

PART 7

COST PRINCIPLES

7-101 Applicability of Cost Principles.

(1) Application. This Subpart contains cost principles and procedures to be used as guidance in:

(a) establishment of contract cost estimates and prices under contract made by competitive sealed proposals where the award may not be based on adequate price competition, contracts for certain services, or architect-engineer services;

(b) establishment of price adjustments for contract changes;

(c) pricing of termination for convenience settlements; and

(d) any other situation in which cost analysis is required.

(2) Limitation. Cost principles in this Subpart are not applicable to:

(a) the establishment of prices under contracts made by competitive sealed bidding or otherwise based on adequate price competition rather than the analysis of individual, specific cost elements, except that this subpart does apply to the establishment of adjustments of price for changes made to such contracts;

(b) prices which are fixed by law or regulation;

(c) prices which are based on established catalog prices or established market prices; and

(d) stipulated unit prices.

7-102 Allowable Costs.

(1) General. Any contract cost proposed for estimating purposes or invoiced for cost-reimbursement purposes shall be allowable as provided in the contract. The contract shall provide that the total allowable cost of a contract is the sum of the allowable direct costs actually incurred (or, in the case of forward pricing, the amount estimated to be incurred) in the performance of the contract in accordance with its terms, plus the properly allocable portion of the allowable indirect costs, less any applicable credits (such as discounts, rebates, refunds, and property disposal income).

(2) Accounting Consistency. All costs shall be accounted for in accordance with generally accepted accounting principles and in a manner that is consistent with the contractor's usual accounting practices in charging costs to other activities. In pricing a proposal, a contractor shall estimate costs consistently with cost accounting practices used in accumulating and reporting costs.

(3) When Allowable. The contract shall provide that costs shall be allowed to the extent they are:

(a) reasonable, as defined in Section 7-103 (Reasonable Costs);

(b) allocable, as defined in Section 7-104 (Allocable Costs);

(c) not made unlawful under any applicable law;

(d) not unallowable under Section 7-105 (Treatment of Specific Costs) or Section 7-106 (Costs Requiring Prior Approval to be Allowable); and

(e) actually incurred or accrued and accounted for in accordance with generally accepted accounting principles in the case of costs invoiced for reimbursement.

7-103 Reasonable Costs.

Any cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by an ordinarily prudent person in the conduct of competitive business. In determining the reasonableness of a given cost, consideration shall be given to:

(1) whether the cost is of a type generally recognized as ordinary and necessary for the conduct of the contractor's business or the performance of the contract;

(2) the restraints inherent in and the requirements imposed by such factors as generally accepted sound business practices, arm's length bargaining, federal and county laws and regulations, and contract terms and specifications;

(3) the action that a prudent businessman would take under the circumstances, considering responsibilities to the owners of the business, employees, customers, the purchasing agency, and the general public;

(4) significant deviations from the contractor's established practices which may unjustifiably increase the contract costs; and

(5) any other relevant circumstances.

7-104 Allocable Costs.

(1) General. A cost is allocable if it is assignable or chargeable to one or more cost objectives in accordance with relative benefits received and if it:

(a) is incurred specifically for the contract;

(b) benefits both the contract and other work, and can be distributed to both 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.

(2) Allocation Consistency. costs are allocable as direct or indirect costs. Similar costs (those incurred for the same purpose, in like circumstances) shall be treated consistently either as direct costs or indirect costs except as provided by these regulations. When a cost is treated as a direct cost in respect to one cost objective, it and all similar costs shall be treated as a direct cost for all cost objectives. Further, all costs similar to those included in any indirect cost pool shall be treated as indirect costs. All distributions to cost objectives from a cost pool shall be on the same basis.

(3) Direct Cost. A direct cost is any cost which can be identified specifically with a particular cost objective. A direct cost shall be allocated only to its specific cost objective. To be allowable, a direct cost must be incurred in accordance with the terms of the contract.

(4) Indirect Costs.

(a) An indirect cost is one identified with more than one cost objective. Indirect costs are those remaining to be allocated to the several cost objectives after direct costs have been determined and charged directly to the contract or other work as appropriate. Any direct costs of minor dollar amount may be treated as indirect costs, provided that such treatment produced substantially the same results as treating the cost as a direct cost.

(b) Indirect costs shall be accumulated into logical cost groups with consideration of the reasons for incurring the costs. Each group should be distributed to cost objectives benefiting from the costs in the group. Each indirect cost group shall be distributed to the cost objectives substantially in proportion to the benefits received by the cost objectives. The number and composition of the groups and the method of distribution should not unduly complicate indirect cost allocation where substantially the same results could be achieved through less precise methods.

(c) The contractor's method of distribution may require examination when:

(i) any substantial difference exists between the cost patterns of the work performed under the contract and the contractor's other work;

(ii) any significant change occurs 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

(iii) indirect cost groups developed for a contractor's primary location are applied to off-site locations. Separate cost groups for costs allocable to off-site locations may be necessary to distribute the contractor's costs on the basis of the benefits accruing to the appropriate cost objectives.

(d) The base period for indirect cost allocation is the one in which such costs are incurred and accumulated for distribution to work performed in that period. Normally, the base period is the contractor's fiscal year. A different base period may be appropriate under unusual circumstances. In such cases, an appropriate period should be agreed to in advance.

7-105 Treatment of Specific Costs.

(1) Advertising. The only allowable advertising costs are those for:

(a) the recruitment of personnel;

(b) the procurement of scarce items;

(c) the disposal of scrap or surplus materials;

(d) the listing of business' name and location in a classified directory; and

(e) other forms of advertising as approved by the purchasing agency when in the best interest of the agency.

(2) Bad Debts. Bad debts include losses arising from uncollectible accounts and other claims, such as dishonored checks, employee advances, and related collection and legal costs. All bad debt costs are unallowable.

(3) Contingencies.

(a) Contingency costs are contributions to a reserve account for unforeseen costs. Such contingency costs are unallowable except as provided in Subsection (3)(b) of this Section.

(b) For the purpose of establishing a contract cost estimate or price in advance of performance of the contract, recognition of uncertainties within a reasonably anticipated range of costs may be required and is not prohibited by this Subsection. However, where contract clauses are present which serve to remove risks from the contractor, there shall not be included in the contract price a contingency factor for such risks. Further, contributions to a reserve for self-insurance in lieu of, and not in excess of, commercially available liability insurance premiums, are allowable as an indirect charge.

(4) Depreciation and Use Allowances.

(a) Depreciation and use allowances are allowable to compensate contractors for the use of buildings, capital improvements, and equipment. Depreciation is a method of allocating the acquisition costs of an asset to period of its useful life. Useful life refers to the asset's period of economic usefulness in the particular contractor's operation as distinguished from its physical life. Use allowances provide compensation in lieu of depreciation or other equivalent costs. Consequently, these two methods may not be combined to compensate contractors for the use of any one type of property.

(b) The computation of depreciation or use allowances shall be based on acquisition costs. When the acquisition costs are unknown, reasonable estimates may be used.

(c) Depreciation shall be computed using any generally accepted method, provided that the method is consistently applied and results in equitable charges considering the use of the property. The straight-line method of depreciation is preferred unless the circumstances warrant some other method. However, the purchasing agency will accept any method which is accepted by the Internal Revenue Service.

(d) In order to compensate the contractor for use of depreciated, contractor-owned property which has been fully depreciated on the contractor's books and records and is being used in the performance of a contract, use allowances may be allowed as a cost of that contract. Use allowances are allowable, provided that they are computed in accordance with an established industry or government schedule or other method mutually agreed upon by the parties. If a schedule is not used, factors to consider in establishing the allowance are the original cost, remaining estimated useful life, the reasonable fair market value, and the affect of any increased maintenance or decreased efficiency.

(5) Entertainment.

(a) Entertainment costs include costs of amusements, social activities, and incidental costs relating thereto, such as meals, beverages, lodging, transportation, and gratuities. Entertainment costs are unallowable.

(b) Nothing herein shall make unallowable a legitimate expense for employee morale, health, welfare, food service, or lodging cost; except that, where a net profit is generated by such employer related services, it shall be treated as a credit as provided in Section 7-207 (Applicable Credits). This section shall not make unallowable costs incurred for meetings or conferences, including, but not limited to, costs of food, rental facilities, and transportation where the primary purpose of incurring such cost is the dissemination of technical information or the stimulation of production.

(6) Fines and Penalties. Fines and penalties include all costs incurred as the result of violations of or failure to comply with federal, state, county, and local laws and regulations. Fines and penalties are unallowable costs unless incurred as a direct result of compliance with specific provisions of the contract or written instructions of the purchasing agent. To the extent that workman's compensation is considered by State law to constitute a fine or penalty, it shall not be an allowable cost under this Subsection.

(7) Gifts, Contributions, and Donations. A gift is property transferred to another person without the other person providing return consideration of equivalent value. Reasonable costs for employee morale, health, welfare, food services, or lodging are not gifts and are allowable. Contributions and donations are property transferred to a no profit institution which are not transferred in exchange for supplies or services of equivalent fair market value rendered by a nonprofit institution. Gifts, contributions, and donations are unallowable.

(8) Interest Costs.

(a) Interest is a cost of borrowing. Interest is not allowable except as provided in Subsection (8)(b) of this Section.

(b) Interest costs on contractor claims for payments due under purchasing agency contracts shall be allowable as provided in Section 63-56-64 of the Utah Procurement Code.

(9) Losses Incurred Under Other Contracts. A loss is the excess of costs over income earned under a particular contract. Losses may include both direct and indirect costs. A loss incurred under one contract may not be charged to any other contract.

(10) Material Costs.

(a) Material costs are the costs of all supplies, including raw materials, parts, and components (whether acquired by purchase from an outside source or acquired by transfer from any division, subsidiary, or affiliate under the common control of the contractor), which are acquired in order to perform the contract. Material costs are allowable, subject to Subsection 10(b) and Subsection 10(c) of this Section. In determining material costs, consideration shall be given to reasonable spoilage, reasonable inventory losses and reasonable overages.

(b) Material costs shall include adjustments for all available discounts, refunds, rebates and allowances which the contractor reasonably should take under the circumstances, and for credits for proceeds the contractor received or reasonably should receive from salvage and material returned to suppliers.

(c) Allowance for all materials transferred from any division (including the division performing the contract), subsidiary, or made on the basis of costs incurred by the transferor (determined in accordance with these cost principles regulations, except that double charging of indirect costs is unallowable), except the transfer may be made at the established price provided that the price of materials is not determined to be unreasonable by the purchasing agent and the price is not higher than the transferor's current sales price to its most favored customer for a like quantity under similar payment and delivery conditions and:

(i) the price is established either by the established catalog price, as defined in Section 63-56-5 of the Utah Procurement Code; or

(ii) by the lowest price offer obtained as a result of competitive sealed bidding or competitive sealed proposals conducted with other businesses that normally produce the item in similar quantities.

(11) Taxes.

(a) Except as limited in Subsection 11(b) of this Section, all taxes which the contractor is required to pay and which are paid and accrued in accordance with generally accepted accounting principles are allowable.

(b) The following costs are unallowable:

(i) federal income taxes and federal excess profit taxes;

(ii) all taxes from which the contractor could have obtained an exemption, but failed to do so, except where the administrative cost of obtaining the exemption would have exceeded the tax savings realized from the exemption;

(iii) any interest, fines, or penalties paid on delinquent taxes unless incurred at the written direction of the purchasing agent; and

(iv) income tax accruals designed to account for the tax effects of differences between taxable income and pretax income as reflected by the contractor's books of account and financial statements.

(c) Any refund of taxes which were allowed as a direct cost under the contract shall be credited to the contract. Any refund of taxes which were allowed as an indirect cost under a contract shall be credited to the indirect cost group applicable to any contracts being priced or costs being reimbursed during the period in which the refund is made.

(d) Direct government charges for services such as water, or capital improvements such as sidewalks, are not considered taxes and are allowable costs.

7-106 Costs Requiring Prior Approval to be Allowable.

(1) General. The costs described in Subsections (2), (3), (4), and (5) of this Section are allowable as direct costs to cost-reimbursement type contracts to the extent that they have been approved in advance by the purchasing agent. In other situations those costs are negotiable in accordance with general standards set out herein.

(2) Pre-Contract Costs. Pre-contract costs are those incurred prior to the effective date of the contract directly pursuant to, and in anticipation of, the award of the contract. Such costs are allowable to the extent that they would have been allowable if incurred after the date of the contract; provided that, in the case of a cost-reimbursement type contract, a special provision must be inserted in the contract setting forth the period of time and maximum amount of cost which will be covered as allowable pre-contract costs.

(3) Bid and Proposal Costs. Bid and proposal costs are the costs incurred in preparing, submitting, and supporting bids and proposals. Reasonable ordinary bid and proposal costs are allowable as indirect costs. Bid and proposal costs are allowable as direct costs only to the extent that they are specifically permitted by a provision of the contract or solicitation document. Where bid and proposal costs are allowable as direct costs, to avoid double accounting, the same bid and proposal costs shall not be charged as indirect costs.

(4) Insurance.

(a) Insurance costs are the costs of obtaining insurance in connection with performance of the contract or contributions to a reserve account for the purpose of self-insurance. Ordinary and necessary insurance costs are allowable in accordance with these cost principles. Self-insurance contributions are allowable only to the extent of the cost to the contractor to obtain similar insurance.

(b) Insurance costs may be approved as a direct cost only if the incurrence is specifically required for the performance of the contract.

(c) Actual losses which should reasonably have been covered by permissible insurance or were expressly covered by self insurance are unallowable unless the parties expressly agree otherwise in the terms of the contract.

(5) Litigation Costs. Litigation costs include all filing fees, legal fees, expert witness fees, and all other costs involved in litigating claims in court or before an administrative board. Litigation costs are allowable as indirect costs in accordance with these regulations, except that costs incurred in litigation against the purchasing agency are unallowable.

7-107 Applicable Credits.

(1) Definitions and Examples. Applicable credits are receipts or price reductions which offset or reduce expenditures allocable to contracts as direct or indirect costs. Examples include purchase discounts, rebates, allowance, recoveries or indemnification for losses, sale of scrap and surplus equipment and materials, adjustments for overpayments or erroneous charges, and income from employee recreational or incidental services and food sales.

(2) Reducing Costs. Credits shall be applied to reduce related direct or indirect costs.

(3) Refund. The purchasing agency shall be entitled to a cash refund if the related expenditures have been paid to the contractor under a cost-reimbursement type contract.

7-108 Advance Agreements.

(1) Purpose. Both the purchasing agency and the contractor should seek to avoid disputes and litigation arising from potential problems by providing in the terms of the contract the treatment to be accorded special or unusual costs.

(2) Procedure Required. Advance agreements may be negotiated either before or after contract award, but shall be negotiated before a significant portion of the cost covered by the agreement has been incurred. Advance agreement shall be in writing, executed by both contracting parties, and incorporated in the contract.

(3) Limitation on Costs Covered. An advance agreement shall not provide for any treatment of costs inconsistent with these regulations unless a determination has been made pursuant to Section 7-210 (Authority to Deviate from Cost Principles).

7-109 Use of Federal Cost Principles.

(1) Cost Negotiations. In dealing with contractors operating according to federal cost principles, such as Defense Acquisition Regulation, Section 15, or Federal Procurement Regulations, Part 1-15, the purchasing agent, after notifying the contractor, may use the federal cost principles as guidance in contract negotiations, subject to Subsection (2) of this Section.

(2) Incorporation of Federal Cost Principles; Conflicts Between Federal Principles and this Part.

(a) In contracts not awarded under a program which is funded by federal assistance funds, the purchasing agent may explicitly incorporate federal cost principles into a solicitation and thus into any contract awarded pursuant to that solicitation. The purchasing agent and the contractor by mutual agreement may incorporate

federal cost principles into a contract during negotiation or after award. In either instance, the language incorporating the federal cost principles shall clearly state that to the extent federal cost principles conflict with the regulations issued pursuant to Section 63-56-28(1) of the Utah Procurement Code, the county regulations shall control.

(b) In contracts awarded under a program which is financed in whole or in part by federal assistance funds, all requirements set forth in the assistance document including specified federal cost principles, must be satisfied. Therefore, to the extent that the cost principles specified in the grant document conflict with the cost principles issued pursuant to Section 63-56-28 (1) of the Utah Procurement Code, the cost principles specified in the grant shall control.

7-110 Authority to Deviate from Cost Principles.

If a purchasing agent desires to deviate from the cost principles set forth in these regulations, a written determination shall be made by such officer specifying the reason for the deviation.