interrelationship of the tasks, so the ability to meet a particular milestone cannot be determined from this calculation. Said another way, there is no critical path consideration in the determination of schedule variance. Therefore, schedule variance is only a measure of how much more or less work has been accomplished than originally planned, *not* a complete measure of progress toward a completion date.

If “earned value” or BCWP is the key to good performance measurement, how is it calculated? Basically, BCWP is a measurement of the work performed compared to the original plan. For example, in the design task the budgeted cost for the task was \$4 million. All work has been performed, so a value of \$4 million worth of work has been “earned.” BCWP for this task is \$4 million. Note that the calculation of BCWP is completely independent of the actual cost of the work. In the manufacturing

**Figure 5. CURRENT STATUS  
IMPOSED ON THE SPEND PLAN  
TOTAL ALLOCATED BUDGET**



task, we have performed two-thirds of the total budgeted work of \$6 million. Therefore, BCWP for this task is \$4 million. Likewise, we have performed half of the component test task that was budgeted at \$4 million. Therefore, BCWP for this task is \$2 million. If we add the BCWP for the tasks, we can see that the BCWP for the program at time now is \$10 million. This means we can take "credit" for, or we have actually completed, \$10 million of the originally budgeted work.

The BCWP term is then plotted on the spend plan as shown in Figure 5. We are now in a better position to answer some of the pharaoh's questions. As far as determining current over/underrun is concerned, we simply subtract the ACWP (\$13 million) from the BCWP (\$10 million) and find we have an unfavorable variance of \$3 million or an overrun to date of \$3 million. We have scheduled to perform \$14 million worth of work (BCWS), but have performed (BCWP) only \$10 million worth. We have therefore performed \$4 million less work than planned, and are \$4 million behind schedule. Remember this work may or may not be on the critical path, so we must look at the schedule to determine progress

toward the completion date.

The percent complete may be calculated by dividing the work performed by the budget at completion (BAC). Therefore, 10/20 or 50 percent of the work has been accomplished. Remember, from an earlier calculation that 65 percent of the money has been spent (ACWP).

We are now ready to answer the pharaoh's last question. There are many different methods used to reach an estimate at completion (EAC). We could take the actual cost incurred to date (ACWP) and do a complete bottoms-up estimate for the remaining work. This is a time-consuming and costly process. We could use a "management estimate" of the remaining work. This tends to be very subjective and open to management optimism. We could make the assumption that in our work to date, we have established a certain cost efficiency, which will continue to program completion. We can develop such a "cost-efficiency index" by dividing the budgeted cost of work performed by the actual cost of work performed (BCWP/ACWP). In our example, this is 10/13 or .77. The cost efficiency index for the first half of the work accomplished is .77. If we

assume that this efficiency will continue to completion, we divide the BAC by the efficiency index (20/.77), and determine the EAC to be \$26 million. Said another way, we have accomplished 50 percent of the work at a cost of \$13 million, therefore, when the program is 100 percent complete, the cost is projected to be \$26 million.

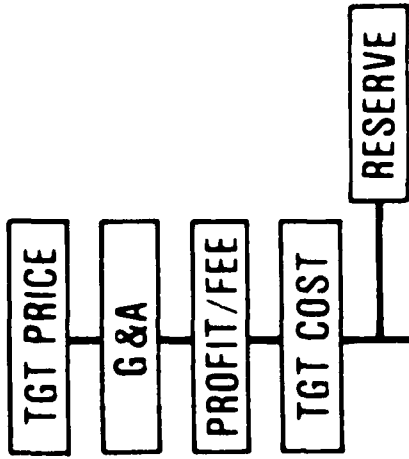
**T**his estimate at completion is \$4 million greater than currently authorized. What do we do? First, we must recognize the limitations of our estimate, but it indicates that it's time to reevaluate the direction of the program. Perhaps we should consider descopeing our effort, perhaps building the pyramid out of 800 blocks rather than 1,000, or canceling one of the tests. If this descopeing is not feasible, another alternative would be to look around for additional funds. Whatever we do, we must remember that the pharaoh doesn't like surprises and we must inform him as early as possible when we think we may have a funding problem. Earned value (BCWP) helps in finding those problems much earlier in the program life when a wide variety of alternatives are viable.

The purpose of this example is to point out the utility of the "earned value" method and to introduce some terms used in cost performance measurement. Many of the concepts, such as determination of BCWP, were only touched upon and will be further developed in future articles. The next article in this series will discuss preparing the environmental impact statement for the Pegasus project.

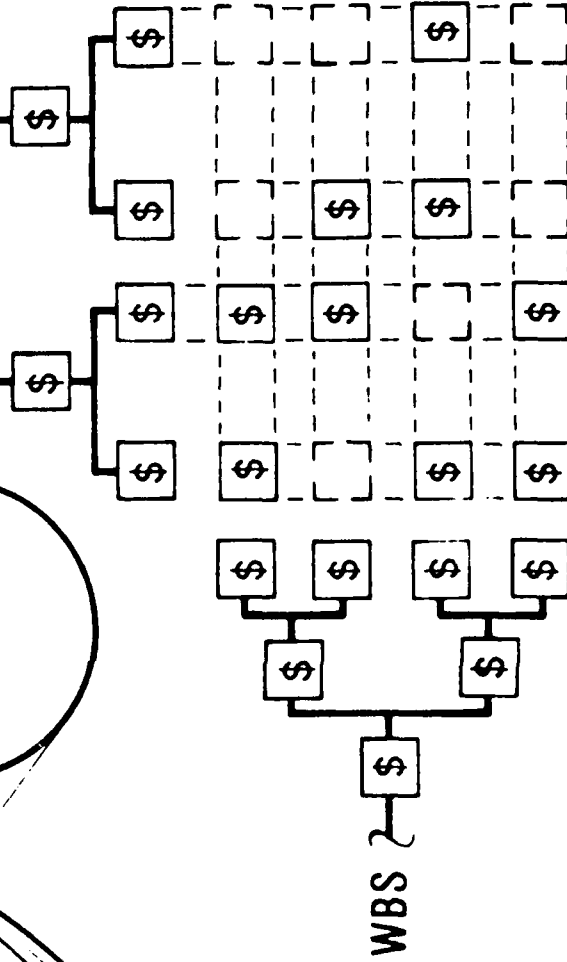
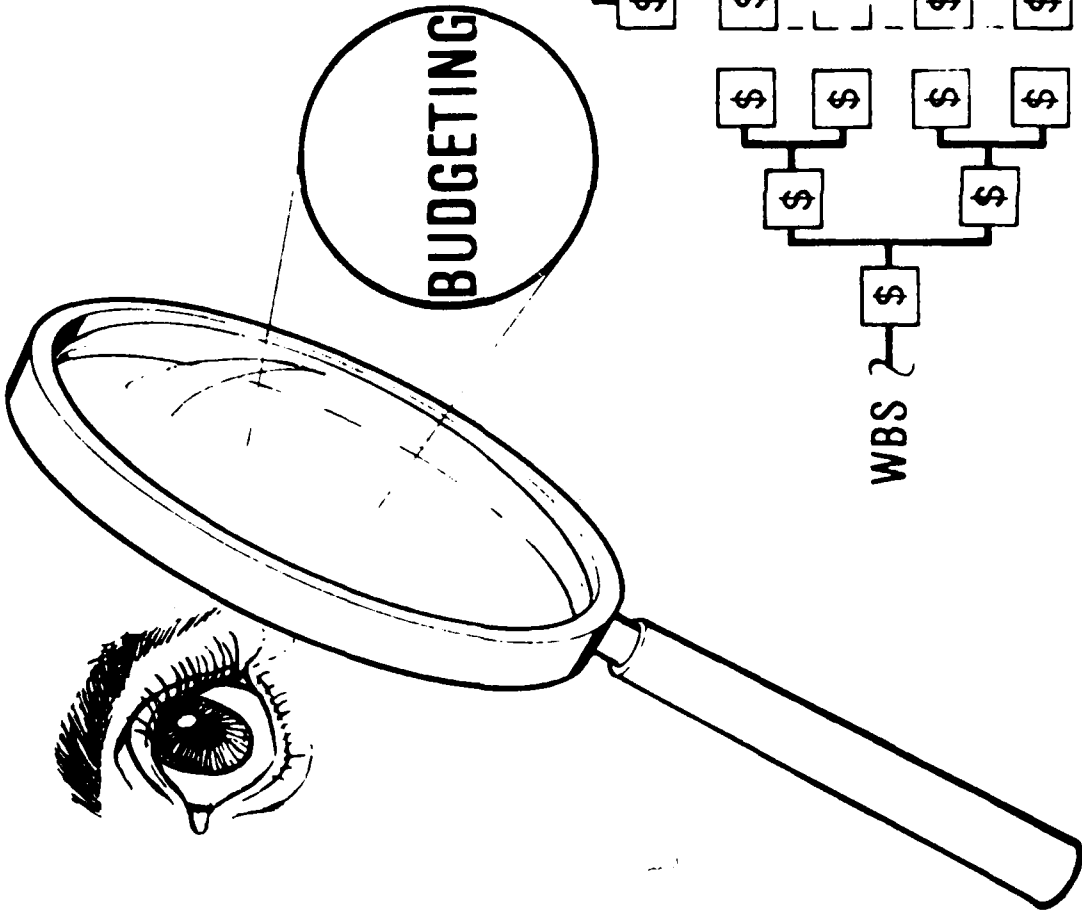


*LtCol Niemann is an Instructor of Systems Acquisition Management in DSMC's School of Systems Acquisition Education.*

**ORGANIZATION**



**BUDGETING**





WHEN DO WE USE

C/SCSC

- SELECTED CONTRACTORS  
MAJOR ACQUISITIONS

- RDT & E COSTS ARE ESTIMATED  
TO EXCEED \$ 200 MILLION
- PRODUCTION COSTS ARE ESTIMATED  
TO EXCEED \$1 BILLION
- SELECTED SUBCONTRACTORS ON  
CRITICAL PROGRAMS

- HOW MUCH DID WE PLAN TO SPEND FOR THE WORK THAT HAS BEEN DONE?
- HOW MUCH DID WE ACTUALLY SPEND FOR THAT WORK?
- WHAT DO THE VARIANCES MEAN?
- HOW MUCH DETAIL DO WE NEED?

WHAT DO I NEED TO KNOW?



C/S<sub>2</sub> COST VARIANCE

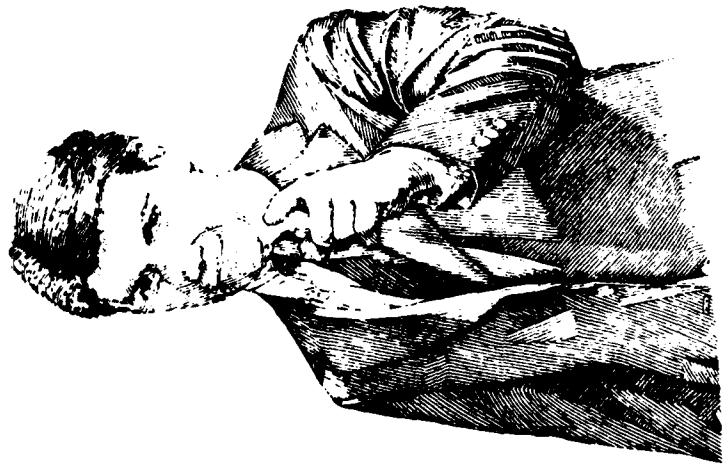


• HOW MUCH WORK WAS SCHEDULED TO BE DONE?

• WHAT DID WE PLAN TO SPEND FOR THAT WORK?

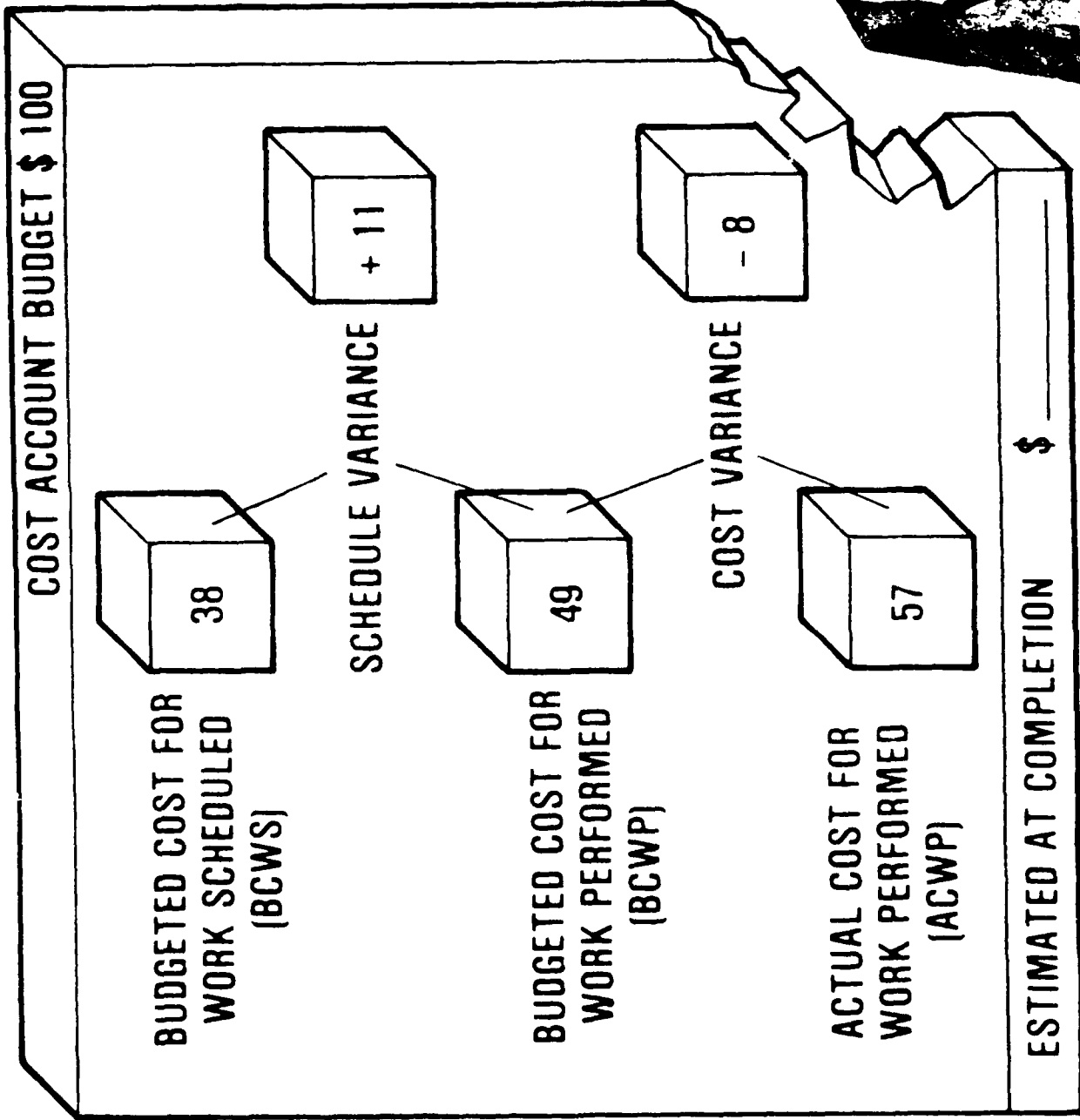
• HOW MUCH WORK WAS ACTUALLY DONE?

• WHAT DO THE VARIANCES MEAN?



WHAT DO I NEED TO KNOW?



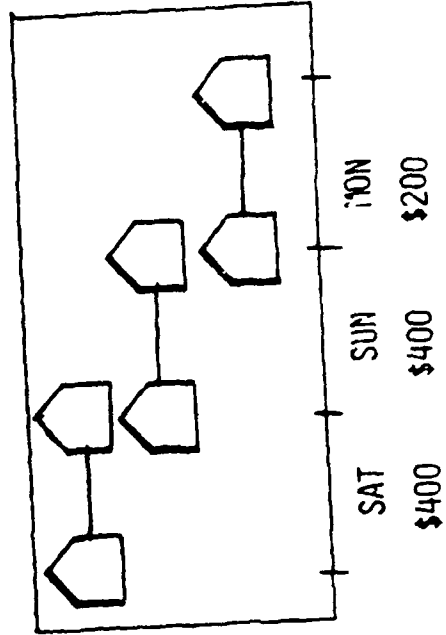


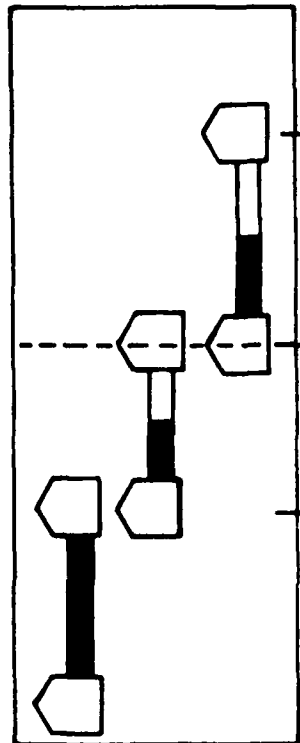
EARNED VALUE EXAMPLE

- WORK PACKAGE SCHEDULE
  - SUBTASK B.21
- STATEMENT OF WORK
  - INTERIOR PAINTING, CLASSROOMS 2, 3, 4
- RESPONSIBLE MANAGER
  - MR. NORM BECKWALL
- SCHEDULE
  - 15, 16, 17 FEBRUARY

PAINT C.R. 2  
 PAINT C.R. 3  
 PAINT C.R. 4

B.C.W.S.





PAINT C.R. 2  
 PAINT C.R. 3  
 PAINT C.R. 4

	SAT	SUN	MON
BCWS DAILY	\$400	\$400	\$200
CUM	\$400	\$800	
BCWP DAILY	\$400	\$350	
CUM	\$400	\$750	
ACWP DAILY	\$500	\$350	
CUM	\$500	\$850	

BENEFITS PROVIDED BY C/SCSC

- CONFIDENCE IN CONTRACTOR'S INTERNAL MANAGEMENT SYSTEM
- OBJECTIVE (RATHER THAN SUBJECTIVE) CONTRACT STATUS INFORMATION
- COST IMPACT OF KNOWN PROBLEMS
- IDENTIFICATION OF PROBLEMS NOT PREVIOUSLY RECOGNIZED
- CAPABILITY TO TRACE PROBLEMS TO SOURCE (HARDWARD AND FUNCTION)
- QUANTATIVE MEASURE OF SCHEDULE DEVIATION IN DOLLARS
- MEASUREMENT AGAINST A CONTRACT ORIENTED BASELINE

CONTRACTOR		COST/SCHEDULE STATUS REPORT			SIGNATURE, TITLE & DATE		FORM APPROVED	
LOCATION:	PROGRAM NAME/NUMBER	CONTRACT TYPE/NO:	REPORT PERIOD:			ONR NUMBER		
ROB & D PRODUCTION	00019-XX-C-0157	FP/EP	12-1-XX to 12-31-XX	P.M. 1-8-XX+1		22R0327		
CONTRACT DATA								
(11) ORIGINAL CONTRACT TARGET COST	(12) NEGOTIATED CONTRACT CHANGES	(13) CURRENT TARGET COST (11) + (12)	(14) ESTIMATED COST OF AUTHORIZED, UNPRICED WORK	(15) CONTRACT BUDGET BASELINE (13) + (14)				
\$228,900	\$63,520	\$292,420	0	\$292,420				
PERFORMANCE DATA								
WORK BREAKDOWN STRUCTURE	BUDGETED COST			ACTUAL COST		VARIANCE		AT COMPLETION
	WORK SCHEDULED	WORK PERFORMED	WORK PERFORMED	SCHEDULE	COST	BUDGETED	LATEST REVISED ESTIMATE	
AIR VEHICLE	29,775	25,348	32,235	(4427)	(6887)	76,234	76,584	(350)
COMMAND & LAU Eqp	24,772	23,506	26,008	(1266)	(2502)	82,494	83,255	(761)
TRACKED VEHICLE	6,399	6,185	6,496	(214)	(311)	23,026	23,239	(213)
TRAINING	274	271	285	(3)	(14)	1,930	1,930	0
PECULIAR SUPPORT Eqp	119	115	114	(4)	1	2,386	2,386	0
SYSTEMS TEST & EVAL	6,487	5,655	6,975	(832)	(1320)	26,681	26,995	(314)
PROJECT MGT	7,570	7,380	7,470	(190)	(90)	18,836	18,836	0
DATA	886	911	911	25	0	8,362	8,062	300
REPAIR PARTS	0	0	0	0	0	6,699	6,699	0
G&A	10,451	9,504	11,028	(947)	(1524)	33,790	33,974	(184)
SUBTOTAL	86,733	78,875	91,522	(7858)	(12647)	280,438	281,960	(1522)
UNDISTRIBUTED BUDGET								
MANAGEMENT RESERVE						11,982		11,982
TOTAL	86,733	78,875	91,522	(7858)	(12647)	292,420	281,960	10,460



## C/SCSC ANALYSIS TECHNIQUES/FORMULAE

1. COST/SCHEDULE VARIANCE--Can apply to either current or cumulative data.
  - a.  $CV = BCWP - ACWP$
  - b.  $SV = BCWP - BCWS$
2. COST/SCHEDULE VARIANCE PERCENTAGES
  - a.  $CV \% = \frac{CV}{BCWP}$
  - b.  $SV \% = \frac{SV}{BCWS}$
3. PERFORMANCE INDICES (PI)--There are two general concepts: efficiency and performance. Either can apply to current or cumulative data; however, it tends to be more meaningful with cumulative data.
  - a. Under the efficiency concept, the purpose of the PI is to indicate the efficiency with which work has been accomplished.
    - (1) Cost Performance Index  $CPI(E) = \frac{BCWP}{ACWP}$
    - (2) Schedule Performance Index  $SPI(E) = \frac{BCWP}{BCWS}$
  - b. Under the performance concept, the purpose of the cost performance index is to indicate the actual cost of each planned dollar of work accomplished. The formula for this CPI is merely the inverse of the one shown above, or:
$$CPI(P) = \frac{ACWP}{BCWP}$$
4. SCHEDULE CONVERSION TECHNIQUES--There are several techniques; however, they all have shortcomings because of some of the following reasons:
  - a. No "critical path" is reflected on the CPR data.
  - b. There can be a masking effect using summary level reporting.

- c. Most techniques are based on the assumption of an average expenditure rate, which may not be valid.

Regardless of these shortcomings, techniques do exist and are used. Shown below are a few examples:

$$d. \text{ MONTHS (AHEAD OR BEHIND) } = \frac{SV_{cum}}{BCWP_{cum} / \text{Months of Contract to date}}$$

$$e. \text{ MONTHS (AHEAD OR BEHIND) } = \frac{(BAC^* / SPI_{cum} - BAC)}{BCWP_{cur}}$$

$$f. \text{ MONTHS (AHEAD OR BEHIND) } = \frac{SV_{cum}}{BCWS_{cur}}$$

5. PERCENT COMPLETE/SPENT

$$a. \text{ PERCENT COMPLETE } = \frac{BCWP_{cum}}{BAC}$$

- b. PERCENT SPENT--There are two ways of looking at this, depending upon whether you are comparing the percent spent to (1) the contract amount or (2) the contractor's latest revised estimated cost at completion. These two methods are reflected below:

$$(1) \% \text{ SPENT } = \frac{ACWP_{cum}}{BAC \text{ (Column 12)}}$$

$$(2) \% \text{ SPENT } = \frac{ACWP_{cum}}{LRE \text{ (Column 13)}}$$

6. "TO COMPLETE" PERFORMANCE INDEX (TCPI)--Basically, this is a comparison of the work remaining to the amount of money remaining. The results of this formula indicate the cost efficiency at which the contractor must perform to meet his estimated cost at completion (EAC) reported in Column 13 of the CPR. For example, if the TCPI was 1.15, this means that to complete the contract within the EAC, he must perform at an efficiency of 115 percent. If his performance to date is significantly below that, this should raise a serious question. The formula itself is as follows:

$$TCPI = \frac{\text{Work Remaining}}{\text{Money Remaining}} = \frac{BAC - BCWP_{cum}}{LRE - ACWP_{cum}}$$

\*Unless otherwise stated all occurrences of BAC should be interpreted as BAC less management reserve (MR).

MIL-STD-1567A

DEFINITION

TRADITIONAL:

COMPARISON OF ACTUAL TIME TO COMPLETE A  
TASK TO TIME IT "SHOULD TAKE" (LABOR TIME  
STANDARD) TO COMPLETE THE SAME TASK

PREFERRED:

A STRUCTURED APPROACH TO PRODUCTIVITY  
IMPROVEMENT

## FOREWORD

The purpose of this standard is to assist in achieving increased discipline in contractors' work measurement programs with the objective of improved productivity and efficiency in contractor industrial operations. Experience has shown that excess manpower and lost time can be identified, reduced, and continued method improvements made regularly where work measurement programs have been implemented and conscientiously pursued.

Active support of the program by all affected levels of management, based on an appreciation of work measurement and its objectives, is vitally important. Work Measurement and the reporting of labor performance is not considered an end in itself but a means to more effective management. Understanding the implication inherent in the objectives of the work measurement program will promote realization of its full value. It is important that objectives be presented and clearly demonstrated to all personnel who will be closely associated with the program.

The following are benefits which can accrue as a result of the employment of a work measurement program.

(a) Achieving greater output from a given amount of resources.

(b) Obtaining lower unit cost at all levels of production because production is more efficient.

(c) Reducing the amount of waste time in performing operations.

(d) Reducing extra operations and the extra equipment needed to perform these operations.

(e) Encouraging continued attention to methods and process analysis because of the necessity for achieving improved performance.

(f) Improving the budgeting process and providing a basis for price estimating, including the development of Government Cost Estimates and should cost analyses.

(g) Acting as a basis for planning for long-term manpower, equipment, and capital requirements.

(h) Improving production control activities and delivery time estimation.

(i) Focusing continual attention on cost reduction and cost control.

(j) Helping in the solution of layout and materials handling problems by providing accurate figures for planning and utilization of such equipment.

(k) Providing an objective and measured base from which management and labor can project piecework requirements, earnings and performance incentives.

While recognizing the benefits that may normally be expected from the requirement for a work measurement system, it is DOD policy to selectively apply and tailor standardization documents to ensure their cost-effective use in the acquisition process. Each program office should carefully consider, within DOD and Service guidelines, benefits and costs of imposing MIL-STD-1567 on each specific acquisition. Contractors may propose document application and tailoring modifications with supporting rationale for such modifications.

The DOD is committed to development and coordination with industry of detailed application guidance to accompany MIL-STD-1567. The purpose of this guidance is to provide non-contractual information on when and how to use the document, the source of and flexibility inherent within specific document requirements, information on what is required to satisfy document requirements, and the extent of Government review and approval. The guidance is intended to promote consistency in application and interpretation of MIL-STD-1567 requirements. Until this guidance can be issued in the form of an "Application Guidance" appendix to MIL-STD-1567, or in a separate Military Handbook, the following applies:

(a) Use and correct application of appropriate predetermined time systems can be assumed to satisfy Government requirements for system accuracy.

(b) The contractor and the Government are encouraged to come to an early agreement (possibly in the form of a Memorandum of Understanding) of what constitutes an acceptable system satisfying the intent of this standard.

(c) Care should be exercised in the use of a work measurement system to ensure that the overall intent is not lost. Management understanding and attention to the manufacturing process is necessary for increased productivity. Work measurement provides one of the tools; however, misuse could result in reduced workforce motivation and productivity.

Feedback on the success or difficulties encountered (benefits and costs) in the application of this standard on specific contracts is encouraged. Contractor/industry and Government experience should be forwarded to the address indicated on page ii.

MIL-STD 1567A

APPLICATION CRITERIA

DEVELOPMENT  $\geq$  \$100 MIL

PROD'N  $\geq$  \$20 MIL ANNUALLY OR \$100 MIL CUM

SUBCONTRACTS  $\geq$  \$5 MIL ANNUALLY OR \$25 MIL CUM

DOES NOT APPLY TO:

LOW VOLUME, NON-REPETITIVE PROD'N

SERVICE CONTRACTS

FACILITIES, CONSTRUCTION, SHIP CONSTRUCTION

OFF-THE-SHELF ITEMS

TIME & MAT'LS, RESEARCH, STUDY, OR DEVELOPMENT  
NOT CONNECTED WITH AN ACQUISITION PROGRAM

POTENTIAL BENEFITS / ADVANTAGES

EVALUATE WORKER PERFORMANCE + PERFORMANCE GOAL SETTING

PLAN WORK FORCE NEEDS

CONVERSELY, DETERMINE AVAILABLE CAPACITY

GIVE VISIBILITY INTO LABOR INEFFICIENCIES

COMPARE WORK METHODS / ALTERNATE MFG METHODS

FACILITATE OPERATIONS SCHEDULING

DETERMINE COST / PRICE OF A PRODUCT

ESTABLISH WAGE INCENTIVES



ISSUES / CONCERNS

MISUSE AS A "CLUB" OVER WORKERS

MISUSE BY CONGRESS / MEDIA TO JUDGE PROJECT PERFORMANCE

MISUSE OF TYPE I STANDARDS FOR NON-REPETITIVE WORK

INAPPROPRIATE MICROMANAGEMENT OF INDUSTRY IMPLEMENTATION

MISUSE OF STANDARDS TO COMPARE DIFFERENT CONTRACTORS,  
PROGRAMS, OR PROGRAM PHASES

**PART 48**  
**VALUE ENGINEERING**

**48.000 Scope of part.**

This part prescribes policies and procedures for using and administering value engineering techniques in contracts.

**48.001 Definitions.**

"Acquisition savings," as used in this part, means saving resulting from the application of a value engineering change proposal (VECP) to contracts awarded by the same contracting office or its successor (and by other contracting offices if included in an extended sharing base under 48.102(e)) for essentially the same unit. Acquisition savings include—

(a) Instant contract savings, which are the net cost reductions on the contract under which the VECP is submitted and accepted, and which are equal to the instant unit cost reduction multiplied by the number of instant contract units affected by the VECP, less the contractor's allowable development and implementation costs;

(b) Concurrent contract savings, which are measurable net reductions in the prices of other contracts that are definitized and ongoing at the time the VECP is accepted; and

(c) Future contract savings, which are the product of the future unit cost reduction multiplied by the number of future contract units scheduled for delivery during the sharing period (but see 48.102(f)). If the instant contract is a multiyear contract, future contract savings include savings on all quantities funded after VECP acceptance.

"Collateral costs," as used in this part, means agency costs of operation, maintenance logistic support, or Government-furnished property.

"Collateral savings," as used in this part, means those measurable net reductions resulting from a VECP in the agency's overall projected collateral costs, exclusive of acquisition savings, whether or not the acquisition cost changes.

"Contracting office," as used in this part, includes any contracting office that the acquisition is transferred to, such as another branch of the agency or another agency's office that is performing a joint acquisition action.

"Contractor's development and implementation costs," as used in this part, means those costs the contractor incurs on a VECP specifically in developing,

testing, preparing, and submitting the VECP, as well as those costs the contractor incurs to make the contractual changes required by Government acceptance of a VECP.

"Future unit cost reduction," as used in this part, means the instant unit cost reduction adjusted as the contracting officer considers necessary for projected learning or changes in quantity during the sharing period. It is calculated at the time the VECP is accepted and applies either (a) throughout the sharing period, unless the contracting officer decides that recalculation is necessary because conditions are significantly different from those previously anticipated or (b) to the calculation of a lump-sum payment, which cannot later be revised.

"Government costs," as used in this part, means those agency costs that result directly from developing and implementing the VECP, such as any net increases in the cost of testing, operations, maintenance, and logistics support. The term does not include the normal administrative costs of processing the VECP or any increase in instant contract cost or price resulting from negative instant contract savings.

"Instant contract," as used in this part, means the contract under which the VECP is submitted. It does not include increases in quantities after acceptance of the VECP that are due to contract modifications, exercise of options, or additional orders. If the contract is a multiyear contract, the term does not include quantities funded after VECP acceptance. In a fixed-price contract with prospective price redetermination, the term refers to the period for which firm prices have been established.

"Instant unit cost reduction" means the amount of the decrease in unit cost of performance (without deducting any contractor's development or implementation costs) resulting from using the VECP on the instant contract. In service contracts, the instant unit cost reduction is normally equal to the number of hours per line-item task saved by using the VECP on the instant contract, multiplied by the appropriate contract labor rate.

"Negative instant contract savings" means the increase in the instant contract cost or price when the acceptance of a VECP results in an excess of the contractor's allowable development and implementation costs over the product of the instant unit cost reduction multiplied by the number of instant contract units affected.

"Net acquisition savings" means total acquisition savings, including instant, concurrent, and future contract savings, less Government costs.

"Sharing base," as used in this part, means the number of affected end items on contracts of the contracting office accepting the VECP or, if the sharing base has been extended under 48.102(e), the number of affected end items on contracts of the contracting offices within the extended base.

"Sharing period," as used in this part, means the period beginning with acceptance of the first unit incorporating the VECP and ending at the later of (a) 3 years after the first unit affected by the VECP is accepted or (b) the last scheduled delivery date of an item affected by the VECP under the instant contract delivery schedule in effect at the time the VECP is accepted (but see 48.102(f)).

"Unit," as used in this part, means the item or task to which the contracting officer and the contractor agree the VECP applies.

"Value engineering change proposal (VECP)" means a proposal that—

(a) Requires a change to the instant contract to implement; and

(b) Results in reducing the overall projected cost to the agency without impairing essential functions or characteristics; *provided*, that it does not involve a change—

(1) In deliverable end item quantities only;

(2) In research and development (R&D) items or R&D test quantities that are due solely to results of previous testing under the instant contract; or

(3) To the contract type only.

## SUBPART 48.1—POLICIES AND PROCEDURES

### 48.101 General.

(a) Value engineering is the formal technique by which contractors may (1) voluntarily suggest methods for performing more economically and share in any resulting savings or (2) be required to establish a program to identify and submit to the Government methods for performing more economically. Value engineering attempts to eliminate, without impairing essential functions or characteristics, anything that increases acquisition, operation, or support costs.

(b) There are two value engineering approaches:

(1) The first is an incentive approach in which contractor participation is voluntary and the contractor uses its own resources to develop and submit any value engineering change proposals (VECP's). The contract provides for sharing of savings and for payment of the contractor's allowable development and implementation costs only if a VECP is accepted. This voluntary approach should not in itself increase costs to the Government.

(2) The second approach is a mandatory program in which the Government requires and pays for a

specific value engineering program effort. The contractor must perform value engineering of the scope and level of effort required by the Government's program plan and included as a separately priced item of work in the contract Schedule. Except in architect-engineer contracts, the contractor shares in savings on accepted VECP's, but at a lower percentage rate than under the voluntary approach. The objective of this value engineering program requirement is to ensure that the contractor's value engineering effort is applied to areas of the contract that offer opportunities for considerable savings consistent with the functional requirements of the end item of the contract.

### 48.102 Policies.

(a) Agencies shall provide contractors a substantial financial incentive to develop and submit VECP's. However, the agency head may elect to exempt the agency completely (or exempt a category of contracts) from the requirements of this Part 48.

(b) Agencies shall provide contractors (1) objective and expeditious processing of VECP's submitted and (2) a fair share of the savings on accepted VECP's.

(c) By requiring incorporation of value engineering clauses in appropriate subcontracts, agencies shall encourage subcontractors to submit VECP's.

(d) Value engineering incentive payments do not constitute profit or fee within the limitations imposed by 10 U.S.C. 2306(d) and 41 U.S.C. 254(b) (see 15.903(d)).

(e) The agency head or a designee shall, to the maximum extent feasible, extend the sharing base to include affected end items on contracts of the entire agency or any part of it by determining in writing that to do so would be more equitable or would significantly increase contractor participation. The agency head or a designee may delegate to the head of a contracting activity authority to extend the sharing base to include the entire contracting activity or any part of it.

(f) In the case of contracts for items requiring an extended period for production (e.g., ship construction, major system acquisition), agencies may prescribe sharing of future contract savings on all future contract units to be delivered under contracts awarded for essentially the same item during the sharing period, even if the scheduled delivery date is outside the sharing period. For engineering-development and low-rate-initial-production contracts, the future sharing shall be on scheduled deliveries equal in number to the quantity required over the highest 36 consecutive months of planned production, based on planning or production documentation at the time the VECP is accepted.

(g) Agencies shall establish procedures for funding and payment of the contractor's share of collateral savings and future contract savings.

**48.103 Processing value engineering change proposals.**

(a) Instructions to the contractor for preparing a VECP and submitting it to the Government are included in paragraphs (c) and (d) of the value engineering clauses prescribed in Subpart 48.2. Upon receiving a VECP, the contracting officer or other designated official shall promptly process and objectively evaluate the VECP in accordance with agency procedures.

(b) The contracting officer is responsible for accepting or rejecting the VECP within 45 days from its receipt by the Government. If the Government will need more time to evaluate the VECP, the contracting officer shall notify the contractor promptly in writing, giving the reasons and the anticipated decision date. If the VECP is rejected, the contracting officer shall notify the contractor promptly in writing, giving the reasons. A VECP is accepted by a contract modification. The contracting officer shall cite the contract's value engineering clause when modifying the contract to incorporate a VECP or when making any value-engineering-related change.

(c) The following Government decisions are not subject to the Disputes clause or otherwise subject to litigation under the Contract Disputes Act of 1978 (41 U.S.C. 601-613):

- (1) The decision to accept or reject a VECP.
- (2) The determination of collateral costs or collateral savings.
- (3) The decision as to which of the sharing rates applies when Alternate II of the clause at 52.248-1, Value Engineering, is used.

**48.104 Sharing arrangements.**

**48.104-1 Sharing acquisition savings.**

(a) *Supply or service contracts.* (1) The sharing base for acquisition savings is normally the number of affected end items on contracts of the contracting office accepting the VECP. When the agency head or designee has extended the sharing base under 48.102(e), the contracting officer shall specify the scope of the extended sharing base in the contract Schedule. The sharing rates (Government/contractor) for net acquisition savings for supplies and services are based on the type of contract, the value engineering clause or alternate used, and the type of savings, as follows:

**GOVERNMENT/CONTRACTOR SHARES OF NET ACQUISITION SAVINGS**

(figures in percent)

Contract Type	Sharing Arrangement			
	Incentive (voluntary)		Program requirement (mandatory)	
	Instant contract rate	Concurrent and future rate	Instant contract rate	Concurrent and future contract rate
Fixed-price (other than incentive)	50/50	50/50	75/25	75/25
Incentive (fixed-price or cost)	*	50/50	*	75/25
Cost-reimbursement (other than incentive)**	75/25	75/25	85/15	85/15

\*Same sharing arrangement as the contract's profit or fee adjustment formula.

\*\*Includes cost-plus-award-fee contracts.

(2) Acquisition savings may be realized on the instant contract, concurrent contracts, and future contracts. The contractor is entitled to a percentage share (see subparagraph (1) above) of any net acquisition savings. Net acquisition savings result when the total of acquisition savings becomes greater than the total of Government costs and any negative instant contract savings. This may occur on the instant contract or it may not occur until reductions have been negotiated on concurrent contracts or until future contract savings are calculated, either through lump-sum payment or as each future contract is awarded. The contractor's profit or fee shall be excluded when calculating instant and future contract savings.

(i) When the instant contract is not an incentive contract, the contractor's share of new acquisition savings is calculated and paid each time such savings are realized. This may occur once, several times, or, in rare cases, not at all.

(ii) When the instant contract is an incentive contract, the contractor shares in instant contract savings through the contract's incentive structure. In calculating acquisition savings under incentive contracts, the contracting officer shall add any negative instant contract savings to the target cost or to the target price and ceiling price and then offset these negative instant contract savings and any Government costs against concurrent and future contract savings.

(3) The contractor shares in the savings on all affected units scheduled for delivery during the sharing period (but see 48.102(f)). The contractor is responsible for maintaining, for 3 years after final payment on the contract under which the VECP was

accepted, records adequate to identify the first delivered unit incorporating the applicable VECP.

(4) Contractor shares of savings are paid through the contract under which the VECP was accepted. On incentive contracts, the contractor's share of concurrent and future contract savings and of collateral savings shall be paid as a separate firm-fixed-price contract line item on the instant contract.

(5) Within 3 months after concurrent contracts have been modified to reflect price reductions attributable to use of the VECP, the contracting officer shall modify the instant contract to provide the contractor's share of savings.

(6) The contractor's share of future contract savings may be paid as subsequent contracts are awarded or in a lump-sum payment at the time the VECP is accepted. The lump-sum method may be used only if the contracting officer has established that this is the best way to proceed and the contractor agrees. The contracting officer ordinarily shall make calculations as future contracts are awarded and, within 3 months after their award, modify the instant contract to provide the contractor's share of savings. For future contract savings calculated under the optional lump-sum method, the sharing base is an estimate of the number of items that the contracting office (but see 48.102(e) and subparagraph (1) above) will purchase for delivery during the sharing period. In deciding whether or not to use the more convenient lump-sum method for an individual VECP, the contracting officer shall consider--

(i) The accuracy with which the number of items to be delivered during the sharing period can be estimated and the probability of actual production of the projected quantity;

(ii) The availability of funds for a lump-sum payment; and

(iii) The administrative expense of amending the instant contract as future contracts are awarded.

(b) *Construction contracts.* Sharing on construction contracts applies only to savings on the instant contract and to collateral savings. The contractor's share of savings is determined by subtracting Government costs from instant contract savings and multiplying the result by (1) 55 percent for fixed-price contracts or (2) 25 percent for cost-reimbursement contracts. Value engineering sharing does not apply to incentive construction contracts.

#### 48.104-2 Sharing collateral savings.

(a) The Government shares collateral savings with the contractor, unless the head of the contracting activity has determined that the cost of calculating and tracking collateral savings will exceed the benefits to be derived (see 48.201(e)).

(b) The contractor's share of collateral savings is 20 percent of the estimated savings to be realized during an average year of use but shall not exceed (1) the

contract's firm-fixed-price, target price, target cost, or estimated cost, at the time the VECP is accepted, or (2) \$100,000, whichever is greater. In determining collateral savings, the contracting officer shall consider any degradation of performance, service life, or capability. (See 48.104-1(a)(4) for payment of collateral savings through the instant contract.)

#### 48.104-3 Sharing alternative—no-cost settlement method.

To minimize the administrative costs for both parties when there is a known continuing requirement for the unit, consideration should be given to the settlement of a VECP submitted against the VE Incentive clause of the contract at no cost to either party. Under this method of settlement, the contractor would keep all of the savings on the instant contract, and all savings on its concurrent contracts only. The Government would keep all savings resulting from concurrent contracts placed on other sources, savings from all future contracts and all collateral savings. Use of this method must be by mutual agreement of both parties for individual VECPs.

#### 48.105 Relationship to other incentives.

Contractors should be offered the fullest possible range of motivation, yet the benefits of an accepted VECP should not be rewarded both as value engineering shares and under performance, design-to-cost, or similar incentives of the contract. To that end, when performance, design-to-cost, or similar targets are set and incentivized, the targets of such incentives affected by the VECP are not adjusted because of the acceptance of the VECP. Only those benefits of an accepted VECP not rewardable under other incentives are rewarded under a value engineering clause.

### SUBPART 48.2—CONTRACT CLAUSES

#### 48.201 Clauses for supply or service contracts.

(a) *General.* The contracting officer shall insert a value engineering clause in solicitations and contracts when the contract amount is expected to be \$100,000 or more, except as specified in subparagraphs (1) through (5) and in paragraph (f) below. A value engineering clause may be included in contracts of lesser value if the contracting officer sees a potential for significant savings. Unless the chief of the contracting office authorizes its inclusion, the contracting officer shall *not* include a value engineering clause in solicitations and contracts—

(1) For research and development other than full-scale development;

(2) For engineering services from not-for-profit or nonprofit organizations;

(3) For personal services (see Subpart 37.1);

(4) Providing for product or component improvement, unless the value engineering incentive applica-

tion is restricted to areas not covered by provisions for product or component improvement;

(5) For commercial products (see Part 11) that do not involve packaging specifications or other special requirements or specifications; or

(6) When the agency head has elected to exempt the agency (or a category of contracts) from the requirements of this Part 48.

(b) *Value engineering incentive.* To provide a value engineering incentive, the contracting officer shall insert the clause at 52.248-1, Value Engineering, in solicitations and contracts except as provided in paragraph (a) above (but see subparagraph (e)(1) below).

(c) *Value engineering program requirement.* (1) If a mandatory value engineering effort is appropriate (i.e., if the contracting officer considers that substantial savings to the Government may result from a sustained value engineering effort of a specified level), the contracting officer shall use the clause with its Alternate I (but see subparagraph (e)(2) below).

(2) The value engineering program requirement may be specified by the Government in the solicitation or, in the case of negotiated contracting, proposed by the contractor as part of its offer and included as a subject for negotiation. The program requirement shall be shown as a separately priced line item in the contract Schedule.

(d) *Value engineering incentive and program requirement.* (1) If both a value engineering incentive and a mandatory program requirement are appropriate, the contracting officer shall use the clause with its Alternate II (but see subparagraph (e)(3) below).

(2) The contract shall restrict the value engineering program requirement to well-defined areas of performance designated by line item in the contract Schedule. Alternate II applies a value engineering program to the specified areas and a value engineering incentive to the remaining areas of the contract.

(e) *Collateral savings computation not cost-effective.* If the head of the contracting activity determines for a contract or class of contracts that the cost of computing and tracking collateral savings will exceed the benefits to be derived, the contracting officer shall use the clause with its—

(1) Alternate III if a value engineering incentive is involved;

(2) Alternate III and Alternate I if a value engineering program requirement is involved; or

(3) Alternate III and Alternate II if both an incentive and a program requirement are involved.

(f) *Architect-engineer contracts.* (1) The clause at 52.248-1, Value Engineering, with or without its Alternate III, both of which provide incentive sharing, may be used in solicitations and contracts for architect-engineer services only when specifically authorized by agency acquisition regulations. Alternates I and II, which require a mandatory value engineering effort and provide sharing on accepted VECP's, shall not be used in architect-engineer contracts.

(2) The contracting officer shall insert the clause at 52.248-2, Value Engineering Program—Architect-Engineer, in architect-engineer contracts when a mandatory value engineering program requirement is appropriate (see paragraph (c) above).

(3) When the clause at 52.248-2, Value Engineering Program—Architect-Engineer, is used, the contract schedule shall show the program requirement as a separately priced line item (this clause makes no provision for sharing of savings on accepted VECP's resulting from the program effort).

(g) In no event shall the clause at 52.248-1, Value Engineering, and 52.248-2, Value Engineering Program—Architect-Engineer, be used in the same contract.

#### 48.202 Clause for construction contracts.

The contracting officer shall insert the clause at 52.248-3, Value Engineering—Construction, in construction solicitations and contracts when the contract amount is estimated to be \$100,000 or more, unless an incentive contract is contemplated. The contracting officer may include the clause in contracts of lesser value if the contracting officer sees a potential for significant savings. The contracting officer shall not include the clause in incentive-type construction contracts. If the head of the contracting activity determines that the cost of computing and tracking collateral savings for a contract will exceed the benefits to be derived, the contracting officer shall use the clause with its Alternate I.

**52.248-1 Value Engineering.**

As prescribed in 48.201, insert the following clause in supply or service contracts to provide a value engineering incentive under the conditions specified in 48.201. In solicitations and contracts for items requiring an extended period for production (e.g., ship construction, major system acquisition), if agency procedures prescribe sharing of future contract savings on all units to be delivered under contracts awarded during the sharing period, the contracting officer shall modify subdivision (i)(3)(i) and the first sentence under subparagraph (3) of the definition of acquisition savings by substituting "under contracts awarded during the sharing period" for "during the sharing period." For engineering-development and low-rate-initial-production solicitations and contracts, the contracting officer shall modify subdivision (i)(3)(i) and the first sentence under subparagraph (3) of the definition of acquisition savings by substituting for "the number of future contract units scheduled for delivery during the sharing period," "a number equal to the quantity required over the highest 36 consecutive months of planned production, based on planning or production documentation at the time the VECP is accepted."

**VALUE ENGINEERING (APR 1984)**

(a) *General.* The Contractor is encouraged to develop, prepare, and submit value engineering change proposals (VECP's) voluntarily. The Contractor shall share in any net acquisition savings realized from accepted VECP's, in accordance with the incentive sharing rates in paragraph (f) below.

(b) *Definitions.* "Acquisition savings," as used in this clause, means savings resulting from the application of a VECP to contracts awarded by the same contracting office or its successor (and by other contracting offices if included in an extended sharing base specified in the Schedule) for essentially the same unit. Acquisition savings include—

(1) Instant contract savings, which are the net cost reductions on this, the instant contract, and which are equal to the instant unit cost reduction multiplied

by the number of instant contract units affected by the VECP, less the Contractor's allowable development and implementation costs;

(2) Concurrent contract savings, which are measurable net reductions in the prices of other contracts that are definitized and ongoing at the time the VECP is accepted; and

(3) Future contract savings, which are the product of the future unit cost reduction multiplied by the number of future contract units scheduled for delivery during the sharing period. If this contract is a multiyear contract, future contract savings include savings on all quantities funded after VECP acceptance.

"Collateral costs," as used in this clause, means agency cost of operation, maintenance, logistic support, or Government-furnished property.

"Collateral savings," as used in this clause, means those measurable net reductions resulting from a VECP in the agency's overall projected collateral costs, exclusive of acquisition savings, whether or not the acquisition cost changes.

"Contracting office" includes any contracting office that the acquisition is transferred to, such as another branch of the agency or another agency's office that is performing a joint acquisition action.

"Contractor's development and implementation costs," as used in this clause, means those costs the Contractor incurs on a VECP specifically in developing, testing, preparing, and submitting the VECP, as well as those costs the Contractor incurs to make the contractual changes required by Government acceptance of a VECP.

"Future unit cost reduction," as used in this clause, means the instant unit cost reduction adjusted as the Contracting Officer considers necessary for projected learning or changes in quantity during the sharing period. It is calculated at the time the VECP is accepted and applies either (1) throughout the sharing period, unless the Contracting Officer decides that recalculation is necessary because conditions are significantly different from those previously anticipated or (2) to the calculation of a lump-sum payment, which cannot later be revised.

"Government costs," as used in this clause, means those agency costs that result directly from developing and implementing the VECP, such as any net increases in the cost of testing, operations, maintenance, and logistics support. The term does not include the normal administrative costs of processing the VECP or any increase in this contract's cost or price resulting from negative instant contract savings.

"Instant contract," as used in this clause, means this contract, under which the VECP is submitted. It does not include increases in quantities after acceptance of the VECP that are due to contract modifications, exercise of options, or additional orders. If this is a multiyear contract, the term does not include quantities

funded after VECP acceptance. If this contract is a fixed-price contract with prospective price redetermination, the term refers to the period for which firm prices have been established.

"Instant unit cost reduction" means the amount of the decrease in unit cost of performance (without deducting any Contractor's development or implementation costs) resulting from using the VECP on this, the instant contract. If this is a service contract, the instant unit cost reduction is normally equal to the number of hours per line-item task saved by using the VECP on this contract, multiplied by the appropriate contract labor rate.

"Negative instant contract savings" means the increase in the cost or price of this contract when the acceptance of a VECP results in an excess of the Contractor's allowable development and implementation costs over the product of the instant unit cost reduction multiplied by the number of instant contract units affected.

"Net acquisition savings" means total acquisition savings, including instant, concurrent, and future contract savings, less Government costs.

"Sharing base," as used in this clause, means the number of affected end items on contracts of the contracting office accepting the VECP or, if the sharing base has been extended under paragraph 48.102(e) of the Federal Acquisition Regulation (48 CFR Chapter 1), the number of affected end items on contracts of contracting offices included in the extended base specified in the Schedule.

"Sharing period," as used in this clause, means the period beginning with acceptance of the first unit incorporating the VECP and ending at the later of (1) 3 years after the first unit affected by the VECP is accepted or (2) the last scheduled delivery date of an item affected by the VECP under this contract's delivery schedule in effect at the time the VECP is accepted.

"Unit," as used in this clause, means the item or task to which the Contracting Officer and the Contractor agree the VECP applies.

"Value engineering change proposal (VECP)" means a proposal that—

(1) Requires a change to this, the instant contract, to implement; and

(2) Results in reducing the overall projected cost to the agency without impairing essential functions or characteristics; *provided*, that it does not involve a change—

(i) In deliverable end item quantities only;

(ii) In research and development (R&D) end items or R&D test quantities that is due solely to results of previous testing under this contract; or

(iii) To the contract type only.

(c) *VECP preparation.* As a minimum, the Contractor shall include in each VECP the information described



in subparagraphs (1) through (8) below. If the proposed change is affected by contractually required configuration management or similar procedures, the instructions in those procedures relating to format, identification, and priority assignment shall govern VECP preparation. The VECP shall include the following:

(1) A description of the difference between the existing contract requirement and the proposed requirement, the comparative advantages and disadvantages of each, a justification when an item's function or characteristics are being altered, the effect of the change on the end item's performance, and any pertinent objective test data.

(2) A list and analysis of the contract requirements that must be changed if the VECP is accepted, including any suggested specification revisions.

(3) Identification of the unit to which the VECP applies.

(4) A separate, detailed cost estimate for (i) the affected portions of the existing contract requirement and (ii) the VECP. The cost reduction associated with the VECP shall take into account the Contractor's allowable development and implementation costs, including any amount attributable to subcontracts under the Subcontracts paragraph of this clause, below.

(5) A description and estimate of costs the Government may incur in implementing the VECP, such as test and evaluation and operating and support costs.

(6) A prediction of any effects the proposed change would have on collateral costs to the agency.

(7) A statement of the time by which a contract modification accepting the VECP must be issued in order to achieve the maximum cost reduction, noting any effect on the contract completion time or delivery schedule.

(8) Identification of any previous submissions of the VECP, including the dates submitted, the agencies and contract numbers involved, and previous Government actions, if known.

(d) *Submission.* The Contractor shall submit VECP's to the Contracting Officer, unless this contract states otherwise. If this contract is administered by other than the contracting office, the Contractor shall submit a copy of the VECP simultaneously to the Contracting Officer and to the Administrative Contracting Officer.

(e) *Government action.* (1) The Contracting Officer shall notify the Contractor of the status of the VECP within 45 calendar days after the contracting office receives it. If additional time is required, the Contracting Officer shall notify the Contractor within the 45-day period and provide the reason for the delay and the expected date of the decision. The Government will process VECP's expeditiously; however, it shall not be liable for any delay in acting upon a VECP.

(2) If the VECP is not accepted, the Contracting Officer shall notify the Contractor in writing, explaining the reasons for rejection. The Contractor may withdraw any VECP, in whole or in part, at any time before it is accepted by the Government. The Contracting Officer may require that the Contractor provide written notification before undertaking significant expenditures for VECP effort.

(3) Any VECP may be accepted, in whole or in part, by the Contracting Officer's award of a modification to this contract citing this clause and made either before or within a reasonable time after contract performance is completed. Until such a contract modification applies a VECP to this contract, the Contractor shall perform in accordance with the existing contract. The Contracting Officer's decision to accept or reject all or part of any VECP and the decision as to which of the sharing rates applies shall be final and not subject to the Disputes clause or otherwise subject to litigation under the Contract Disputes Act of 1978 (41 U.S.C. 601-613).

(f) *Sharing rates.* If a VECP is accepted, the Contractor shall share in net acquisition savings according to the percentages shown in the table below. The percentage paid the Contractor depends upon (1) this contract's type (fixed-price, incentive, or cost-reimbursement), (2) the sharing arrangement specified in paragraph (a) above (incentive, program requirement, or a combination as delineated in the Schedule), and (3) the source of the savings (the instant contract, or concurrent and future contracts), as follows:

#### CONTRACTOR'S SHARE OF NET ACQUISITION SAVINGS

(figures in percent)

Contract Type	Sharing Arrangement			
	Incentive (voluntary)		Program requirement (mandatory)	
	Instant contract rate	Concurrent and future contract rate	Instant contract rate	Concurrent and future contract rate
Fixed-price (other than incentive)	50	50	25	25
Incentive (fixed-price or cost)	•	50	•	25
Cost-reimbursement (other than incentive)**	25	25	15	15

\*Same sharing arrangement as the contract's profit or fee adjustment formula.

\*\*Includes cost-plus-award-fee contracts.

(g) *Calculating net acquisition savings.* (1) Acquisition savings are realized when (i) the cost or price is reduced on the instant contract, (ii) reductions are negotiated in concurrent contracts, (iii) future contracts are awarded, or (iv) agreement is reached on a lump-sum

payment for future contract savings (see subparagraph (i)(4) below). Net acquisition savings are first realized, and the Contractor shall be paid a share, when Government costs and any negative instant contract savings have been fully offset against acquisition savings.

(2) Except in incentive contracts, Government costs and any price or cost increases resulting from negative instant contract savings shall be offset against acquisition savings each time such savings are realized until they are fully offset. Then, the Contractor's share is calculated by multiplying net acquisition savings by the appropriate Contractor's percentage sharing rate (see paragraph (f) above). Additional Contractor shares of net acquisition savings shall be paid to the Contractor at the time realized.

(3) If this is an incentive contract, recovery of Government costs on the instant contract shall be deferred and offset against concurrent and future contract savings. The Contractor shall share through the contract incentive structure in savings on the instant contract items affected. Any negative instant contract savings shall be added to the target cost or to the target price and ceiling price, and the amount shall be offset against concurrent and future contract savings.

(4) If the Government does not receive and accept all items on which it paid the Contractor's share, the Contractor shall reimburse the Government for the proportionate share of these payments.

(h) *Contract adjustment.* The modification accepting the VECP (or a subsequent modification issued as soon as possible after any negotiations are completed) shall—

(1) Reduce the contract price or estimated cost by the amount of instant contract savings, unless this is an incentive contract;

(2) When the amount of instant contract savings is negative, increase the contract price, target price and ceiling price, target cost, or estimated cost by that amount;

(3) Specify the Contractor's dollar share per unit on future contracts, or provide the lump-sum payment;

(4) Specify the amount of any Government costs or negative instant contract savings to be offset in determining net acquisition savings realized from concurrent or future contract savings; and

(5) Provide the Contractor's share of any net acquisition savings under the instant contract in accordance with the following:

(i) Fixed-price contracts—add to contract price.

(ii) Cost-reimbursement contracts—add to contract fee.

(i) *Concurrent and future contract savings.* (1) Payments of the Contractor's share of concurrent and future contract savings shall be made by a modification to the instant contract in accordance with subparagraph (h)(5) above. For incentive contracts, shares

shall be added as a separate firm-fixed-price line item on the instant contract. The Contractor shall maintain records adequate to identify the first delivered unit for 3 years after final payment under this contract.

(2) The Contracting Officer shall calculate the Contractor's share of concurrent contract savings by (i) subtracting from the reduction in price negotiated on the concurrent contract any Government costs or negative instant contract savings not yet offset and (ii) multiplying the result by the Contractor's sharing rate.

(3) The Contracting Officer shall calculate the Contractor's share of future contract savings by (i) multiplying the future unit cost reduction by the number of future contract units scheduled for delivery during the sharing period, (ii) subtracting any Government costs or negative instant contract savings not yet offset, and (iii) multiplying the result by the Contractor's sharing rate.

(4) When the Government wishes and the Contractor agrees, the Contractor's share of future contract savings may be paid in a single lump sum rather than in a series of payments over time as future contracts are awarded. Under this alternate procedure, the future contract savings may be calculated when the VECP is accepted, on the basis of the Contracting Officer's forecast of the number of units that will be delivered during the sharing period. The Contractor's share shall be included in a modification to this contract (see subparagraph (h)(3) above) and shall not be subject to subsequent adjustment.

(5) *Alternate no-cost settlement method.* When, in accordance with subsection 48.104-3 of the Federal Acquisition Regulation, the Government and the Contractor mutually agree to use the no-cost settlement method, the following applies:

(i) The Contractor will keep all the savings on the instant contract and on its concurrent contracts only.

(ii) The Government will keep all the savings resulting from concurrent contracts placed on other sources, savings from all future contracts, and all collateral savings.

(j) *Collateral savings.* If a VECP is accepted, the instant contract amount shall be increased, as specified in subparagraph (h)(5) above, by 20 percent of any projected collateral savings determined to be realized in a typical year of use after subtracting any Government costs not previously offset. However, the Contractor's share of collateral savings shall not exceed (1) the contract's firm-fixed-price, target price, target cost, or estimated cost, at the time the VECP is accepted, or (2) \$100,000, whichever is greater. The Contracting Officer shall be the sole determiner of the amount of collateral savings, and that amount shall not be subject to the Disputes clause or otherwise subject to litigation under 41 U.S.C. 601-613.

(k) *Relationship to other incentives.* Only those benefits of an accepted VECP not rewardable under performance, design-to-cost (production unit cost, operating and support costs, reliability and maintainability), or similar incentives shall be rewarded under this clause. However, the targets of such incentives affected by the VECP shall not be adjusted because of VECP acceptance. If this contract specifies targets but provides no incentive to surpass them, the value engineering sharing shall apply only to the amount of achievement better than target.

(l) *Subcontracts.* The Contractor shall include an appropriate value engineering clause in any subcontract of \$100,000 or more and may include one in subcontracts of lesser value. In calculating any adjustment in this contract's price for instant contract savings (or negative instant contract savings), the Contractor's allowable development and implementation costs shall include any subcontractor's allowable development and implementation costs, and any value engineering incentive payments to a subcontractor, clearly resulting from a VECP accepted by the Government under this contract. The Contractor may choose any arrangement for subcontractor value engineering incentive payments; provided, that the payments shall not reduce the Government's share of concurrent or future contract savings or collateral savings.

(m) *Data.* The Contractor may restrict the Government's right to use any part of a VECP or the supporting data by marking the following legend on the affected parts:

"These data, furnished under the Value Engineering clause of contract \_\_\_\_\_, shall not be disclosed outside the Government or duplicated, used, or disclosed, in whole or in part, for any purpose other than to evaluate a value engineering change proposal submitted under the clause. This restriction does not limit the Government's right to use information contained in these data if it has been obtained or is otherwise available from the Contractor or from another source without limitations."

If a VECP is accepted, the Contractor hereby grants the Government unlimited rights in the VECP and supporting data, except that, with respect to data qualifying and submitted as limited rights technical data, the Government shall have the rights specified in the contract modification implementing the VECP and shall appropriately mark the data. (The terms "unlimited rights" and "limited rights" are defined in Part 27 of the Federal Acquisition Regulation.)

(End of clause)

- (R 7-104.44(a)(1) 1977 SEP)
- (R 7-104.44(a)(2) 1976 JUL)
- (R 7-104.44(a)(3) 1976 JUL)
- (R 7-104.44(a)(4) 1976 JUL)
- (R 7-104.44(a)(5) 1976 JUL)
- (R 7-104.44(a)(6)(i)(A) 1976 FEB)
- (R 7-104.44(a)(6)(i)(B) 1976 FEB)
- (R 7-104.44(a)(6)(i)(D) 1976 FEB)
- (R 7-104.44(a)(6)(ii)(A) 1976 FEB)
- (R 7-104.44(a)(6)(ii)(B) 1976 FEB)

- (R 7-104.44(a)(6)(ii)(D) 1976 FEB)
- (R 7-204.32(b) 1976 JUL)
- (R 7-204.32(c) 1976 JUL)
- (R 7-204.32(d)(i) 1976 FEB)
- (R 7-204.32(d)(ii) 1976 FEB)
- (R 7-204.32(d)(iii) 1976 JUL)
- (R 7-204.32(d)(iv) 1976 FEB)
- (R 7-1903.51 1976 JUL)

*Alternate I (APR 1984).* If the contracting officer selects a mandatory value engineering program requirement substitute the following paragraph (a) for paragraph (a) of the basic clause:

(a) *General.* The Contractor shall (1) engage in a value engineering program, and submit value engineering progress reports, as specified in the Schedule and (2) submit to the Contracting Officer any resulting value engineering change proposals (VECP's). In addition to being paid as the Schedule specifies for this mandatory program, the Contractor shall share in any net acquisition savings realized from accepted VECP's, in accordance with the program requirement sharing rates in paragraph (f) below.

(R 7-104.44(b) 1974 APR)

*Alternate II (APR 1984).* If the contracting officer selects both a value engineering incentive and mandatory value engineering program requirement, substitute the following paragraph (a) for paragraph (a) of the basic clause:

(a) *General.* For those contract line items designated in the Schedule as subject to the value engineering program requirement, the Contractor shall (1) engage in a value engineering program, and submit value engineering progress reports, as specified in the Schedule and (2) submit to the Contracting Officer any resulting VECP's. In addition to being paid as the Schedule specifies for this mandatory program, the Contractor shall share in any net acquisition savings realized from VECP's accepted under the program, in accordance with the program requirement sharing rates in paragraph (f) below. For remaining areas of the contract, the Contractor is encouraged to develop, prepare, and submit VECP's voluntarily; for VECP's accepted under these remaining areas, the incentive sharing rates apply.

(NM)

*Alternate III (APR 1984).* When the head of the contracting activity determines that the cost of calculating and tracking collateral savings will exceed the benefits to be derived in a contract calling for a value engineering incentive, delete paragraph (j) from the basic clause and redesignate the remaining paragraphs accordingly.

PART 48--VALUE ENGINEERING  
SUBPART 48.2--CONTRACT CLAUSES

**48.201 Clauses For Supply or Service Contracts.**

(a) General.

(1) Supply or service contracts for spare parts and repair kits of \$25,000 or more, for other than standard commercial parts, shall contain a VE incentive clause (see FAR 48.201(b)).

(2) A VE program requirement clause (FAR 52.248-1, Alternates I or II) shall be placed in initial production solicitations and contracts (first and second production buys) for major system acquisition programs as defined in DoD Directive 5000.1, except as specified in paragraphs (i) and (ii) below. A program requirement clause may be included in initial production contracts for less than major system acquisition programs if there is a potential for savings. The contracting officer is not required to include a program requirement clause in initial production contracts--

(i) where, in the judgment of the contracting officer, the prime contractor has demonstrated an effective VE program during either earlier program phases, or during other recent comparable production contracts.

(ii) which are awarded on the basis of competition.

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