

## Chapter 10 - Cost and Profit

- 10.001 (1998-02-16) When a contract is to be awarded on a non-competitive basis, or when, following a competitive process, price negotiations with the successful bidder are required, contracting officers are to determine the contract price based on the procedures outlined in this Chapter.
- 10.002 (2005-06-10) The calculation of prices and costs depends on the circumstances of each contract. Before referring to the general sections on Establishing Costs (see [10.005](#)) and Profit (see [10.010](#)), contracting officer should determine that the following special circumstances do not apply:
- Travel and Living Expenses (see [10.030](#));
  - Prices for Out of Plant Services of Individuals (see [10.040](#));
  - Surplus Materials in Cost-Reimbursable Contracts (see [10.050](#));
  - Costing of Lease Transactions (see [10.065](#));
  - Service Contracts (see [10.070](#));
  - Joint Ventures (see [10.080](#));
  - Research and Development Contracts with Universities and Colleges (see [10.090](#));
  - Non-Competitive Contracts with Non-Profit Organizations, excluding Universities and Colleges (see [10.105](#));
  - Non-Competitive Acquisitions from Agency and Resale Outlets, and for Manufactured Products and Repair and Overhaul Services (see [10.115](#));
  - Transfer Pricing (see [10.130](#));
  - Special Production Tooling and Special Test Equipment (see [10.150](#)).

*Contracting officers should also refer to the requirements for Audit. (See [6C.337](#).)*

### Establishing Costs

- 10.005 (2005-06-10) Whenever a contract price is negotiated based on costs, the costs are determined using Contract Cost Principles [1031-2](#) of the *Standard Acquisition Clauses and Conditions* (SACC) Manual.

In particular, for non-competitive contracts valued at \$50,000 and over, with a firm price or fixed time rate basis of payment, except in cases for the acquisition of commercial products and services, the price or rate shall be negotiated based on the estimated costs computed using the Contract Cost Principles [1031-2](#).

For non-competitive contracts valued at \$50,000 or over, with a cost reimbursable basis of payment, except in cases for the acquisition of commercial products and services, the price shall be determined based on actual costs incurred, computed in accordance with the Contract Cost Principles.

In both of the above cases, the Contract Cost Principles shall be included as a condition of the contract. [Annex 10.1.0](#) explains why certain costs are considered non-applicable when utilizing Contract Cost Principles [1031-2](#).

*For determining costs in accordance with the Contract Cost Principles, the Cost Interpretations issued by Cost and Forensic Accounting Directorate should be taken into consideration at the time of negotiations. There are currently Cost Interpretation Bulletins on:*

- *Excess Facilities - [Annex 10.1.1](#)*
- *Depreciation - [Annex 10.1.2](#)*
- *Lease Costs - [Annex 10.1.3](#)*
- *Travel Costs - [Annex 10.1.4](#)*

- *Head Office Expenses - [Annex 10.1.5](#)*
- *Pension Costs - [Annex 10.1.6](#)*
- *Research and Development Expenses - [Annex 10.1.7](#)*
- *Bid and Proposal Expenses - [Annex 10.1.8](#)*
- *Selling and Marketing Expenses - [Annex 10.1.9](#)*
- *Severance Payments - [Annex 10.1.10](#)*
- *Pension Plan Refunds - [Annex 10.1.11](#)*
- *Company Funded Costs - [Annex 10.1.12](#)*
- *Executive Compensation - [Annex 10.1.13](#)*
- *Mobile Repair Party Requirements - [Annex 10.1.14](#)*
- *Environmental Costs - [Annex 10.1.15](#)*
- *Take Out Rates - [Annex 10.1.16](#)*
- *Government Supplied Materials - [Annex 10.1.17](#)*
- *Incentive Remuneration Profit Sharing Plans - [Annex 10.1.18](#)*
- *Purchased Labour – Personnel Procured from Outside Sources - [Annex 10.1.19](#)*

10.006 (2004-05-14) The Contract Cost Principles [1031-2](#) are not required for commercial products and services, since these are used regularly for other than government purposes, and are sold by the supplier in the course of carrying out its normal business operations; and there is a sufficient number of buyers, other than the government to establish a going price for the product or service.

## Calculation of Profit on Negotiated Contracts

10.010 (1998-11-23) The policy and guidelines for the calculation of the amount of profit applicable to negotiated contracts and parts thereof with Canadian-based suppliers, for both products and services are detailed in [10.011](#) to [10.021](#) below. Contracts valued under \$50,000 do not require negotiation of profit under this section.

There are differences in the guidelines for contracts with total costs between \$50,000 and \$249,999, and for contracts with total costs of \$250,000 or more.

For agency and resale outlets, the procedures for profit determination in [10.122](#) apply.

10.011 (1994-06-23) When for any reason it is not possible to establish an acceptable basis of price by competition or a fair and reasonable price assessment, the price shall be negotiated. The object of price negotiation is to duplicate a fair market price, while establishing a realistic division of responsibilities and risks between the contractor and the Crown.

A fair market price for non-competitive contracts for the acquisition of products or services (other than commercial products or services), shall be negotiated. The object of such negotiation is to arrive at a price which is considered to be fair and reasonable in the circumstances based upon an estimate of the costs, to be incurred in the performance of the contract, computed in accordance with the Contract Cost Principles [1031-2](#), plus a fair profit. A fair profit is an amount no greater than that calculated under this section.

There are the following exceptions:

- (a) Generally, all contracts placed on behalf of the Canadian Commercial Corporation (CCC). However, if the ultimate customer for the CCC contract is the United States Department of Defense or National Aeronautics and Space Administration or the United Kingdom Ministry of Defence, the profit may be calculated in accordance with this section.
- (b) Contracts or parts thereof for which the price is based on catalogues, price lists or fee schedules where only discounts are subject to negotiation.

10.012 (1994-06-23) Profit levels shall vary:

- (a) to recognize the cost of money associated with the capital employed by the contractor in performance of the contract;
- (b) to recognize the levels of general business and contractual risk assumed by the contractor in performance of the contract.

The calculation of the amount of profit attributable to each of the above factors shall normally be made in accordance with the following guidelines.

#### **Return on Capital Employed**

10.013 (1994-06-23) The return on capital employed will be determined in two parts:

- (a) return on fixed capital employed, and
- (b) return on working capital employed.

The determination is different for contracts with total costs between \$50,000 and \$249,999 and for contracts with total costs of \$250,000 or more. (See [10.015](#).)

#### **Return on Fixed Capital Employed (Between \$50,000 and \$249,999)**

10.014 (1994-06-23) For contracts with total costs between \$50,000 and \$249,999, the return on fixed capital employed is calculated as follows:

If machinery and/or equipment owned by the contractor is used on a regular basis in the manufacture of the product(s) or provision of the service(s) being acquired under the contract, an amount equivalent to 1 percent of total allowable costs will be awarded as a return on fixed capital employed.

#### **Return on working capital employed (Between \$50,000 and \$249,999)**

10.015 (1994-06-23) The following rates applied to the total contract costs will be used to provide for a return on working capital employed:

- (a) if there are no advance or progress or milestone payments - 3 percent;
- (b) if there are progress or milestone payments - 1½ percent;
- (c) if there are advance payments - 1½ percent (NOTE: The profit factor of 1½ percent will apply only to total costs less amount of advance.);
- (d) if there are both advance and progress payments - 0 percent.

#### **Return on Fixed Capital Employed (\$250,000 or more)**

10.016 (2005-06-10) For contracts with total costs of \$250,000 or more, the return on fixed capital employed is calculated as follows:

The provision of a return on fixed capital employed is intended not only to compensate contractors for the cost of money associated with the fixed capital employed on the contract but also to encourage investment in new capital equipment, the result of which is generally greater productivity and consequently reduced costs to the Crown.

- (a) For the purpose of this section, the fixed capital employed is defined as the net book

value of fixed assets, less

- (i) land and any intangible assets,
- (ii) any fixed assets not in use such as idle plant, and
- (iii) any surplus value arising from re-appraisal.

(b) The determination of fixed capital employed will be as follows:

(i) Determine the percentage:

$$(A/B) \times 100\%$$

A = overhead recovery base allocated to the contract

B = total budgeted amount of recovery base

(ii) Apply the percentage in (i) to the net book value of fixed assets.

Such determination will be performed in accordance with the format set out in [Annex 10.2](#).

(c) The rate of return to be applied to the fixed capital employed applicable to the contract will be 1.7 times the corporate bond rate, which will be published monthly by the Director of Cost and Forensic Accounting Directorate (CFAD). The rate used will be the latest rate published at the date that the contractor's price proposal is firmed up. In the event that the published rate at the time of contract award has changed by more than one full point, up or down, this rate shall be used to recompute the return.

(d) The rate used in the contractor's price proposal will be the latest figure published at the time the price proposal is submitted. In order to conform to (c) above, it is necessary that the following clause be included in the price proposal:

"The price quoted includes an amount of profit using a corporate bond rate of \_\_\_\_ percent. In the event that the corporate bond rate, as published by the Director, CFAD, at the time of contract award, has changed by more than one full point, up or down from this rate, the price will be adjusted to reflect such rate."

### Return on Working Capital Employed (\$250,000 or more)

10.017 (2005-06-10) The amount of working capital employed applicable to a particular contract is defined as all allowable contract costs (exclusive of depreciation where considered significant) less contract revenue (exclusive of profit).

For contracts with total costs of \$250,000 or more, the return on working capital employed is calculated as follows:

- (a) During negotiations, a schedule of the estimated net working capital for the contract, as defined above, on a month-by-month basis, will be determined and agreed to between the contracting officer and the contractor.
- (b) The rate of return to be applied to the cumulative monthly amounts of working capital is defined below. However, as this is an annual rate of return, one-twelfth only of the rate is applicable to each monthly amount. For ease of calculation, the equivalent formula, to be used for determining the return on working capital employed on a particular contract, is as follows:

$$(A/12) \times B$$

A = sum of the cumulative monthly working capital amounts

B = prescribed rate

- (c) The rate of return to be applied to working capital employed applicable to the contract will be the chartered bank prime rate. This rate will be published weekly by the Director, CFAD. The rate used will be the latest rate published at the date that the contractor's price proposal is firmed up. In the event that the published rate at the time of contract award has changed by more than one full point, up or down, this rate shall be used to recompute the return.
- (d) The rate used in the contractor's price proposal will be the latest figure published at the time the price proposal is submitted. The following clause must be included in the price proposal:

"The price quoted includes an amount of profit using the chartered bank prime rate of \_\_\_ percent. In the event that the chartered bank prime rate, as published by the Director, CFAD, at the time of contract award, has changed by more than one full point, up or down from this rate, the price will be adjusted to reflect such rate."

10.018 (1998-02-16) Specific guidelines in regard to the **cost base** for purposes of all profit calculations are as follows:

- (a) **Direct material costs** should include the costs of all materials purchased specifically for the contract together with the costs of any other materials issued specifically for the contract from the contractor's own inventories except Accountable Advance (AA) spares embodied. Direct materials shall not include the value of Government Furnished (GF) nor Contract Issue (CI) materials. However, direct labour and overhead costs associated with the acquisition, stocking and handling of GF and CI materials and AA spares embodied may be included under the appropriate cost element for profit purposes.
- (b) **Overhead** in this context includes not only plant or factory overhead but engineering, material handling, general and administrative or any other overheads as appropriate to and allowable on the contract.
- (c) **All other allowable costs** are those costs not considered to be direct material, direct labour or overhead but nevertheless are an appropriate and allowable direct charge to the contract. Royalty payments and the goods and services tax or the harmonized sales tax, although they may be an appropriate and allowable direct charge to the contract, must not be included for the purpose of profit calculation.

### General Business Risk

10.019 (1994-06-23) The award of profit under this factor is intended to recognize the level of effort a contractor makes in the management of all the resources required to perform the contract in an efficient and economical manner.

The level of effort is considered to vary according to the elements of cost and is reflected in the following rates of profit to be applied to the costs in each element:

Direct Materials: 1½%  
 Subcontracts: 2%  
 Accountable Advance Spares Embodied: 2%  
 Direct Labour: 4%  
 Overhead: 4%

All other Allowable Costs: 1½%

**Contractual Risk**

10.020 (1994-06-23) The rates of profit to be paid for contractual risk will depend upon the basis of payment selected for each individual line item of the contract, or part thereof, and the cost base associated with each distinct basis of payment.

The basis of payment determines the maximum level of profit, and requires the following consideration of different factors in arriving at the appropriate profit level.

- (a) Firm Price and Firm Base Price with Economic Price Adjustments (7 percent maximum) - consider:
  - (i) the ability of the Crown to state its requirements in the form of a well-defined specification;
  - (ii) the ability of the contractor to convert the Crown's specification into a comprehensive statement of work;
  - (iii) the ability of the Crown and the contractor to precast the statement of work;
  - (iv) the duration of the contract and its effect on the predictability of labour and material costs and overhead distribution, taking into account whether protection in this regard is provided to the contractor by the inclusion in the contract of a provision for economic price adjustment (Firm Base Price with Economic Price Adjustments Basis of Payment);
  - (v) whether the final determination of the firm price takes place before or after a portion of the contract period has elapsed.
- (b) Fixed Time Rate with Ceiling Price (4½ percent maximum) and Without Ceiling Price (3½ percent maximum) - consider:
  - (i) the duration of the contract and its effect on the predictability of the labour and overhead rates;
  - (ii) if a ceiling price is included, the familiarity of the contractor with the work being performed under the contract resulting from the previous manufacture of the same or similar products, or the provision of the same or similar services;
  - (iii) whether the final determination of the fixed time rates takes place before or after a portion of the contract period has elapsed.
- (c) Cost Reimbursable with Incentive Fee (4½ percent maximum) - consider:
  - (i) the degree to which the difference between the target fee and the maximum fee will provide an incentive for more effective cost control and contract performance by the contractor;
  - (ii) whether the agreement on target costs and target fee was reached before or after a portion of the contract period has elapsed.

To calculate the bonus on target incentive fee contracts: the maximum fee for cost reimbursable with incentive fee contracts shall consist of the target fee plus an added amount which brings the total profit for the General Business Risk and Contractual Risks Factors to a maximum of 10 percent of target costs.

- (d) Cost Reimbursable with Fixed Fee with Ceiling Price (4½ percent maximum) and Without Ceiling Price (1 percent maximum) - consider:
- (i) the reliability of the cost estimate used for determining the fixed fee, taking into account the duration of the contract and its effect on the predictability of costs, and provided that no "swing points" at which the fixed fee will be renegotiated are included in the contract;
  - (ii) if a ceiling price is included, the familiarity of the contractor with the work being performed under the contract resulting from the previous manufacture of the same or similar products, or the provision of the same or similar services;
  - (iii) whether the fixed fee was determined before or after a portion of the contract period has elapsed.
- (e) Cost Reimbursable with No Fixed Fee and No Ceiling Price (0 percent): there is no business or contractual risk.

### Total Profit

10.021 (1994-06-23) The total amount of profit awarded under all factors shall in no event exceed 20 percent of the total contract costs.

The amount of profit for all factors should be calculated separately and included in the price of each line item with a distinct basis of payment in the contract (see Examples in [annexes 10.3](#) and [10.4](#)).

### Travel and Living Expenses

10.030 (1994-06-23) Normally, travelling and living expenses incurred by a contractor in the ordinary course of business are to be treated as indirect costs chargeable to overhead. Crown contracts bear their proportionate share of such overhead, and this overhead is profit bearing. Therefore, no special provision with respect to these incidental travel and living expenses is required for such contracts.

However, some firms consistently charge travel and living expenses directly to contracts. Where a price is negotiated with suppliers, these charges will be acceptable as direct charges against Crown contracts if:

- (a) the expenses are directly attributable to the performance of the work under the contract, and these expenses are eliminated from indirect costs; and
- (b) the practice of direct charging is consistently followed by the contractor in the costing of both government and commercial work; and
- (c) the expenses referred to in (a) above are eliminated from indirect costs allocated to Crown contracts.

10.031 (2005-06-10) When travel and living expenses are to be directly charged to the contract, such expenses will attract administrative overhead either at full rates, where adequate support for the claimed general and administrative rate can be demonstrated, or at a lower negotiated rate where such substantiation cannot be provided. Alternatively, where industry practice so dictates, a contract may provide for travel and living expenses to be charged at cost with no allowance for overhead or profit.

When travel and living expenses are to be directly charged to a contract on a cost reimbursable basis, contracting officers must use *Standard Acquisition Clauses and Conditions (SACC)*

Manual clause [C4000C](#) or [C4001C](#).

The Treasury Board (TB) Travel Directive applies to travel costs incurred on contracts with persons, i.e. individuals, outside the Public Service, when these costs are a specific element of the contract. Refer to the TB Government Travel & Living Accommodations Policies: [Travel Directive](#) and [Special Travel Authorities](#) for more details.

The contracting officer may accept a supplier's travel and living rates, if these are lower than the TB rates.

*For additional information, contracting officers should consult [Annex 10.1.4](#), Cost Interpretation Bulletin - Travel Costs.*

- 10.032 (1994-06-23) Department of National Defence (DND) service establishments may be able to provide transportation, mess and lodging facilities to the contractor's employees performing work at or near these establishments under mobile repair party and maintenance type contracts. The commanding officer of the establishment will, upon request, advise the contractor as to the availability of these facilities, which will reduce direct contract expenses.

In order that contractors may be reimbursed for any charges plus incidental expenses incurred by their personnel beyond the cost of such Crown-furnished facilities, SACC Manual clause [C4004C](#) should be used with SACC Manual clause [C4000C](#) or [C4001C](#).

## Prices for Out of Plant Services of Individuals

- 10.040 (1998-11-23) The following methods are applicable to all negotiated charge-out rates irrespective of whether any subsequent contract is fixed price, fixed unit price, cost reimbursable, etc. and covers out-of-plant services of individuals or groups of individuals with or without equipment.

*Services include field service representatives, out-of-plant technical services and mobile repair parties away from the contractor's plant.*

- 10.041 (2004-05-14) When rates have not been established commercially or when they are considered excessive, the Contract Cost Principles [1031-2](#) shall be used as a basis for negotiating out-of-plant charge-out rates (including applicable overhead). Profit shall be negotiated in accordance with [10.010](#). Travel and living expenses shall be determined in accordance with [10.030](#).
- 10.042 (1994-06-23) Contracting officers are responsible for negotiating fair and reasonable charge-out rates which would normally be on a fixed time rate, i.e. hourly, per diem, monthly, etc. Charge-out rates will be shown as a separate line item in the basis of payment.

*In determining charge-out rates, some items to be considered are:*

- *normal industrial practice/commercial rates;*
- *whether the company usually provides the service;*
- *availability of the service from other sources;*
- *wages of the individuals;*
- *whether the plant overhead should apply or whether a separate overhead should be negotiated;*
- *equipment utilized;*
- *use of Crown facilities.*

Prior to award of a contract, contracting officers are advised to seek guidance and cost interpretations from the sector/region cost analyst with respect to negotiated charge-out rates.

- 10.043 (1998-11-23) Full plant overhead should not be applied to out-of-plant charge-out rates unless



the out of plant technical services are a relatively minor part (less than 10 percent) of the contractor's total business (volume/direct labour) in any one year.

- 10.044 (2005-06-10) Dislocation/displacement pay allowances may be allowed provided that the amount of the displacement pay is reasonable; the displacement pay is for justifiable purposes; and/or displacement pay is in accordance with the contractor's established practice.

For removal, living, car allowances and outside Canada expenses, contracting officers should consider the following:

- (a) Only one removal from and back to the original residence will be paid for any one representative. Where removal expenses to the site of the work have been paid by the Crown on a previous contract and the services are being extended for a further period, such contract amendment or subsequent contract should provide for reimbursement only for expenses incurred for moving the representative back to the original residence.
- (b) Removal expenses should not be paid on assignments of less than six months, and any removal by a married employee for assignments exceeding six months should be carried out during the first 90 days, and by a single employee during the first 60 days.
- (c) Reimbursement for living expenses for a married employee on an assignment exceeding six months should cease when the family is moved (whether or not removal expenses have been paid) to permanent quarters at the location of the work.
- (d) Reimbursement for living expenses for a single employee on an assignment exceeding six months should cease when the employee's effects have been moved (whether or not removal expenses have been paid) to the location of the work or in any event after the first 60 days of such assignment.
- (e) Reasonable car allowances in accordance with the contractor's practice may be paid for the use of personally owned motor cars by the contractor's personnel for essential on-base travelling where local Crown transportation is not available.
- (f) Cases where the representative is required to go abroad should be dealt with individually and considered on their merits.

*For additional information, contracting officers should consult [Annex 10.1.14](#), Cost Interpretation Bulletin - Mobile Repair Party Requirements.*

## Surplus Materials in Cost Reimbursable Contracts

- 10.050 (1994-06-23) Surplus materials resulting from the performance of a contract may be disposed of in several ways:

- (a) declared surplus to a Crown Assets Distribution Centre (CADC);
- (b) transferred to the client, or to another contract with the same contractor, or to another contractor; or
- (c) returned to the original supplier.

Each of these has implications for contract terms relating to costs and profits.

- 10.051 (1998-11-23) Costs of surplus materials are allowable costs in a production contract if the surplus is due to:

- (a) normal accumulation of stores, during or on completion of a contract, and which are

- declared surplus to CADC, or transferred to the client, or transferred to another contract with the same or a different contractor;
- (b) major design changes or other major adjustments of a substantial nature not including termination;
  - (c) minor design changes or other minor adjustments in the scope of the work provided the contract does not specifically exclude such items.
- 10.052 (1998-11-23) When the surplus is due to excess purchasing by a contractor, the costs are not allowable in a contract.
- 10.053 (1998-11-23) Material handling costs associated with the surplus materials are allowable costs in a contract whenever the costs of surplus materials are allowable.
- 10.054 (1994-06-23) General and administrative overhead costs associated with surplus materials are allowable costs in a contract only when the surplus materials consist of work-in-process and finished goods resulting from design changes and minor cutbacks.
- 10.055 (1998-11-23) Profit will be allowed on the following categories ([10.051](#), [10.053](#), [10.054](#)) of allowable costs, except that:
- (a) in the case of surplus materials arising from the normal accumulation of stores, during or on completion of a contract, profit will be allowed only if the inventories acquired for a contract were financed by the contractor;
  - (b) in the case of surplus materials arising from major design changes, or other major changes of a substantial nature, profit will be allowed only if the inventories were either purchased by the contractor or, if not purchased by the contractor, were manufactured by the contractor and rendered surplus as the result of the changes.
- 10.058 (2005-06-10) For cost reimbursable fixed fee or cost reimbursable incentive fee contracts, and contracts containing a ceiling price, allowable costs of surplus materials will be treated as an extra direct cost to the contract, outside the area of fixed fee, incentive fee or ceiling price considerations. It may be necessary to renegotiate the principal terms of the contract.
- 10.059 (1994-06-23) Where incentive fee contracts require negotiation of targets, the costs of surplus materials should be included in the revision of a target only where other reasons make it essential to re-open the calculation for the protection of either the contractor or the Crown. Alternatively, when a contract so provides, these costs may be paid for as an extra to the target or other arrangements, e.g. at cost plus a fixed fee at whatever rate of profit is appropriate.

## Costing of Lease Transactions

- 10.065 (1994-06-23) When a contractor proposes to include, in the cost of a contract, costs relating to the leasing by the contractor of an asset, the amount of allowable charge depends on the type of lease.

The necessary information for contracting officers is in [Annex 10.1.3](#)

## Service Contracts

- 10.070 (2005-06-10) Fees for all services not established by price competition, except Repair and Overhaul, are negotiated on the basis of the prevailing rates for the type of work required and recognizing the circumstances of each contract. Considerations are:
- (a) requirements of the task: an assessment of skill level, expertise necessary, or

complexity of the task requirements;

- (b) supplier qualifications: fees will vary in terms of factors like the calibre of proposed personnel, knowledge or expertise, previous experience, personnel utilization rate, use of facilities, or the area of specialization;
- (c) market conditions: a determination as to whether there is a commercial or going rate for a particular expertise or service capability in private industry should be made. If these rates cannot be determined, the fee scales recommended by provincial professional associations may be used as a reference point from which the reasonableness of a negotiated rate can be compared;
- (d) costing/fee practices: the costing structures of individuals, firms and universities are different and will vary significantly. Some costs that would otherwise be charged separately are sometimes charged to overhead, thus increasing the total rate.

10.071 (1994-06-23) Fees should include only those elements of cost properly associated with the actual time expended on the work. These are the direct labour costs and their fair share of overheads, general and administrative expenses and profit. Other direct costs such as charges for publication of reports, special computer or test services, travel and living, should normally be shown separately. Each case must be taken on its own merits to arrive at an assessment of which amounts are reasonable charges, either as a fee element, or as a separately charged item.

10.072 (1994-06-23) In all contracts for services with a cost reimbursable or fixed time rate basis of payment, the time rates of payment should be specified for the entire period required for performance of the contract, including all phases and specified option periods. When this is not possible, payments for each year or phase should be based on a pre-agreed rate or formula that is to be specified in the contract.

## Joint Ventures

10.080 (2005-06-10) For non-competitive contracts, i.e. single or sole sourced, intended to be awarded to a joint venture, special costs that may be attributed to the joint venture arrangement alone, such as legal, accounting and consulting fees in connection with the setting up of the joint venture, are not an acceptable charge.

10.081 (1994-06-23) Ongoing operational costs related to the joint venture arrangement are acceptable to the extent that they are considered reasonable and can be allocated to the contract using the Contract Cost Principles [1031-2](#).

10.082 (2005-06-10) When materials, supplies or services are to be transferred to the joint venture under subcontracts issued to a member of the joint venture, the contracting officer should negotiate acceptable subcontract costs with such member(s) in accordance with the pricing policy stated in procedures [10.115](#) to 10.119.

10.083 (1994-06-23) The joint venture cannot submit a price proposal based on average rates. Each joint venture member's workload will be priced separately using appropriate costing procedures. The total of all the joint venture member prices will be the total proposed contract price.

## Research and Development Contracts with Universities and Colleges

10.090 (1994-06-23) Research and development work carried out by universities or colleges is priced at direct costs plus a contribution to overhead. This contribution is a maximum take-out rate of 65 percent of direct payroll costs for on-campus work, and 30 percent of direct payroll costs for off-campus work. In addition, a contribution equivalent to 2 percent of applicable and acceptable travelling and living expenses will be made.

10.091 (1994-06-23) Contract Cost Principles [1031-2](#) will not be called up in the contract, and post-contract audits of overhead charges will not be carried out. Direct costs will be subject to cost verification or audit.

10.092 (1994-06-23) Allowable direct costs are:

(a) Direct Payroll Costs

Professional salaries  
 Clerical salaries  
 Technicians' wages  
 Fellowships - daily rate of personnel working directly on a contract  
 Fringe benefits including:  
     Unemployment Insurance  
     Workmen's Compensation  
     Canada or Quebec Pension Plan  
 University pension plan (current service only)  
 University portion of medical plans  
 Sick leave

Annual salaries will be prorated over annual working days taking into account statutory holidays and annual vacation.

(b) Materials and Supplies

Stationery  
 Postage  
 Materials issued from stores  
 Materials, parts and components purchased specially for the contract at "laid-down cost"  
 Long distance telephone charges  
 Telegrams and cables  
 Freight and express  
 Publication charges as agreed in contract

(c) Direct Expenses - those costs which can be specifically identified and measured as having been used or to be used in the performance of the contract, and which are so identified and measured by the institution's cost accounting system. These expenses may include such items as:

Travelling expenses  
 Consultant services  
 Apparatus and equipment acquisition. (This will remain the property of the Crown and be subject to CADC procedures.)  
 Other costs as agreed and negotiated, including charges for computer time.

10.093 (1994-06-23) Consultants are to be considered in three separate categories:

- (a) in-house standard rate of pay: the 65 percent overhead is applicable;
- (b) external type consultant, which is in-house personnel working additional hours at increased rates, but using university equipment: direct charge without overhead;
- (c) outside consultant: direct charge without overhead.

10.094 (1994-06-23) Manufactured equipment is to be considered as a "make" or "buy" decision for the contracting officer. If it is a "buy", it will be a direct charge, and be the property of the Crown: a

decision regarding disposal will be made later. If it is a "make", the university would be allowed the cost of parts and labour as laid out in the proposal, including the 65 percent overhead, with ownership and disposal the same as for a buy. This should be a separate item under the contract.

10.095 (1994-06-23) Allowable overhead costs are:

- (a) Maximum of 65 percent applicable to Direct Payroll Costs for on-campus work;
- (b) Maximum of 30 percent applied to Direct Payroll Costs for off-campus work;
- (c) An administration charge of 2 percent on travelling and living expenses incurred directly against the contract will be allowed.

10.096 (1994-06-23) Costs incurred by the university or college which have no direct bearing on the research activity will not be acceptable as direct charges against Crown research contracts. These include:

- University annual reports
- Contingency reserves
- Convention expenses - unless applicable to specific contract
- Post service lump-sum payments
- Termination allowances not earned during the course of the contract
- Admissions Department
- Grants - unless for services rendered for a specific contract
- Finance charges (bank, debenture, bond interest, etc.)

10.097 (1994-06-23) No additional special facility charges will be included in the price, since these are accounted for in the contribution to overhead.

10.098 (1994-06-23) Charges for use of a computer centre will be direct to a contract at a predetermined rate per hour, including general overhead, and computed at a break-even level for the centre. These charges shall be in line with normal policies of the university for internal use.

10.099 (2005-06-10) Departments and agencies of the United States (U.S.) Government negotiate directly with Canadian universities and colleges towards research and development contracts. Public Works and Government Services Canada may be asked for assistance in developing an appropriate overhead rate. These requests will be handled by the Services and Technology Acquisition Management Sector, which will develop the overhead rates from the latest certified financial statements of the university or college, with indirect costs prorated over the direct cost base in conformity with the costing principles set out in the applicable U.S. Government directive on the subject.

## **Non-Competitive Contracts with Non-Profit Organizations, excluding Universities and Colleges**

10.105 (1994-06-23) Non-profit organizations incur financing charges for working capital, over and above normal operating costs as determined in accordance with the Contract Cost Principles [1031-2](#). They are also subject to business and contractual risk, though less than profit-oriented organizations.

10.106 (1994-06-23) The price is based on costs incurred, computed using the Contract Cost Principles [1031-2](#) plus an allowance in lieu of profit.

10.107 (1994-06-23) For financing charges on working capital employed, the allowance depends on the basis of payment:

- (a) If there is provision for milestone or progress payments: 1½ percent of costs incurred;
- (b) If there is no provision for milestone or progress payments: 3 percent of costs incurred.

10.108 (1994-06-23) For General Business Risk, the allowance is based on contract costs:

- (a) Direct materials, subcontracts and direct charges: up to 1 percent of such costs;
- (b) Direct labour and overhead: up to 2 percent of such costs.

10.109 (1994-06-23) The allowance which may be included in recognition of contractual risk depends upon the basis of payment selected for the contract or part thereof:

- (a) Firm price: up to 4 percent of costs incurred;
- (b) Fixed time rate with ceiling price: up to 3 percent of costs incurred;
- (c) Cost reimbursable with ceiling price: up to 3 percent of costs incurred;
- (d) Fixed time rate with no ceiling price: up to 2 percent of costs incurred;
- (e) Cost reimbursable with no ceiling price: 0 percent.

### **Non-Competitive Acquisitions from Agency and Resale Outlets, and for Manufactured Products and Repair and Overhaul Services**

10.115 (1994-06-23) The procedures detailed in [10.116](#) to [10.122](#) provide for the establishment of fair and reasonable prices, when the competitive process cannot be used for:

- (a) acquisitions from Canadian agency and resale outlets, and
- (b) acquisitions of manufactured products and repair and overhaul services, from Canadian suppliers, except Canadian agency and resale outlets.

There are key differences between these two types of acquisitions in the determination of what costs will be allowed, and how profits will be determined. The procedures also differ depending on whether the product or service is commercial or non-commercial.

#### **Non-competitive acquisitions of commercial products and services**

10.116 (1994-06-23) The contracting officer should negotiate a fair price on the basis of at least one of the following criteria:

- (a) recent prices paid;
- (b) published price lists or catalogues;
- (c) prices paid by others, such as other governments, Crown corporations, hospitals, universities and large private sector corporations or companies.

10.117 (1998-11-23) For acquisitions valued at less than \$50,000, additional price support by way of a price certification signed by the supplier may be requested at the discretion of the contracting officer, but for acquisitions valued at \$50,000 or over, price certifications should be obtained in all cases.

The price certification and corresponding discretionary audit clause used should be in accordance with the following:

- for non-competitive acquisitions of commercial products and services, other than petroleum products, from Canadian suppliers other than agency and resale outlets, use *Standard Acquisition Clauses and Conditions* (SACC) Manual clauses [C0002T](#) and [C0100D](#);
- for non-competitive acquisitions of commercial products and services, other than petroleum products, from agency and resale outlets, use SACC Manual clauses [C0004T](#) and [C0100D](#);
- for non-competitive acquisitions of petroleum products, use SACC Manual clauses [C0006T](#) and [C0100D](#).

### Non-competitive acquisitions of non-commercial products and services

10.118 (1998-11-23) For non-competitive acquisitions of non-commercial products and services valued at less than \$50,000, a fair price may be negotiated in accordance with the guidelines for commercial products and services given above, provided the data required to follow this guideline is available.

For acquisitions from agency and resale outlets only, if the data is not available, then the guideline presented in [10.121](#) below should be followed.

10.119 (1998-11-23) The supplier should be requested to provide the contracting officer with an itemized breakdown of the price quoted. The price breakdown should be analyzed by the contracting officer (in the case of agency and resale outlets, in accordance with the guideline in [10.122](#) below). The depth of the analysis required will depend on the value of the acquisition and the quality and completeness of the support data provided by the supplier. The cost of performing the analysis versus the potential benefit in the form of cost savings on the acquisition should be taken into account.

See [6E.521](#) for additional detail on the bases of payment. A firm price basis of payment is generally used for contracts with agency and resale outlets.

The price certification and corresponding discretionary audit clause used should be in accordance with the following:

- for non-competitive acquisitions of non-commercial products and services from Canadian suppliers as well as agency and resale outlets, use SACC Manual clauses [C0003T](#) and [C0101D](#).

### Agency and Resale Outlets - Additional Requirements

10.121 (1994-06-23) The two chief types of agency and resale outlets encountered when purchasing for the Crown are:

- (a) those engaged in manufacturing, which also act as agency or resale outlets representing other manufacturers (type 1); and
- (b) those not engaged in any form of manufacturing, which act solely as agents, distributors, wholesalers, jobbers or retailers. They may conduct the functions of purchasing, receiving, storing, shipping and accounting (type 2).

### Price Analysis

10.122 (1994-06-23) The following should be considered when analyzing the price breakdown:

- (a) Laid-down Costs

Ensure that the necessary support for the price of the product/service quoted by the principal is provided by the supplier, and that all trade discounts have been deducted. The applicability and amount of any added charges for transportation, foreign exchange, customs duty and brokerage should be verified. Transfer prices representing fair market value, constitute laid-down cost for the purposes of price analysis and profit calculations.

(b) Cost of Necessary Services and Overhead

Establishment of the cost of necessary services rendered by the supplier will depend upon requirements, the type of organization the supplier operates, and the degree of sophistication in the supplier's cost accounting system.

Types of services which may be considered for costing purposes:

- purchasing;
- internal handling including unpacking, incoming inspection, inhibiting, warehousing, and re-packing for delivery to one or more destinations, but excluding costs related to the supplier's own manufacturing or other related costs;
- general and administrative expenses applicable to the activity required.

After-sales activity, such as on-site installation and test should be taken into account in establishing the overall price structure.

An examination of the overhead costs allocated to the particular buy should be made to ensure that the allocation represents a fair and reasonable distribution of overhead costs in accordance with the Contract Cost Principles [1031-2](#).

If the government's requirements can be met by direct shipment from the principal, the supplier's charges will normally be confined to the costs of purchasing and invoicing, and in such cases, a special direct shipment rate of overhead should be developed.

The negotiated rates established in accordance with the foregoing are generally applied as a percentage additive to the laid-down costs.

(c) Profit

Agency and Resale Outlet (type 1)

A reasonable rate of profit will be allowed on the total of laid-down costs and the cost of services required by the Crown. The rate should be commensurate with the risk, the volume of resale business to the Crown and other circumstances. For example, if the services required include the maintenance of an inventory, a higher rate of profit is permitted.

Agency and Resale Outlet (type 2)

The profit amounts should be calculated by application of the following:

(i) Profit on Laid-down Costs:

Recognizing the cost of financing and risks associated with the maintenance of stocks, the maximum rates of profit applied to laid-down costs vary in accordance with the method of supply as follows:



- supplied from stocks maintained and financed by the supplier: up to 4 percent.
- supplied from stocks held by the supplier on consignment from the principal: up to 3 percent.
- supplied by the principal through the supplier, only when ordered by the government: up to 3 percent.
- supplied by the principal in direct shipment to the government: up to 2 percent.

(ii) Profit on Cost of Necessary Services and Overhead:

Recognizing the associated general business risk, the rates of profit applied to the cost of necessary services and overhead may vary in accordance with the services provided and are:

- where the services include those of purchasing and invoicing only: up to 7½ percent.
- where the services include other than purchasing and invoicing: up to 10 percent.

(d) Price Certification and Discretionary Audit:

Subsequent to the price negotiation, the supplier should resubmit its price proposal based on the agreement reached and include a price certification. In addition, all contracts for non-competitive acquisitions from agency and resale outlets valued at \$50,000 and over should contain a discretionary audit clause. (see [10.117](#) and [10.119](#)).

## Transfer Pricing

10.130 (2005-06-10) When materials, supplies or services are transferred to a seller to the Crown from divisions, subsidiaries or affiliates under common control, the transfer price should be established in conformity with standard criteria, to avoid the payment of a rate of profit exceeding departmental norms.

*Considerations of materiality and practicality will govern in the application of these criteria. Consistency is also an objective - consistency between government and commercial work, consistency among the various kinds of firm price and cost reimbursable contracts, and consistency from one year to the next. In order to ensure consistency, personnel from all sectors/regions shall consult early in the negotiation process a repository of applicable data maintained by the Cost and Forensic Accounting Directorate.*

10.131 (1994-06-23) The following criteria apply to the establishment of acceptable inter-company and intra-company transfer prices on Crown contracts in non-competitive situations for which a price is negotiated with the supplier through a process involving analysis of costs and determination of profit.

These criteria do not apply if the transfer price can be verified to be reasonable by reference to comparable third party prices involving transactions between the Canadian subsidiary (agency or resale outlet) or its parent and a third party, or between unrelated parties.

10.132 (1994-06-23) **Intra-company** transfer prices (that is, for transfers between divisions of the same legal or corporate entity) shall be charged to Crown contracts at cost according to the Contract Cost Principles [1031-2](#) without allowances for profit or an allocation of corporate general and

administrative expenses. These allowances will apply on the cost of the finished product sold to the Crown.

- 10.133 (2005-06-10) **Inter-company** transfer prices (that is, for transfers between a company and its subsidiary or affiliate enjoying separate legal status but otherwise under common ownership control) charged to Crown contracts shall, whenever possible, be not greater than those which approximate fair market value. In those situations where approximate fair market value cannot be determined, inter-company transfer prices shall be those that can be considered as reasonable under the circumstances if the parties to the transaction had been dealing at arm's length.

**Fair Market Value** means the price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and not under any compulsion to transact.

If the product/service has a **going price** at which significant quantities are known to sell in the market in arm's length transactions, such a price will represent fair market value. Examples: regulated prices, posted prices, catalogue prices and other prices actually available and given in past transactions to arm's-length parties for the size, quality, timing and location of the transaction, after all discounts have been considered. An inter-company transfer price representing fair market value will be used as "laid-down cost" for that item for the purposes of computing mark-up, profit and contract price.

In any case where the circumstances described in the last paragraph do not apply, the company shall be deemed to have transfer prices at cost calculated in accordance with Contract Cost Principles [1031-2](#) without allowance for profit and without an allocation of corporate general and administrative expenses.

In interpreting the term "reasonable under the circumstances," the following considerations apply:

- (a) If the seller to the Crown can prove that the transfer price is **at cost**, then a normal profit at rates set out in [10.010](#) will apply to the final product cost.
- (b) If the seller to the Crown can provide satisfactory price support for a transfer price **in excess of cost**, the profit element in such transfer price will be limited to a return (at a rate not exceeding the corporate bond rate periodically published by the Director, Cost and Forensic Accounting Directorate, on the fixed and working capital used in the production of the goods/services. The formula for computing profit is as follows:

$$(R/12) \times M(a \times (b/c)) = P$$

R = corporate bond rate

M = period (in months of capital use)

a = fixed and working capital employed

b = transfer price less profit

c = total company annual cost of sales and transfers

P = profit amount to include in transfer price

It should be noted that satisfactory price support originating from the transferor should be capable of being verified by reference to instances of transactions in similar goods either between the Canadian subsidiary or its parent and a third party, or between unrelated parties.

- (c) In situations other than (a) and (b) above, profit will not be allowed on the transfer price component of the total costs of the final product sold to the Crown.

- 10.134 (1994-06-23) Where necessary, common ownership control will be determined by reference to the latest issue of appropriate trade surveys (e.g. Financial Post Survey of Industrials, Moody's Industrials, etc.), as confirmed by means of a certification from the company as to control (use SACC Manual clause [K9000C](#), for this purpose). Ownership control is presumed in cases where at least 50 percent of the voting rights are held by the affiliate.

### **Special Production Tooling and Special Test Equipment**

- 10.150 (1994-06-23) No profit is allowed on Special Production Tooling (SPT) or Special Test Equipment (STE) which is purchased by a contractor for use under a contract, or purchased or otherwise acquired by its subcontractors for use under approved subcontracts.
- 10.151 (1994-06-23) When the production of the end product involves prior or concurrent expenditures for SPT or STE under a separate agreement, or pursuant to a clause in a contract or subcontract, a profit of up to 5 percent may be allowed on all SPT fabricated in a plant owned or operated by a contractor.

*No profit is allowed on the cost of purchased equipment incorporated or built into the STE.*

- 10.152 (1994-06-23) Expenditures incurred by a contractor in connection with purchased SPT or STE (other than the cost of such tooling or equipment) are usually recovered as preproduction expenses or factory overhead.

*Administrative overhead is not accepted on STE.*

Purchased tooling should be included in the Cost of Sales base for the distribution of administrative overhead.

- 10.153 (1994-06-23) Since the cost of SPT or STE represents part of the cost of the end product being acquired by a client, payment is made out of the client's funds appropriated for the purchase of that end product.
- 10.154 (1994-06-23) SPT may be acquired on a firm price or a cost reimbursable basis irrespective of the price arrangement for the end product for which the tooling is required.

When SPT is to be provided on a cost basis:

- (a) the cost of such tooling is to be in accordance with the Contract Cost Principles [1031-2](#);
- (b) a dollar limit is to be placed on the cost of the tooling with the provision that the cost is not to exceed this limit until further authorization is obtained.