



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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IN REPLY REFER TO

PAC 730.3.B.01/2004-09

May 28, 2004
04-PAC-030(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Change to General Provisions of FAR Part 31

FAC 2001-022 revised general provisions of the cost principles in FAR Part 31. The changes are effective on contracts awarded on or after May 5, 2004. The new rule amends the general provisions of the cost principles by adding the definition of "direct cost" and revising the definition of "indirect cost" to be consistent with the terminology used in the Cost Accounting Standards (CAS), restructuring the paragraphs, and removing unnecessary/duplicative language to increase clarity. The new rule does not materially change the substance of the provisions. However, the changes described in item 5 are noteworthy.

Specific changes to the cost principle language are included in the enclosure in line-in line-out format and summarized below:

1. FAR 2.101, Definitions –
 - The definition of "direct cost" was added; and
 - The wording of the "indirect cost," definition in FAR 31.203 was revised to be consistent with CAS terminology and moved to FAR 2.101.
2. FAR 31.201-1, Composition of total cost, Revised paragraph (a) to improve clarity and remove the reference to FAR 31.201-2.
3. FAR 31.201-2, Determining allowability –
 - Revised the introductory sentence to paragraph (a) to specify that the listed factors are requirements and not simply considerations; and
 - Editorial changes were made to paragraph (c) and (d).
4. FAR 31.202, Direct costs –
 - Removed the first sentence in paragraph (a) as it is duplicative of the definition of "direct costs" now included in FAR 2.101(b); and
 - Editorial changes were made to paragraph (a) and (b).

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5. FAR 31.203, Indirect costs –

- Added a new paragraph (a) stating that all CAS provisions apply to fully CAS covered contracts and the applicable CAS provisions identified in the remaining paragraphs of 31.203 apply to all other contracts;
- Changed the provisions related to the cost accounting period in prior paragraph (g). For non-CAS covered contracts the contractor is now required to use its fiscal year as its cost accounting period. For both full and modified CAS covered contracts the provisions of CAS 406 must be followed; and
- Removed redundancy, restructured, and made editorial changes throughout the cost principle.

If FAO personnel have any questions, they should contact regional personnel. If regional personnel have any questions, they should contact John Shire, Program Manager, Accounting and Cost Principles Division, at (703) 767-3250 or john.shire@dcaa.mil.

/S/ Frances T. Cornett
/for/ Robert DiMucci
Assistant Director
Policy and Plans

DISTRIBUTION: C

Enclosure

Change to General Provisions of FAR Part 31 (Line-In/Out)

Changes to General Provisions of FAR Part 31

Line In/Out

Changes published in FAC 2001-22, dated April 5, 2004, are noted with underline for additions to the current text and ~~striketrough~~ for deletions.

2.101 Definitions.

(b) ****

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

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

31.201-1 Composition of total cost.

- (a) The total cost, including standard costs properly adjusted for applicable variances, of a contract is the sum of the direct and indirect costs allocable to the contract, incurred or to be incurred, ~~less any allocable credits~~, plus any allocable cost of money pursuant to 31.205-10, less any allocable credits. In ascertaining what constitutes a cost, any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used, ~~including standard costs properly adjusted for applicable variances. See 31.201-2(b) and (c) for Cost Accounting Standards (CAS) requirements.~~
- (b) While the total cost of a contract includes all costs properly allocable to the contract, the allowable costs to the Government are limited to those allocable costs which are allowable pursuant to Part 31 and applicable agency supplements.

31.201-2 Determining allowability.

- (a) ~~The factors to be considered in determining whether a cost is allowable include the following~~ A cost is allowable only when the cost complies with all of the following requirements:

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- (1) Reasonableness.
 - (2) Allocability.
 - (3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting 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 ~~S~~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 are unallowable.
- (d) A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost ~~that which~~ is inadequately supported.

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~~ shall be charged directly to the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.
- (b) For reasons of practicality, the contractor may treat any direct cost of 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.

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31.203 Indirect costs.

(a) For contracts subject to full CAS coverage, allocation of indirect costs shall be based on the applicable provisions. For all other contracts, the applicable CAS provisions in paragraphs (b) through (h) of this section apply.

~~(ab) 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 intermediate or two or more final cost objectives. An indirect cost shall not be allocated to a No final cost objective shall have allocated to it as an indirect cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective.~~

~~(bc) Indirect costs The contractor shall be accumulated indirect costs by logical cost groupings with due consideration of the reasons for incurring such costs. The contractor shall determine 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 use of an allocation base that is common to all cost objectives to which the grouping is to be allocated. 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 shall allocate the grouping on the basis of the benefits accruing to the several intermediate and final cost objectives. When substantially the same results can be achieved through less precise methods, the number and composition of cost groupings should be governed by practical considerations and should not unduly complicate the allocation.~~

~~(ed) Once an appropriate base for distributing-allocating indirect costs has been accepted, it-the contractor shall not be fragmented the base by removing individual elements. All items properly includable in an indirect cost base should-shall bear a pro rata share of indirect costs irrespective of their acceptance as Government contract costs. For example, when a cost input base is used for the distribution-allocation of G&A costs, the contractor shall include in the base all items that would properly be part of the cost input base, whether allowable or unallowable, shall be included in the base and these items shall bear their pro rata share of G&A costs.~~

~~(de) 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-revision when-~~

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- (1) ~~Substantial differences occur between the cost patterns of work under the contract and the contractor's other work;~~
- (2) ~~there is a 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;~~
- (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.
- (eg) A base period for allocating indirect costs is the cost accounting period during which such costs are incurred and accumulated for ~~distribution~~ allocation to work performed in that period.
- (1) For contracts subject to full or modified CAS coverage, the contractor shall follow the criteria and guidance in 48 CFR 9904.406 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.~~
- (2) For contracts other than those subject to paragraph (g)(1) of this section, the base period for allocating indirect costs shall be the contractor's fiscal year used for financial reporting purposes in accordance with generally accepted accounting principles. The fiscal year will normally be 12 months, but a different period may be appropriate (e.g., when a change in fiscal year occurs due to a business combination or other circumstances).
- (fh) ~~Special care should be exercised in applying the principles of paragraphs (bc), (ed), and (de)~~ Special care should be exercised in applying the principles of paragraphs (bc), (ed), and (de) of this section when Government-owned contractor-operated (GOCO) plants are involved. The distribution of corporate, division, or branch office G&A expenses to such plants operating with little or no dependence on corporate administrative activities may require more precise cost groupings, detailed accounts screening, and carefully developed distribution bases.
