

## 2.5 Cost Principles

### Lesson Goals

- To introduce students to cost principles those small businesses and individuals need to be aware of.

### Start Video



- Please watch the video now – Lesson 2.5 Cost Principles
- Use the following pages to take notes.

### Truth in Negotiations Act (TINA)

#### Purpose

-To put the Government on an equal footing with contractors by requiring contractors to provide the Government with an extremely broad range of cost or pricing information relevant to the expected costs of contract performance.

### Requires

- Contractors and subcontractors to submit cost or pricing data to Government and to certify that, to the best of their knowledge and belief, the data are current, accurate, and complete.
- Defects or omissions in the cost or pricing data even if unintentional can lead to reductions in the contract price or to a fraud investigation.

### Costs

- Government contracts require the application of accounting concepts not used in commercial sector
- Costs that might be perfectly \_\_\_\_\_ when judged under IRS or financial reporting criteria are sometimes unallowable under the laws governing Government contracts

**Notes:**

## Cost Principles

### Applicability

- Extent depends on type of contract awarded
- Cost analysis involves the evaluation of the judgmental factors used by the contractor in estimating costs.
- FAR primary but not only source for cost principles.

## FAR Part 31

- Four sets of cost principles, each applicable to contracts with different types of organizations
  - FAR \_\_\_\_\_ Commercial Organizations
  - FAR 31.3 Educational Institutions, OMB Circular A-21 which is in effect on the date of the contract is used for determining allowable costs
  - FAR 31.6 State, local and federally recognized Indian tribal governments, OMB Circulars A-87 and A-102 apply
  - FAR 31.7 Nonprofit organizations, OMB Circulars A-110 and A-122 apply

**Notes:**

### Allowability

- FAR 31.2 lists five general factors for determining cost allowability
  - Reasonableness
  - Allocability
  - Standards promulgated by the Cost Accounting Standards Board, if applicable, otherwise generally accepted accounting principles and practices
  - Terms of the contract
  - Any limitations set forth in this subpart.

### Reasonableness

- Criteria for determining – vague and subjective
- FAR provides 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.
- Burden of proof on contractor to establish that such cost is \_\_\_\_\_.

**Notes:**

### Allocability

- FAR 31.2 definition

- 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. Subject to the foregoing, a cost is allocable to a Government contract if it –

- Is incurred\_\_\_\_\_ for the contract;
    - Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
    - Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

- Necessary to assess whether a cost should be charged directly or indirectly.

- \_\_\_\_\_ cost is any cost that can be identified specifically with a particular final cost objective.

- \_\_\_\_\_ cost is an cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective.

### Selected Costs

- FAR 31

- 48 specific types of costs are treated in FAR 31.205.

- Must not only meet the general requirements for \_\_\_\_\_, they must also meet other, special criteria.

- Even if expense is reasonable and allocable, may still be deemed unallowable.

- Subpart not intended to cover every element of cost.

### Sample Costs in 31.2

- Public Relations and Advertising Costs allowable solely for

- \_\_\_\_\_ of scarce items needed for performance of the contract, or

- The disposal of scrap or surplus materials required during performance.

- Certain \_\_\_\_\_ costs such as costs of responding to inquiries on company policies, plant tours, and open houses.



**Mini-Lab**

- Go to the FAR online.
- Using FAR Subpart 31, determine if each of these costs are allowable or unallowable. Place a check in the appropriate column

Cost	Allowable	Unallowable
New product announcement ceremony		
Bad debts		
Contributions or donations		
Entertainment costs		
Fines		
Losses on other contracts		
Maintenance and repair costs		
Incorporating a business		
Royalties on a patent		
Attendance to IEEE conference for an engineer		
Travel costs to conference		
Wine for a reception		
Insurance		

- Email your answers to [cschmitt@fit.edu](mailto:cschmitt@fit.edu). You will receive an email back, with the correct answers.

References

- FAR
- DFARS
- USC Code
- CFR
- *Government Contract Guidebook*, Donald P. Arnavas, Thompson-West, 2001.