

Allowability of Costs on U.S. Government Contracts

Dear UTC Colleague:

The UTC Government Accounting Policy Committee (GAPC) was established nearly 15 years ago to ensure, among other things, accounting treatment of costs consistent with U.S. Government contract and related regulatory requirements. The committee operates under the direction of the Corporate Controller's office and is comprised of representatives from all aerospace and defense segments, the Corporate Controller's office and legal departments. This employee guide entitled "Allowability of Costs on U.S. Government Contracts" contains the latest regulatory requirements and replaces any previous publications on cost allowability.

As a contractor with the U.S. Government, we are obligated by the Federal Acquisition Regulation (FAR) and UTC Policy to charge our Government customer only costs which are allowable. Failure to comply with the FAR can result in significant fines and penalties being assessed to individuals and the Corporation, depending on the circumstances. It is important to ensure that employees are aware of what the Government considers to be allowable costs.

This guide has been prepared to assist employees in properly classifying costs as either allowable or unallowable and includes an index to facilitate a quick identification of costs typically incurred throughout all UTC business units. Additionally, the narrative description of each cost contains a reference to the appropriate section in the FAR for a more in-depth discussion of the subject matter.

Please use this guide as a handy reference when cost allowability decisions are required. If you prefer, you can access the on-line version of this guide (UTC Financial Manual Section 29.29.8A – Index of Specific Items of Cost and Section 29.29.8B – Specific Items of Cost) located at <http://www.corphq.utc.com/emhand/finance/fintoc.htm> for the most current regulations. If you have any further questions concerning cost allowability, please contact one of the GAPC representatives listed on the following page.



Steven F. Slitt
Assistant Controller –
Government Accounting

Operating Segment	TechNet
Corporate Headquarters Michael E. Thomann	8-439-7530
Hamilton Sundstrand Edith C. Cottle	8-433-2220
Pratt & Whitney John A. Erling	8-557-0766
Pratt & Whitney — Liquid Space Propulsion Donna S. Ryan	8-796-7853
Pratt & Whitney — Military Aftermarket Services Richard L. Gilland	8-797-2918
Shared Business Services R. Christopher Lagasse	(860) 731-9107
Sikorsky Aircraft Joseph C. Chancio	8-536-6052
UTC Power Brad P. Presnick	8-442-7136
United Technologies Research Center Christopher M. Fransen	8-446-2127

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1 Public Relations and Advertising Costs (FAR 31.205-1)

1A Advertising

Most forms of advertising are unallowable. Advertising means using the various media to promote sales of products and services. Unallowable costs include advertisements on television or radio or in magazines, newspapers, etc. and the actual cost of advertising time or space, including printing, layout, graphics, distribution, etc. Costs of services performed by outside organizations and the applicable portion of salaries, fringe benefits, and travel of employees performing advertising functions are also unallowable.

The only allowable advertising costs are:

1. Those costs specifically required by contract or that arise from requirements of U.S. Government contracts and that are exclusively for:
 - > acquiring scarce items for contract performance
 - > disposing of scrap or surplus materials acquired for contract performance.
2. Costs of activities that contain a significant effort to promote export sales of products normally sold to the U.S. Government are allowable. These activities include trade shows, air shows, and conventions. Reasonable costs include transportation of displays and equipment, parts, and support costs, but exclude entertainment, hospitality suites, memorabilia and other costs necessary to establish or operate a display.
3. Recruitment costs of advertising related to specific job postings (help wanted advertising).

1B Public Relations

Public relations expenses may be allowable or unallowable depending on their nature and the purpose for which they are incurred. Allowable costs of public relations include costs of responding to inquiries on company policies and activities; communicating with the public, press, shareowners, creditors and customers; conducting general liaison with news media and government public relations offices; and coordinating plant tours and open houses. However, allowable communication and liaison costs are limited to those activities necessary to keep the public and financial community informed on matters of public concern including the financial condition of the company, announcements of contract awards, plant closings or openings, employee layoffs or rehires, sales and profit changes, etc.

Unallowable public relations costs include the following:

- > costs of promotional material, motion pictures, video/audio tapes, brochures, handouts, magazines and other media designed to call favorable attention to the company
- > costs of sponsoring meetings, symposiums, seminars, and other special events when the principal purpose of the event is the enhancement of the image of the company or its products
- > costs of items that are normally distributed free of charge, such as giveaways, gifts and souvenirs, which include such items as hats, T-shirts, pens and pencils, golf balls, briefcases, product models, neckties, key chains, umbrellas, etc. whether distributed to employees, customers or the public
- > costs of conventions, trade shows and other special events that do not contain a significant effort to promote export sales of products normally sold to the U.S. Government, including the costs of displays, exhibits, meeting rooms, and other special facilities

- > costs of ceremonies such as corporate celebrations and new product announcements
- > all other public relations activities to promote the sale of products or services, either directly by stimulating interest in a product or indirectly by disseminating messages calling favorable attention to the company, for purposes of enhancing the company image to sell the company's products.

1C Community and Social Programs

Cost of membership in civic and community organizations are expressly unallowable. While no definitions of civic and community organizations are provided in the regulations, it should be interpreted as memberships in organizations that (1) enhance or further civic goals or objectives such as fostering common goals that concern the duties and rights of citizenship, e.g., Lions Club, Rotary, Elks, or (2) support community oriented efforts such as promoting pride in one's community or support efforts oriented towards a particular segment of a community, e.g., Downtown Council, clean-up projects, neighborhood beautification programs.

While the costs of memberships in civic and community organizations are expressly unallowable, the costs of participation in community service activities are expressly allowable. Examples provided in the regulations include the costs of participating in blood drives, charity drives, savings bond drives, and disaster assistance. UTC interprets the cost principle to allow internal salary and out-of-pocket costs of participating in community service activities including such activities as Special Olympics, neighborhood assistance programs, the United Way Chairperson and Loaned Executives, as well as costs associated with the Robotics Competition (travel expense and salary) except for those related costs that are clearly unallowable (e.g., giveaways, t-shirts).

1D Media Relations

Media relations include certain costs that may be unallowable. (See 1A, Advertising and 1B, Public Relations.)

Expenses for programs such as television news releases and news features are generally unallowable as public relations costs if primarily intended to enhance the company or its products' images. Included in this category are such items as audio-visual news releases, films of a special or promotional nature, and technical public relations films that promote our products or cast favorable light on the company or its products.

Allowable media relations costs include:

- > subscriptions to news and wire services
- > responding to the press and other inquiries (see 1B, Public Relations)
- > announcements relating broadly to the financial or employment condition of the company (see 1B, Public Relations.)

1E Gifts, Giveaways, and Gratuities

Free meals, services, goods, mementos, souvenirs, and other gifts and giveaways provided free of charge to employees and non-employees for promotional purposes or as remembrances, tokens of appreciation, or gestures of goodwill are not allowable. These items include product models, key chains, golf balls, flowers, etc.

The term gift includes any money paid or item given that is not in payment for goods or services rendered or that the company is not otherwise obligated to pay. An exception to the foregoing exists for awards made to employees under established, non-discriminatory programs designed to recognize employment service and outstanding achievement such as service awards, are allowable.

2 Reserved (FAR 31.205-2)

3 Bad Debts (FAR 31.205-3)

Bad debts from uncollectible accounts receivable, as well as associated collection and legal costs, are unallowable. When a debt becomes uncollectible depends on pertinent entries on the company's books and records.

4 Bonding Costs (FAR 31.205-4)

Bonding costs are those costs incurred by the company to ensure that the Government or another party will not be financially harmed by some action of or default by the company. Included are costs for bid, performance, payment, advance payment, infringement and fidelity bonds.

Costs of bonds required by the terms of a contract are allowable. Costs of bonds in the general course of business, as long as the rates and premiums are reasonable under the circumstances, are also allowable.

5 Reserved (FAR 31.205-5)

6 Compensation for Personal Services (FAR 31.205-6)

Compensation includes but is not limited to the cost of salaries and wages, bonuses and incentives, severance pay, back pay, stock options, pension and postretirement costs, insurance costs, deferred compensation, compensation incidental to business acquisitions, fringe benefits (including adoption assistance), and employee rebates. Although compensation for personal services is generally allowable if the amount is reasonable, complex criteria determine the exact nature of the allowability of these costs and FAR 31.205-6 should be reviewed.

Notwithstanding the above, the following costs are unallowable:

- > the cost of rebates and purchase discounts granted to employees on company products (e.g., the Carrier Rebate Plan)
- > compensation to senior executives (top five at each home office and each segment) in excess of the benchmark compensation determined by the Office of Federal Procurement Policy
- > any compensation calculated or valued based on changes in the prices of corporate securities including stock options, stock appreciation rights, phantom stock plans and junior stock conversions
- > any compensation represented by dividend payments or which is calculated based on dividend payments (e.g., dividend equivalents)
- > differential allowances for additional Federal, State, or local income taxes resulting from domestic assignments
- > severance payments to individual employees in excess of the employee's annual salary (defined as the current rate of pay, as of the date of notification, annualized) including incentive compensation most recently paid
- > all costs of severance payments to foreign nationals if the termination is the result of closing or curtailing operations at the request of the local government in that country.

UTC interprets the cost principle to allow internal salary and out-of-pocket costs for the United Way Chairperson and United Way Loaned Executives to be an allowable expense, as well as, costs associated with the Robotics Competition (travel expense and salary) except for those related costs that are clearly unallowable (e.g., giveaways, t-shirts). In addition, UTC considers pay for the period during which an employee is absent from work due to active annual training duty or encampment, etc. as a member of the National Guard or as a reserve member in the U.S. Armed Forces, at his or her regular base salary rate, less gross earnings paid to him or her for the military duty, to be allowable.

7 Contingencies (FAR 31.205-7)

A contingency is a possible future event or condition the outcome of which is indeterminable at the present time. An example would be the outcome of pending litigation. Costs of contingencies are generally unallowable until the point in time when the costs are either incurred or become accurately measurable.

8 Contributions or Donations (FAR 31.205-8)

Contributions or donations, including company matching gifts to charitable and not-for-profit organizations (whether for operating, capital or other purposes), are unallowable. This includes such organizations as United Way, schools, universities and colleges, hospitals, health organizations, museums, civic organizations, and Special Olympics. Costs of products or services donated to such organizations are also unallowable.

The donation of land/property and associated costs are to be treated as an unallowable expense (e.g., land for new stadium development).

8A Support of Cultural Activities

All costs in support of cultural activities and events, including support of museums, art exhibits, theaters, symphonies, and other such organizations, are unallowable. Support includes advertising, printing, distribution, posters, promotions, etc., as well as direct donation of services, property, or money. Also costs incurred to author, print, and distribute books and similar publications related to cultural matters or activities are unallowable.

9 Reserved (FAR 31.205-9)

10 Cost of Money (FAR 31.205-10)

Facilities capital cost of money (cost of capital committed to facilities) is an imputed cost determined by applying a cost of money rate to facilities capital employed in contract performance. Facilities capital cost of money is allowable if the company's capital investment is measured, allocated to contracts and follows CAS 414; the company maintains adequate records; the estimated facilities capital cost of money is proposed under the contract; and the requirements of FAR 31.205.52, Asset Valuations Resulting from Business Combinations, are observed.

Cost of money as an element of the cost of capital assets under construction is an imputed cost determined by applying a cost of money rate to the investment in tangible and intangible capital assets while they are being constructed, fabricated, or developed for the company's own use. Cost of money as an element of the cost of capital assets under construction is allowable if:

- > the cost is calculated, allocated to contracts and costed in accordance with CAS 417
- > company maintains adequate records
- > for tangible capital assets if included in the capitalized cost (that provided the basis for allowable depreciation costs)
- > for intangible capital assets if the cost of money is included in the cost of those assets for which amortization costs are allowable.

The following apply to facilities capital cost of money and cost of money as an element of the cost of capital assets under construction:

- > cost of money need not be entered on the company's books of account but shall be a memorandum entry of the cost

- > maintained in a manner that permits audit verification (i.e., all relevant schedules, cost data and other data necessary to support the entry)
- > cost of money that is allowable and allocable as noted above is considered “incurred cost” for reimbursement of cost-reimbursement contracts and progress payments for fixed-priced contracts
- > notwithstanding the above, when the purchase method of accounting for business combination is used, allowable cost of money shall be limited to the total of the amounts that would have been allowed had the combination not taken place for intangible capital assets. For tangible capital assets, the allowable cost of money is based on the capitalized asset values measured and assigned in accordance with CAS 404-50(d).

11 Depreciation (FAR 31.205-11)

Depreciation is a charge to current operations that distributes the cost of a tangible capital asset, less estimated residual value, over its useful life in a systematic and logical manner. Notwithstanding, depreciation shall be considered reasonable if the company follows policies and procedures that are:

- > consistent with those followed in the same cost center for business other than Government
- > reflected in the company’s books of accounts and financial statements
- > both used and acceptable for Federal income tax purposes.

Assets of this nature include items such as the physical plant (buildings), equipment and machinery. Assets whose leases are classified as capital leases under FAS 13 are subject to the requirements of this regulation. Assets acquired under operating leases are subject to the requirements on rental costs in FAR 31.205.36. While normal depreciation on plant and equipment is allowable, the regulations on administering this type of cost are numerous and complex.

12 Economic Planning Costs (FAR 31.205-12)

These costs consist of general long-range management planning dealing with future business development. This activity may take into account major changes in the company or the markets in which the company does business. It does not include costs of organization or reorganization. (See 27, Organization Costs.) Economic planning costs are allowable as indirect costs to be properly allocated. Research and development and engineering costs designed to lead new products for sale to the general public are unallowable under this principle but may be allowable as IR&D. (See 18, IR&D.)

13 Employee Morale, Health, Welfare, Food Service and Dormitory Costs and Credits (FAR 31.205-13)

Costs incurred on activities designed to improve working conditions, employer-employee relations, employee morale, and employee performance are allowable. Allowable costs include in-house publications, health clinics, wellness/fitness centers, employee counseling services, and food services.

Costs of gifts are unallowable. Gifts do not include cash compensation (taxable income), plaques, pins, certificates, and the like, which are provided in accordance with established policies and practices for recognition of employee performance, team-building, longevity and service awards designed to recognize employment service.

Costs associated with Quarter Century Club dinners, ACE celebrations, retirement parties, firemen's and foremen's outings, employee picnics and Christmas parties will be treated as unallowable.

Costs of recreation are unallowable except for costs of employee participation in company-sponsored sports teams or employee organizations designed to improve company loyalty, teamwork, or physical fitness.

14 Entertainment Costs (FAR 31.205-14)

14A Entertainment

Costs of amusements, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable. The costs of attending events such as receptions, dances, opening nights and cocktail parties are unallowable. Related costs for such items as liquor, flowers, tickets, tuxedo rental, clothing allowances, childcare expenses and any transportation costs are also unallowable.

The term entertainment is to be construed broadly. Therefore, in connection with otherwise allowable activities, certain costs are unallowable. For example, costs of golf, tennis and other sports, musical entertainment, and identifiable liquor costs incurred in connection with business meetings are considered unallowable entertainment costs.

14B Meals

UTC takes a conservative approach when dealing with business guests. Costs associated with business guests (customers or other non-employees) are not to be claimed except as it relates to potential employment candidates and to in-house working lunches/training programs with valid business purposes and the individual's attendance is essential to achieve the purpose of the meeting. Costs for non-employees under either of these circumstances should be claimed as "Meals - Other UTC Employees".

Local meal costs of employees not in travel status are generally unallowable unless incurred in conjunction with attendance at a trade, business, technical, or professional meeting at which a technical discussion took place. Working lunches with a valid business purpose for UTC employees are considered allowable.

14C Other Guests

All costs associated with travel, lodging, meals, and other expenses pertaining to the attendance of employees' spouses or other guests whose attendance is not required to support or further a business purpose at meetings or events are unallowable. The unallowable amount is the incremental amount applicable to the spouse or guest. For example, the employee must determine the difference between the single and double rate for a hotel room. The difference is unallowable.

14D Memberships

Costs of memberships in social clubs, country clubs, or other clubs with similar purposes are unallowable.

15 Fines, Penalties and Mischarging Costs (FAR 31.205-15)

15A Fines and Penalties

Fines and penalties imposed as a result of failure to comply with Federal, State, local or foreign laws and regulations, such as EPA or OSHA, are unallowable. The only exception to this regulation is when the fine is the result of complying with the terms of a contract or the written instructions of the U.S. Government's contracting officer.

15B Costs Related to Mischarging

Costs incurred in connection with, or related to, the mischarging of costs on U.S. Government contracts are unallowable when the costs are caused by, or result from, alternation or destruction of records, or other false or improper charging or recording of costs. However, costs of activities associated with normal audit and compliance programs are allowable.

16 Gains or Losses on Disposition of Depreciable Property or Capital Assets (FAR 31.205-16)

A gain or loss from the sale, retirement, or other disposition of a tangible capital asset is considered to be the difference between the net amount realized from the sale or disposition and the undepreciated balance of the asset.

Gains or losses on disposition of tangible assets are allowable and are treated as adjustments to depreciation costs previously recognized, thereby allowing the U.S. Government to share in the gain or loss. No gain or loss shall be recognized as a result of the transfer of assets in a business combination.

For contract costing purposes, any gain recognized generally is limited to the amount of accumulated depreciation of the asset. However, additional restrictions on gains or losses may apply depending on the accounting treatment of depreciation. Gains and losses shall not be recognized as a separate charge or credit when the transaction is recorded in the depreciation reserve account and reflected in allowable depreciation (FAR 31.205.11) or the property is exchanged as part of the purchase of a similar item, and the gain or loss is reflected in the depreciation cost basis of the new item. Different rules apply to involuntary conversions when there is an insurance award recovered (e.g., property destroyed by events like fire or floods). If there is a cash award and the converted asset is not replaced, the gain or loss shall be recognized in the period of disposition. The gain recognized for contract costing purposes should be limited to the difference between the acquisition cost of the asset and the undepreciated balance. If the converted asset is replaced, the company shall either adjust the depreciable basis of the new asset by the amount of the total realized gain or loss or recognize the gain or loss in the period of disposition.

Gains and losses arising from mass or extraordinary sales; retirements or dispositions other than through business combinations shall be considered on a case-by-case basis. Gains and losses of any nature arising from the sale or exchange of capital assets, other than depreciable property, shall be excluded in computing contract costs.

For long lived tangible assets held for use, no loss shall be allowed for a write-down from the carrying value to the fair value as a result of impairments caused by events or changes in circumstances (e.g., environmental damages, idle facilities arising from a declining business base). If depreciable property or other capital assets have been written down due to impairments, gains or losses upon disposition should be the amounts that would have been allowed had the assets not been written down.

17 Idle Facilities and Idle Capacity Costs (FAR 31.205-17)

Idle facilities/idle capacity costs are the costs of maintenance, repair, rent, housing, and related costs (e.g., insurance, taxes and depreciation) attributed to completely unused excess facilities and partially used facilities, respectively.

Idle facility costs are generally unallowable unless the facilities are necessary to meet fluctuations in workload. However, if facilities become idle because of unforeseen events, such as termination of a contract, production economies, or reorganization, the cost will be allowable for a reasonable period (usually one year).

Idle capacity costs are generally allowable, provided that the idle capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale in accordance with sound business, economic or security practices.

18 Independent Research & Development and Bid & Proposal Costs (IR&D and B&P) (FAR 31.205-18)

IR&D costs result from projects not required in performing a contract or agreement and represent costs of performing applied or basic research, development, or systems and other concept formulation studies.

B&P costs are incurred in preparing, submitting, and supporting bids or proposals (whether solicited or unsolicited) to U.S. Government or non-Government customers including, technical effort expended in developing and preparing technical data specifically to support submitting a bid or proposal. (Also see 38, Selling Costs). The following types of costs must not be charged to either IR&D or B&P:

- > costs of effort sponsored by or required in the performance of U.S. Government or commercial contracts or grants (NOTE: If a contract, grant, or other agreement requires preparation of a follow-on bid/proposal, the costs of preparing such bid/proposal may not be charged to B&P, but may be charged directly to the contract/grant/agreement. Consult your unit's Government Accounting function to determine the proper accounting).
- > development effort that is subcontracted technical effort for the sole purpose of developing an additional source for an existing product
- > development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for eventual sale. (However, see 25, Manufacturing and Production Engineering.)

Costs incurred in preparing, submitting, and supporting offers on potential cooperative arrangements are allowable to the extent they are allocable, reasonable, and not otherwise unallowable.

IR&D may be used to support the cost-share requirements of Co-operative Research and Development

Agreements (CRADAs), Other Transaction, and similar agreements issued by various U.S. Government agencies provided the work to be performed would have been allowed as IR&D had there been no agreement.

Section 29.29.5 of the Corporate Financial Manual should be reviewed for guidance on the allowability of IR&D and B&P costs.

19 Insurance & Indemnification (FAR 31.205-19)

Costs of insurance required by or approved pursuant to a contract are allowable.

Insurance costs associated with the general conduct of business are allowable as long as the types of coverage, rates and premiums are reasonable. There are, however, some restrictions within the cost principle.

Actual losses not covered by insurance are generally unallowable unless the contract expressly provides for them. Exceptions to this are minor losses such as spoilage and breakage. Additional exceptions relating to provisions of the CAS dealing with insurance apply to actual losses.

The cost of insurance to cover correcting defects in material and workmanship is unallowable, except for the cost of insurance to cover casualty losses as a result of defects.

20 Interest and Other Financial Costs (FAR 31.205-20)

Interest on borrowings and bond discounts is unallowable. Related costs of financing and refinancing capital, including associated legal and professional fees, are unallowable. However, interest assessed by state or local taxing authorities under the conditions specified in FAR 31.205-41(a)(3) is allowable.

21 Labor Relations Costs (FAR 31.205-21)

Costs of maintaining satisfactory relations between a company and its employees are allowable. These expenses include the cost of shop stewards, labor-management committees, employee publications, and other related activities.

Costs incurred for activities that assist, promote or deter unionization are unallowable.

22 Legislative Lobbying Costs (FAR 31.205-22)

22A Unallowable Lobbying

The costs associated with the following activities are unallowable:

- > campaign contributions, endorsements, and publicity intended to influence the outcomes of federal, state, or local elections and referendums
- > support of political parties and campaigns, political action committees and the like, the purpose of which is to influence the outcomes of elections
- > cost of lobbying the U.S. Congress or a state legislature or staff members, either directly or indirectly (including supporting grass roots lobbying), for purposes of influencing the introduction or outcome of legislation. Cost of lobbying includes employee salaries, related fringe benefits and travel, as well as related consulting and other professional fees
- > publicity and propaganda, urging public participation in rallies, marches, demonstrations, letter writing and telephone campaigns, the purpose of which is to influence the introduction or outcome of federal or state legislation
- > legislative liaison activity (attending hearings, gathering information, analyzing bills, etc.), when carried out in support of or preparation for engagement in unallowable activities.

22B Allowable Lobbying

The costs associated with the following activities are allowable:

- > legislative liaison (attending hearings, gathering information, etc.), as long as it is not in support of unallowable lobbying
- > costs of providing a factual or technical presentation on information directly related to a topic involving performance of a contract, if in response to a documented request
- > state and local legislative activities (previously noted as unallowable), if for purposes of reducing contract costs or if necessary for contract performance.
- > any activity specifically authorized by statute to be undertaken with funds from the contract.

23 Losses on Other Contracts (FAR 31.205-23)

An excess of costs over income under any contract (including UTC's or its affiliates' contributed portion under cost-sharing contracts) is unallowable.

24 Maintenance and Repair Costs (FAR 31.205-24)

Necessary costs for the upkeep of property (including U.S. Government property), which keep it in an efficient operating condition, are generally allowable. The maintenance and repair costs should be expense items (i.e., not add to the permanent value of the property nor appreciably extend its useful life).

25 Manufacturing and Production Engineering Costs (FAR 31.205-25)

Costs consist of the following:

- > developing and deploying new or improved materials, systems, processes, methods, equipment, tools and techniques expected to be used in production
- > developing and deploying pilot production lines
- > improving current production functions such as plant layout, methods and job analysis, or tooling analysis.
- > Improving current production functions such as plan layout, scheduling and control, methods and job analysis, equipment capabilities and capacities, inspection techniques or tooling analysis.
- > Material and manufacturing producibility analysis for production suitability and to optimize manufacturing processes, methods and techniques.

Costs of this nature are generally allowable, but must be distinguished, however, from effort expended in developing or deploying items intended for sale, which would be considered IR&D.

26 Material Costs (FAR 31.205-26)

Costs for items such as raw material, parts, subassemblies, components, and manufacturing supplies, whether purchased or manufactured, are allowable, subject to the following:

- > the cost of the material should be adjusted for any income or credits such as trade discounts, refunds, rebates and salvage

- > adjustments due to differences in physical and book inventory are allowable provided it relates to the contract performance period
- > materials purchased specifically for a particular contract and are identifiable with it should be charged direct to the contract.

Materials, supplies, and services sold or transferred between entities under common control (e.g., HS and P&W) shall be on the basis of cost incurred. There are exceptions, however, as to when such sale or transfer may be at price. Refer to Section 29.3.5 of the Corporate Financial Manual for additional guidance.

Expenses for services transferred between entities must be reviewed to ensure unallowable costs are identified and segregated. Such expenses should be subject to the same type of scrutiny as professional fees incurred from outside suppliers.

27 Organization Costs (FAR 31.205-27)

Expenses of planning and executing an organization or reorganization of corporate structure, mergers, acquisitions, and raising capital, as well as directly associated expenses of attorneys, accountants, brokers, promoters, consultants, investment advisors, and incorporation fees, are unallowable. UTC interprets the regulation to mean that all organizational costs incurred **AFTER** the management decision is made to pursue a specific merger, acquisition or divestiture will be considered unallowable. (Also see UTC Financial Manual Section 29.8.1, Accounting for Business Combinations, Goodwill, Other Intangible Assets and Disposals of a Business).

28 Other Business Expenses (FAR 31.205-28)

When allocated on an equitable basis, the following types of business expenses are allowable:

- > registry and transfer charges resulting from changes in ownership of securities issued by the company
- > cost of shareholders' meetings
- > normal proxy solicitations
- > preparing and publishing reports to shareholders
- > preparing and submitting required reports and forms to taxing and other regulatory bodies
- > cost of directors' and committee meetings.

29 Plant Protection Costs (FAR 31.205-29)

Costs necessary to protect the Company's property are allowable. They include the following:

- > wages, uniforms and equipment of protection personnel
- > depreciation of plant protection equipment
- > necessary expenses to comply with military requirements.

The costs of commercially provided security protection are also allowable, provided that the costs are reasonable.

30 Patent Costs (FAR 31.205-30)

Costs of preparing and obtaining a U. S. patent are allowable when required by a U.S. Government contract, provided the U.S. Government obtains title or a royalty free license to practice the patent. General counseling services relating to patent matters are allowable. These costs include advice on patent laws, regulations, clauses, and employee agreements. (See 33, Professional and Consultant Service Costs and 37, Royalties and Other Costs for Use of Patents.)

31 Plant Reconversion Costs (FAR 31.205-31)

Costs of restoring or rehabilitating facilities to approximately the same condition that existed prior to starting a U.S. Government contract are generally unallowable.

The only costs allowable in this case are those incurred in removing U.S. Government property and repairing any damage caused by the removal.

32 Precontract Costs (FAR 31.205-32)

Costs incurred in commencing contract performance prior to the actual contract date are allowable if all of the following circumstances exist:

- > costs are incurred in anticipation of contract award
- > costs would have been allowable if incurred after the date of the contract
- > incurrence is necessary to comply with the proposed contract delivery schedule

33 Professional and Consultant Service Costs (FAR 31.205-33)

Generally, professional, legal, and consultant fees are allowable when reasonable in relation to the services rendered. However, costs for services to perform the following are unallowable:

- > improperly obtaining or using data protected by law or regulation
- > improperly influencing contents of solicitations and evaluation of proposals or quotations
- > services in violation of statutes prohibiting improper business practices or conflicts of interest
- > services outside the scope of the services contracted for or agreed to.

To recover allowable professional and consulting costs, the contractual agreement or invoices for services rendered must provide clear and sufficient evidence and documentation of the nature and scope of the services rendered. For this purpose, descriptions on an invoice such as general matters, as requested or instructed by customer, or other vague and non-descript references to services provided are inadequate.

Outside firms providing legal, marketing, accounting, or other services should be given standing instructions on how bills should be rendered so that unallowable amounts are identifiable. Invoices or billings should include sufficient detail as to the time expended and nature of the actual services provided. Consultants' work product and related documents, such as trip reports indicating persons visited and subjects discussed, minutes of meetings, and related memoranda and reports, should be retained in order to substantiate allowability.

Professional or consultant fees associated with otherwise unallowable costs are also unallowable. Accordingly, fees incurred in connection with costs such as advertising, lobbying, defense of antitrust suits, and defense of fraud proceedings are unallowable.

(See also 47, Costs Related to Legal & Other Proceedings Costs.)

34 Recruitment Costs (FAR 31.205-34)

Costs of recruiting employees are generally allowable and include the costs of:

- > help wanted advertising (but see below)
- > operating an employment office
- > travel costs of recruiters and applicants (for interviews)
- > cost for employment agencies not in excess of standard commercial rates.

Help wanted advertising is unallowable, if it:

- > does not describe specific positions or classes of positions
- > includes irrelevant material such as illustrations or descriptions of the company's products.

35 Relocation Costs (FAR 31.205-35)

Relocation costs are generally allowable, subject to certain limitations and exceptions. For a complete list of unallowable relocation costs, refer to FAR 31.205-35.

The following relocation costs are unallowable and should be reviewed for the proper account distribution by the person authorizing payment:

- > loss on sale of the former residence
- > fix-up and improvement costs on the former residence
- > continuing costs of ownership on the vacant former residence for the time period prior to the closing date on the new residence

- > continuing costs of ownership on the vacant former residence for the time period subsequent to the closing date on the new residence, plus closing costs on the former residence in excess of 14% of the sales price of the former residence
- > owner's title insurance costs on the new residence, if such insurance was not previously carried by the employee on the former residence and mortgage life insurance
- > costs incurred to obtain a lower-than-market rate mortgage loan on the new residence
- > closing costs on the purchase of the new residence in excess of 5% of the sales price of the new residence
- > salary allowances in excess of \$5,000 for miscellaneous moving expenses
- > all relocation costs incurred by an employee who resigns for reasons within his/her control within 12 months of the starting date at the new job location
- > real estate brokers fees and commissions.

36 Rental Costs (FAR 31.205-36)

Rental costs of real or personal property, including operating leases, (excluding ADPE) are generally allowable to the extent that the rates are reasonable at the time a decision to rent or lease is made, except that:

- > rental costs under a sale and leaseback arrangement are limited to the amount that would be allowed if the title had been retained by the company
- > rentals between entities under common control are basically limited to normal costs of ownership, such as depreciation, taxes, insurance and maintenance.

37 Royalties & Other Costs for Use of Patents (FAR 31.205-37)

Royalty payments on a patent or the amortization of the purchase cost of a patent or patent rights, if necessary for contract performance and applicable to a contract's products, are generally allowable, unless:

- > the U.S. Government has a license or royalty free use of the patent
- > the patent has been determined to be invalid
- > the patent is considered unenforceable
- > the patent has expired.

Some limits may apply when the royalties are arrived at by something less than arms-length bargaining or are on a patent formerly owned by the company. (Also see 30, Patent Costs.)

38 Selling Costs (FAR 31.205-38)

Selling costs encompass all efforts to market the Company's products and services, including the broad categories of advertising, company image enhancement, B&P, market planning, and direct selling.

Advertising (1A), image enhancement (1B, Public Relations), and B&P costs (18) are addressed in their own sections. Refer to those sections for the allowability of those costs.

Long-range market planning is covered under Economic Planning Costs (12). Other market planning costs such as market analysis and research are generally allowable to the extent that they are reasonable.

Direct selling efforts are actions intended to persuade a particular customer to purchase particular products of the company. It includes efforts such as familiarizing a potential customer with products and services. It also includes negotiation, liaison between customers and the company, and individual demonstrations to potential customers. These types of cost are allowable if reasonable in amount.

Any broadly targeted market planning and direct selling activities that are incurred in connection with a significant effort to promote export sales of products normally sold to the U.S. Government, including costs of exhibits and demonstrations, are generally allowable. Some additional restrictions do apply to these costs.

Compensation, fees, commissions, etc., for sellers and agents are allowable only if they are payable to either bonafide employees of the company or an established commercial selling agency.

39 Service and Warranty Costs (FAR 31.205-39)

Service and warranty costs are allowable when they are consistent with the terms of the contract. Included would be costs for installing, training, correcting defects, replacing defective parts, and making refunds.

40 Special Tooling and Special Test Equipment Costs (FAR 31.205-40)

STE (Special Test Equipment) means an integrated test unit used to accomplish special purpose testing in performing a contract. It does not include equipment used for general plant testing purposes.

ST (Special Tooling) consists of jigs, dies, fixtures, and other equipment of such a specialized nature that it is limited to use in the development or production of particular supplies or services. It does not include general or special machine tools or similar capital items.

The cost of ST/STE used in performing one or more U.S. Government contract is generally allowable.

The cost of such ST/STE should be charged to the specific contract or contracts that it was acquired for, except for items acquired before the contract date and items excluded in the contract. Excepted items are allowable only as depreciation expense.

Some items may not qualify as ST/STE if, with relatively minor expense, they can be converted to or made suitable for general purpose use of the company. In such case, only the cost of adapting it for use on an U.S. Government contract and reconverting it for general use is allowable.

41 Taxes (FAR 31.205-41)

Taxes, such as any federal, state and local taxes, are generally allowable if accounted for in accordance with U.S. generally accepted accounting practices, except for:

- > federal income and excess profits taxes
- > taxes for which exemptions are available
- > taxes related to financing, refinancing, and reorganization
- > special assessments on land that represent capital improvements
- > taxes on property used exclusively for non-government work
- > deferred income taxes
- > taxes on funding deficiencies related to employee deferred compensation plans.

Any taxes, interest, or penalties that are allowed as contract costs and are refunded to the company shall be credited or paid to the U.S. Government.

42 Termination Costs (FAR 31.205-42)

Contract terminations require special treatment of costs that would not have arisen if the contract had not been terminated. The following items outline the types of costs involved and their allowability:

- > common items — The costs of items reasonably usable on other work are generally not allowable, unless the company can show that retaining the items would result in a loss.
- > costs continuing after termination — Costs that cannot be discontinued immediately after the effective date of the termination are generally allowable as long as the company has not willfully or negligently failed to discontinue them.
- > initial costs — Costs of a contract, such as preproduction engineering, training, initial rework and spoilage, and pilot runs, are generally allowable under a termination.
- > loss of useful value — The loss of useful value of special tooling, machinery, and equipment is generally allowable.
- > rental under unexpired leases — Rental costs under an unexpired lease, less the residual value of the lease, are generally allowable unless the amount of rent claimed exceeds the reasonable use value of the property leased or the company fails to terminate, assign, settle or reduce the lease cost.
- > alterations of leased property — Alterations and reasonable restorations required by the lease are allowable when the alterations were necessary for performing the contract.

- > settlement expenses — Expenses such as accounting, legal and clerical expenses reasonably necessary for the preparation and presentation of information on the termination are generally allowable. Also included would be the cost of disposing of U.S. Government-owned material, support of U.S. Government audits on the termination, and negotiation of the claim. If settlement expenses are significant, a separate account or work-order should be used to identify and accumulate the cost.
- > subcontractor claims — Claims from subcontractors, vendors, and suppliers are generally allowable.

43 Trade, Business, Technical, and Professional Activity Costs (FAR 31.205-43)

43A Memberships, Dues & Subscriptions

Memberships in and subscriptions to trade, business, technical, and professional organizations and publications are allowable. Any costs included in the dues/fees related to unallowable activities (lobbying %) are unallowable.

The U.S. Government, however, does not recognize certain types of organizations as bonafide trade, business, technical, and professional organizations. Accordingly, dues, fees, and assessments paid to organizations of the following type are not allowable: military associations (e.g., Navy League, Air Force Association); country clubs; social/dinner clubs (e.g., Hartford Club); political organizations and parties; airline travel clubs; any organization whose purpose is directly related to an unallowable activity (e.g., professional advertising, charitable organizations, or organizations whose primary purpose is legislative lobbying).

Cost of membership in dining, social, and country clubs are unallowable whether or not they are reported as taxable income to the employee. Memberships in community and civic organizations are also unallowable.

43B Meetings, Conferences, and Seminars

If the principal purpose of a meeting, conference, symposium, or seminar is the dissemination of trade, business or technical information, or the stimulation of production or improved productivity, then the following types of costs are allowable:

- > cost of organizing, setting up, and sponsorship, including rental of facilities, transportation, and subsistence
- > cost of attendance by company personnel
- > cost of attendance by non-company individuals, as long as they are not reimbursed by their own employer and their attendance is essential to achieve the purpose of the meetings.

44 Training and Education Costs (FAR 31.205-44)

Costs of training and education for employees (including costs incurred under the Employee Scholar Program) are generally allowable, subject to rules on the nature of the training and voluntary resignations by employees within 12 months of completion of program training or education. This includes vocational training designed to increase the effectiveness of employees. It also includes tuition and fees reimbursed to employees for part-time college level education including training material and textbooks. UTC and the U.S. Government have entered into an administrative arrangement, whereby individual tracking of the above allowability exceptions is not required.

Cost of full-time education is allowable only if the degree pursued is related to the field in which the employee is working or expects to work and does not exceed 2 school years.

Training costs associated with classes scheduled but unattended are considered an ordinary cost of doing business and are therefore treated as an allowable expense.

Costs of scholarships, fellowships, and grants, whether awarded to employees, children of employees or other third parties, are unallowable. Directly associated expenses of an administrative or travel nature are also unallowable.

Claimed amounts for flight time and ground school (for accredited educational institution programs) should be limited to (1) 100% of tuition, course-required books, and academic fees for ground school and (2) 50% of “flight time” or other “in air” instruction for private pilot programs (limited to flight time not to exceed FAA private license certification requirements). Further, no stock awards granted for accredited educational institution programs that result in the issuance of pilots’ licenses should be claimed.

45 Transportation Costs (FAR 31.205-45)

Transportation charges such as freight, express, cartage and postage are allowable when related to items or goods purchased, in process, or delivered.

46 Travel Costs (FAR 31.205-46)

46A Travel

Although normally allowable, subject to limits on amount, travel costs incurred in connection with unallowable activities are also unallowable. (See 46B, Airfare.)

46B Airfare

Airfare in excess of the lowest customary standard is not claimed by UTC.

46C Meals, Lodging, and Incidentals

Costs incurred for meals, incidentals, and lodging expenses for employees in travel status are considered allowable only to the extent that they do not exceed U.S. Government maximum per diem rates in effect at the time of travel for the city of lodging.

46D Company Furnished Vehicles and Limousine Use

UTC will not claim as allowable any costs applicable to the domestic Executive Leased Vehicle Program and non-business use of fleet cars assigned to select personnel. UTC can claim leased vehicle expense for those associates participating in the Global Assignment Program (i.e., expatriates and foreign local nationals). Costs of limousines used in connection with company Ride-Share Programs are allowable. All other use of limousines is not to be claimed.

47 Cost Related to Legal and Other Proceedings (FAR 31.205-47)

Costs incurred in connection with any criminal, civil, or administrative proceeding (including investigations; grand jury investigations or prosecution; civil litigation; or suspension, debarment or other administrative proceedings) brought by a U.S. Government agency or instrumentality (federal, state, local or foreign) are unallowable if the proceeding is based on an alleged violation of statute or regulation by the company or its employees or agents and results in:

- > conviction (including nolo contendere pleas)
- > a decision to debar or suspend the company, or to rescind, void, or terminate a contract
- > a finding of company liability (if fraud or similar misconduct is alleged) or imposition of a monetary penalty (if no fraud or similar misconduct is alleged)
- > a resolution by consent or compromise if the proceeding could have led to any of the foregoing.

Also unallowable are costs incurred in connection with:

- > the defense of claims by or against the U.S. Government (e.g., ASBCA cases)
- > organization, reorganization, or resistance to mergers and acquisitions
- > the defense or prosecution of lawsuits between companies arising from a teaming, joint venture or similar arrangement of shared interest
- > defense of anti-trust suits
- > the defense of suits brought by employees or former employees against the company alleging fraud under a government contract (e.g., “Whistle Blower” suits)
- > patent infringement litigation.

The Legal Department at each entity maintains records sufficient to characterize unallowable costs (including directly associated costs) incurred on matters pertaining to proceedings. The Legal Department should advise other departments, when appropriate, that personnel in those departments must keep records of costs incurred in connection with proceedings.

Certain proceedings cost as described above may be considered allowable subject to specific criteria contained in FAR 31.205-47(e).

(Also see 33, Professional and Consultant Service Costs.)

48 Deferred Research and Development Costs (FAR 31.205-48)

Research and development efforts sponsored by or required in the performance of a contract or grant that are in excess of the contract price or grant, such excess costs are unallowable. See Section 29.29.5 of the Corporate Financial Manual for a detailed definition of research and development effort.

49 Goodwill (FAR 31.205-49)

Goodwill is an intangible asset that arises when the purchase price paid for the acquisition of a business or product line exceeds the total value of all identifiable assets acquired, less liabilities assumed. The excess value is commonly called goodwill.

Any cost of amortizing, writing down, or writing off goodwill is unallowable.

50 Reserved (FAR 31.205-50)

51 Cost of Alcoholic Beverages (FAR 31.205-51)

Costs of alcoholic beverages are unallowable. A pro rata share of tax and gratuity associated with alcohol are also unallowable. Minibar purchases are to be treated as alcohol, unless the item purchased is specified as non alcohol.

52 Asset Values Resulting from Business Combinations (FAR 31.205-52)

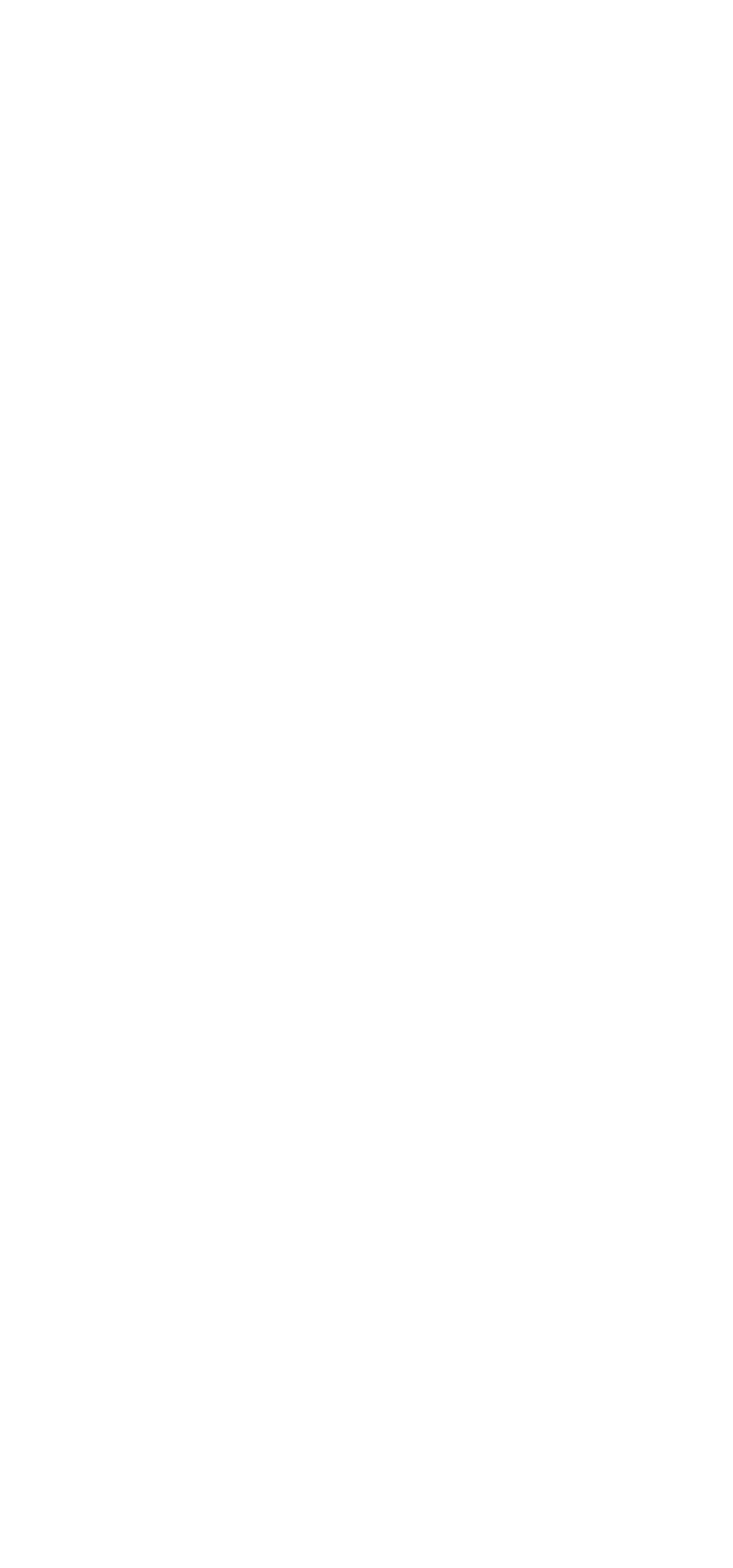
Under the purchase method of accounting for a business combination;

- > for intangible capital assets, allowable amortization, cost of money and depreciation are limited to the total of these amounts that would have been allowed had the combination not taken place
- > for tangible capital assets, allowable depreciation and cost of money shall be based on capitalized asset values measured and assigned in accordance with 48 CFR 9904.404-50(d).

53 Accounting for Unallowable Costs (FAR 31.201-6)

Where an activity takes place, the direct costs of which are unallowable, all the directly associated indirect costs related to that activity must be charged to unallowable accounts. Directly associated costs include salaries and wages and related fringe benefits, travel costs, printing, and other related items.







United Technologies

**United Technologies Corporation
United Technologies Building
Hartford, CT 06101**