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Part V

**Department of
Defense**

**General Services
Administration**

**National Aeronautics
and Space
Administration**

48 CFR Part 31

**Federal Acquisition Regulation;
Application of Cost Principles and
Procedures and Accounting for
Unallowable Costs; Proposed Rule**

DEPARTMENT OF DEFENSE**GENERAL SERVICES
ADMINISTRATION****NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION****48 CFR Part 31**

[FAR Case 2002–006]

RIN: 9000–AJ65

**Federal Acquisition Regulation;
Application of Cost Principles and
Procedures and Accounting for
Unallowable Costs**

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

ACTION: Proposed rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) are proposing to amend the Federal Acquisition Regulation (FAR) sections relating to accounting for unallowable costs and application of cost principles and procedures.

DATES: Interested parties should submit comments in writing on or before July 21, 2003 to be considered in the formulation of a final rule.

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

Submit electronic comments via the Internet to—farcase.2002-006@gsa.gov.

Please submit comments only and cite FAR case 2002–006 in all correspondence related to this case.

FOR FURTHER INFORMATION CONTACT: The FAR Secretariat, Room 4035, GS Building, Washington, DC, 20405, at (202) 501–4755 for information pertaining to status or publication schedules. For clarification of content, contact Mr. Edward Loeb at (202) 501–0650. Please cite FAR case 2002–006.

SUPPLEMENTARY INFORMATION:**A. Background**

The DoD Director of Defense Procurement established a special interagency ad hoc committee to perform a comprehensive review of policies and procedures in FAR Part 31, Contract Cost Principles and Procedures, related to cost measurement, assignment, and allocation to evaluate the need for each specific requirement in light of the evolution of generally accepted

accounting principles and experience gained from implementation.

The Director of Defense Procurement announced a series of public meetings in the **Federal Register** at 66 FR 13712, March 7, 2001 (with a “correction to notice” published in the **Federal Register** at 66 FR 16186, March 23, 2001). Attendees at the public meetings (held on April 19, 2001, May 10–11, 2001, and June 12, 2001) included representatives from industry, Government, and other interested parties who provided views on potential areas for revision in FAR part 31. The ad hoc committee reviewed the cost principles and procedures and the public comments; identified potential changes to the FAR; and submitted several reports, including draft proposed rules for consideration by the Councils.

The Councils have reviewed the reports related to FAR 31.201–6, Accounting for unallowable costs, and FAR 31.204, Application of principles and procedures, and propose the following revisions:

- Add paragraph (c)(2) to FAR 31.201–6 to provide specific criteria on the use of sampling as a method to identify unallowable costs and the acceptability of contractor sampling methods.
 - Revise the current paragraph (b) of FAR 31.204, which addresses the allowability of subcontract costs, to clarify the language.
 - Make a number of editorial changes.
- This is not a significant regulatory action and, therefore, was not subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

B. Regulatory Flexibility Act

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

U.S.C. 601, *et seq.* (FAR case 2002–006), in correspondence.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the proposed changes to the FAR do not impose information collection requirements that require the approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.*

List of Subjects in 48 CFR Part 31

Government procurement.

Dated: May 16, 2003.

Laura G. Smith,

Director, Acquisition Policy Division.

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

**PART 31—CONTRACT COST
PRINCIPLES AND PROCEDURES**

1. The authority citation for 48 CFR part 31 is revised to read as follows:

Authority: 40 U.S.C. 121(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

2. Revise section 31.201–6 to read as follows:

31.201–6 Accounting for unallowable costs.

(a) Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. A directly associated cost is any cost that is generated solely as a result of incurring another cost, and that would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.

(b) Costs that specifically become designated as unallowable or as unallowable directly associated costs of unallowable costs as a result of a written decision furnished by a contracting officer shall be identified if included in or used in computing any billing, claim, or proposal applicable to a Government contract. This identification requirement applies also to any costs incurred for the same purpose under like circumstances as the costs specifically identified as unallowable under either this paragraph or paragraph (a) of this subsection.

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

(2) Statistical sampling is an acceptable practice for accounting and

presenting unallowable costs provided—

(i) The statistical sampling results in an unbiased sample that accurately represents the sampling universe; and

(ii) The statistical sampling permits audit verification.

(d) If a directly associated cost is included in a cost pool that is allocated over a base that includes the unallowable cost with which it is associated, the directly associated cost shall remain in the cost pool. Since the unallowable costs will attract their allocable share of costs from the cost pool, no further action is required to assure disallowance of the directly associated costs. In all other cases, the directly associated costs, if material in amount, must be purged from the cost pool as unallowable costs.

(e)(1) In determining the materiality of a directly associated cost, consideration should be given to the significance of—

(i) The actual dollar amount;

(ii) The cumulative effect of all directly associated costs in a cost pool; and

(iii) The ultimate effect on the cost of Government contracts.

(2) Salary expenses of employees who participate in activities that generate unallowable costs shall be treated as directly associated costs to the extent of the time spent on the proscribed activity, provided the costs are material

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

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

3. Amend section 31.204 in the first sentence of paragraph (a) by removing "shall be allowed" and adding "are allowable" in its place; revising paragraph (b); and redesignating paragraph (c) as paragraph (d) and adding a new paragraph (c) to read as follows:

31.204 Application of principles and procedures.

* * * * *

(b)(1) For the following subcontract types, costs incurred as reimbursements or payments to a subcontractor are allowable to the extent the reimbursements or payments are for costs incurred by the subcontractor that are consistent with part 31:

(i) Cost-reimbursement.

(ii) Fixed-price incentive.

(iii) Price redeterminable (*i.e.*, fixed-price contracts with prospective price redetermination and fixed-ceiling-price contracts with retroactive price redetermination).

(2) The requirements of paragraph (b)(1) of this section apply to any tier above the first firm-fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions.

(c) Costs incurred as payments under firm-fixed-price subcontracts or fixed-price subcontracts with economic price adjustment provisions or modifications thereto, for which subcontract cost analysis was performed, are allowable if the price was negotiated in accordance with 31.102.

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