OFFICE OF THE UNDER SECRETARY OF DEFENSE

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ACQUISITION,
TECHNOLOGY
AND LOGISTICS

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MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY
(ACQUISITION, LOGISTICS AND TECHNOLOGY)
ASSISTANT SECRETARY OF THE NAVY
(RESEARCH, DEVELOPMENT AND ACQUISITION)
ASSISTANT SECRETARY OF THE AIR FORCE
(ACQUISITION)
DIRECTORS OF DEFENSE AGENCIES

SUBJECT: Contract Pricing and Cost Accounting - Compliance with DFARS 252.211-7003, "Item Identification and Valuation"

The Department of Defense is pursuing the implementation of unique item identification to assure that we reap the significant benefits offered by this initiative. As part of this initiative, an interim rule was issued on December 30, 2003. This interim rule included an implementing contract clause at DFARS 252.211-7003.

Questions have been raised concerning the pricing and accounting for costs necessary to comply with DFARS 252.211-7003. The attached guidance should be used by all DoD contracting personnel in pricing and accounting for DoD contracts subject to the provisions of FAR Part 31 and the applicable Cost Accounting Standards.

If you have any questions regarding this memorandum, please contact Mr. David J. Capitano, Senior Procurement Analyst, at (703)847-7486, or via e-mail at david.capitano@osd.mil.

Deidre A. Lee
Director, Defense Procurement
and Acquisition Policy

Attachment:
As stated

Contract Pricing and Cost Accounting - Compliance with DFARS 252.211-7003

General

The costs necessary to comply with DFARS 252.211-7003 are generally allowable, provided they comply with applicable assignment and allocability requirements of the Cost Accounting Standards and Federal Acquisition Regulations Part 31. The general guidance that follows should be utilized by Contracting Officer's in applying these requirements.

Assignment of Costs to Accounting Periods

Tangible Capital Assets: CAS 404/409 and FAR 31.205-11 address the cost accounting periods for depreciating the cost of (a) purchases or construction of new tangible capital assets, and (b) betterments or improvements of existing capital assets. These provisions shall be followed for all tangible capital assets that are required to comply with DFARS 252.211-7003.

Intangible Capital Assets: The costs of intangible capital assets shall be expensed or amortized in accordance with Generally Accepted Accounting Principles. Specifically, the cost of developing or obtaining computer software for use in complying with DFARS 252.211-7003 shall be capitalized in accordance with the provisions of the AICPA Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use". The Contracting Officer should consult with the cognizant auditor regarding the proper expensing and amortizing of such costs under SOP 98-1.

Other Than Capital Assets: The following guidance shall be used in determining whether to expense or amortize any such costs necessary to comply with DFARS 252.211-7003:

Recurring costs. Costs that are of a recurring nature shall be expensed in the period in which they are incurred.

Non-Recurring costs. Non-recurring costs shall be expensed or amortized in accordance with the following criteria:

- Costs that would otherwise have been incurred (e.g., planning and analysis, contract administration, contract oversight, financial and administrative support) shall be expensed in the period in which they are incurred.

- Costs of nonrecurring or extraordinary activities that would not have otherwise been incurred shall be separately accumulated as a deferred cost. This deferred cost shall be amortized over a period during which the benefits of the non-recurring costs are expected to accrue, but shall not exceed five years. However, the parties (the Contracting Officer and the contractor) have the flexibility to agree to expense these costs in the period in which they are incurred if such treatment will result in a more equitable assignment of costs in the circumstances. Any deferred costs shall not be included in the computation to determine facilities capital cost of money under CAS 414 or FAR 31.205-10.

Allocation of Costs to Contracts.

Costs shall be allocated to contracts based on the relative benefits received or some other equitable relationship. While the item identification may be required for only DoD contracts, any non-DoD contracts (contracts with Government entities other than DoD and/or contracts with non-Government entities) should be included in the cost allocation base when those contracts benefit from the item identification. The Contracting Officer should evaluate the particular facts and circumstances of each situation to determine whether a proposed cost allocation methodology complies with applicable CAS and FAR provisions.

Some contractors may choose to implement item identification on a company wide basis. In such cases, the Contracting Officer will need to evaluate the particular circumstances to determine whether the item identification benefits non-DoD contracts. For example, if the contractor utilizes the item identification on non-DoD items, then the associated costs should be allocated to both DoD and non-DoD contracts. This is the case even though the item identification was not required for the non-DoD items, i.e., the costs should be allocated based on the benefits received (not simply based on whether the identification was a contract requirement). In another example, the contractor produces items for DoD and non-DoD contracts on the same assembly line and applies the item identification to all the items because differentiation is not possible. Under these circumstances, if the contractor provides supporting documentation showing that it does not utilize the item identification for the non-DoD items, the associated costs should not be allocated to the non-DoD contracts.

Pricing Costs in New Contracts

At some contractors, the cost of complying with DFARS 252.211-7003 may be difficult to estimate with reasonable accuracy. When such costs significantly affect the contract price, the Contracting Officer should consider using a re-opener clause in compliance with applicable agency procedures to adjust for the difference between anticipated and actual costs.

Some contractors may propose alternative methods for pricing the costs to comply with DFARS 252.211-7003. The Contracting Officer shall consult with the cognizant Administrative Contracting Officer and auditor before agreeing to any such pricing alternatives.

Pricing Costs in Existing Contracts

It is possible that the requirement to comply with DFARS 252.211-7003 may be extended to existing contracts. The extension of this requirement does not authorize the Contracting Officer to deviate from the CAS and FAR requirements, (including the requirements delineated in this guidance) for assigning and allocating costs to cost accounting periods. However, the Contracting Officer should negotiate an equitable adjustment to the contract price when a contract modification is issued that applies the requirement to comply with DFARS 252.211-7003 and that requirement was not previously included in that contract.