



Australian Government
Defence

Defence Cost Principles

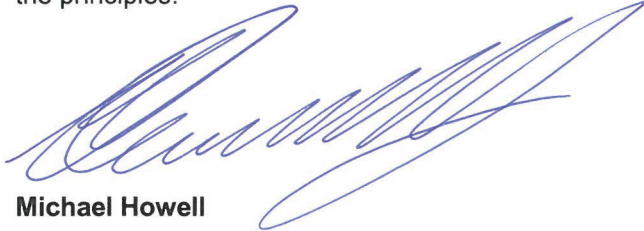
Version 3.0
01 August 2024



Foreword

The Defence Cost Principles provide guidance and clarity to Defence and Industry regarding what costs may be attributed to Defence contracts.

The current release reflects changes arising from consultation and due to legislative amendments since Cost Principles of 2017 was promulgated and reflect contemporary commercial best practice. This document may undergo further refinement in the future to maintain the currency of the principles.



Michael Howell

Acting First Assistant Secretary Procurement and Contracting
Capability Acquisition and Sustainment Group

1 August 2024

Amendment Record

This version of the Cost Principles supersedes all previous versions and applies to contracts agreed on or after 1 August 2024.

Table 1 below summarises the release and application dates of previous and current versions of this document.

Table 1: Amendment record for the Cost Principles

Version Number	Title of Document	Date
Version 0.1	DMO Cost Principles	16 July 2011
Version 1.0	CASG Cost Principles	12 October 2015
Version 2.0	CASG Cost Principles	9 October 2017
Version 3.0	Defence Cost Principles	1 August 2024

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Chapter 1: Introduction to the Cost Principles Overview

Principles Statement

- 1.1 These Cost Principles provide a framework for greater understanding and clarity regarding how costs may be attributed to the Department of Defence (Defence) contracts. The Cost Principles are applied in accordance with Chapter Two below and the Application of the Cost Principles included in Annexure A. The Cost Principles are underpinned by the relevant legislative and policy requirements, including:
- a. the Public Governance, Performance & Accountability Act 2013 (PGPA Act), which provides the framework for the proper management of public money and public property by the Executive arm of the Commonwealth; and
 - b. the Commonwealth Procurement Rules (CPRs) (2022) which set out the rules that officials must comply with when they procure good and services. Achieving value for money is the core rule of the CPRs. The CPRs state that procurements should:
 - i. encourage competition and be non-discriminatory;
 - ii. use public resources in an efficient, effective, economical and ethical manner that is not inconsistent with the policies of the Commonwealth;
 - iii. facilitate accountable and transparent decision making;
 - iv. encourage appropriate engagement with risk; and
 - v. be commensurate with the scale, scope and risk of the procurement.
- 1.2 The Cost Principles provide a well-defined, standard and commercial approach to Defence contract costs.

Objectives

- 1.3 The objectives of the Cost Principles are:
- a. to provide greater understanding and clarity of what costs may be attributed to (cost recovered from) Defence contracts;
 - b. to focus on compliance of the accounting framework to the Cost Principles, not the financial accounting system;
 - c. to operate within the test of 'reasonableness'; and
 - d. not intended to mandate what costs Industry is able to incur or not incur, outside of its contracts with Defence.

Chapter 2: Application

Application

2.1 The Cost Principles:

- a. identify what costs can be passed to Defence (allowable costs) and what costs cannot be passed to Defence (unallowable costs);
- b. require the use of an accounting framework that is compliant with the Cost Principles and relevant to the type of contractual arrangement being undertaken;
- c. apply to all procurements greater than two million Australian dollars (AUD\$2.0m), unless they are subject to the exceptions as per paragraph 2.2 or where there is no requirement to use as per paragraph 2.3

2.2 Exceptions where the Cost Principles do not apply are as follows:

- i. The contractor is a Small to Medium Enterprise (SME) whose accounting system cannot provide the level of detail required under the Cost Principles as approved by Defence. Where this exception is to apply, the relevant Delegate shall be the approver and guidance should be sought from CFA;
- ii. The procurement is made under a Standing Offer Arrangement (e.g. Defence Support Services (DSS) Panel or Major Service Provider (MSP));
- iii. The procurement is made under a Mandatory Whole of Australian Government Arrangement;
- iv. The procurement:
 - is solely for a commodity where there is an active trading market; or
 - is for 'commercial off the shelf' good(s) or service(s) and approved by Defence; or
 - is for 'military off the shelf' good(s) or service(s) and approved by Defence; or
 - is for a commercial item(s) where there is a competitive market with at least three suitable substitutes or suppliers and was awarded on the basis of adequate price competition whereby two or more tenderers, competing independently, submitted priced offers that satisfy Defence's requirements; and
 - requires a low level of customisation for Defence with no material increase in cost.
- v. The contractor has obtained approval for an Accounting Arrangement to apply for a part (or whole) of the Cost Principles to not apply;
- vi. The procurement relates to a good(s) or service(s) where the contract price is set by a law or regulation;
- vii. Contracts to purchase good(s) or service(s) from a Foreign Government(s), including United States Government Foreign Military Sales;
- viii. The procurement relates to a scope of work (or part thereof) performed in a foreign Country (as approved by Defence) by an overseas entity if a comparable set of cost principles (e.g. UK Single Source Regulation Office's Allowable Costs guidance or US Defense Contract Audit Agency's Contract Cost Principles and Procedures) are applied.

2.3 There is no requirement to use the Cost Principles (however, can provide guidance) where:

- i. The procurement relates to a CCP for which:
 - an exception applies (paragraph 2.2); or
 - there was a previously agreed pricing methodology or was previously agreed as a costed contract option;
- ii. The procurement is for firm or fixed price good(s) / service(s);

- awarded on the basis of adequate price competition whereby two or more tenderers, competing independently, submitted priced offers that satisfy Defence's requirements; and
 - awarded to the tenderer whose proposal represents the best value and where price is a substantial factor in source selection; and
 - there was / is no finding that the price of the otherwise successful tenderer was / is unreasonable.
 - for clarity, if a contract includes multiple pricing elements, i.e. fixed price (competitively sourced) and other non-fixed price elements (e.g. Cost Reimbursement or Target Cost Incentive), the Cost Principles remain applicable to the non-fixed price elements (e.g. Cost Reimbursement).
- 2.4 Table 1 'Amendment record for the Cost Principles', details the version of the Cost Principles which applies. This version of the Cost Principles supersedes all previous versions and applies to contracts agreed on or after 1 August 2024. The application date for procurements where price submissions have been lodged to Defence and / or dates when contracts have been executed or amended (e.g. Contract Change Proposal (CCP)) is summarised in Table 1.
- 2.5 The Australian Standard for Defence Contracting (ASDEFCON) contracting suite implement the Cost Principles when they are included in the approach to market documentation. If not using the ASDEFCON contracting suite, the relevant clauses for these Principles can still be applied and/or inserted and are available in the ASDEFCON Contracting suite.
- 2.6 This section should be read in conjunction with Annexure A for further guidance on the application of the Cost Principles.

Records of Information

- 2.7 In order to support the application of the Cost Principles, contractors should maintain a costing system and methodology which:
- a. Retains relevant records for accounting and other purposes, and these are sufficiently kept up-to-date and accurate;
 - b. Allows contractors to reproduce relevant records within a reasonable time;
 - c. Substantiates facts about costs (including base cost and assumptions) to allow Defence to verify certain matters relating to the price payable under a contract that is subject to the Cost Principles, including whether a cost is an allowable contract cost; and
 - d. Contains a sufficient level of evidence proportional to the size and complexity of the underlying cost and / or assumptions used in the build-up of cost.
- 2.8 Commonwealth related policies and Defence guidance should be referred to in understanding what is required in order to be satisfied that a cost is an allowable contract cost. However, relevant parties should, when determining what type and standard of information is required, take a proportionate approach in considering the following:
- a. The specific requirements and circumstances of the contract;
 - b. The materiality of particular costs; and
 - c. What it is reasonable to expect would be available.
- 2.9 Contractors should undertake ongoing monitoring of compliance against the Cost Principles.

Further Information

- 2.10 Defence periodically updates the Cost Principles. Defence officials are to ensure a current version is applied at the time of entering into an arrangement.
- 2.11 Any feedback in relation to the Cost Principles can be sent to: casg.cfa@defence.gov.au.

Chapter 3: Overarching Cost Principles

Overarching Cost Principles

- 3.1 A contractor's costs (which include those already incurred and those which are anticipated) are allowable costs that may be attributed to Defence contracts to the extent they are:
- appropriate;
 - attributable to the contract; and
 - reasonable in the circumstances.
- 3.2 These overarching Cost Principles apply to both estimated contract costs and actual contract costs. Allowable contract costs are the sum of direct and indirect costs to deliver the contract statement of work. The Cost Principles should be complied with when formulating cost recovery rates, including the determination of any annual company billing rates applicable to single supplier direct sourcing procurements.
- 3.3 The guidance in this Section sets out the overarching typical characteristics of costs that meet the requirements of allowable costs. The relevant parties should consider these characteristics in all cases when evaluating whether a particular cost incurred by the contractor meets each requirement.

Determining Appropriateness

- 3.4 A cost is appropriate if it is consistent with relevant policies, which includes policies of the Commonwealth of Australia (CoA) and Defence. Appropriate costs are suitable, and are a type and arising from an activity which:
- a reasonable person informed of the facts would consider enables the performance of the contract or CCP in question; and
 - would withstand public scrutiny, whereby it meets high standards of regularity, propriety and prudence, such that the relevant standards expected by Defence can be met.

Determining if a cost is attributable to a contract

- 3.5 A cost is attributable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is attributable to a Defence contract if it:
- is incurred specifically for the contract;
 - benefits both the contract and other work, and may be distributed to both in reasonable proportion to the benefits received;
 - is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown; or
 - has been allocated in a fair and transparent manner as approved by Defence.
- 3.6 Contractors should ensure that they are able to demonstrate that contract costs allocated to Defence are allocated in accordance with Section 3.5, should the basis of the costs be challenged.

Determining Reasonableness

- 3.7 A cost may be reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.

- 3.8 Reasonableness of specific costs must be examined with a particular care in connection with a company, its separate divisions or associated companies that may not be subject to effective competitive restraints.
- 3.9 No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by a Defence officer or a Defence representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.
- 3.10 Indicators of whether costs are reasonable include, but are not limited to, the level of competitiveness and/or market testing undertaken in the supply chain, any particular specification and performance requirements, any uncertainty involved, the economic environment, the statutory provisions in place at the time of contracting, the expected benefits provided and any alternative options available, for example to justify decisions as to whether to sub-contract or undertake work 'in-house'.
- 3.11 In order to assess whether a cost is reasonable, consideration should be given to the following:
 - a. Whether it is congruent with meeting the contract requirements;
 - b. Whether the cost would withstand public scrutiny;
 - c. Whether the cost is consistent with any available sector/market benchmarks;
 - d. Whether the quantum of the cost is consistent with good business practice; and
 - e. Whether the cost represents value for money; i.e. whether it can be assessed as efficient, effective, economical, and ethical and is consistent with Commonwealth policies.

Chapter 4: Cost Accounting and Financial Reporting

Cost System

- 4.1 The contractor's accounting system, for the purpose of ascertaining the contract cost, shall:
- a. provide for the equitable allocation of costs between cost objectives;
 - b. provide an appropriate, sufficient, auditable trail to substantiate contract costs;
 - c. sustain a causal link for all contract costs to contract activities in the contract statement of work;
 - d. be based on sound accounting principles, appropriate for the purposes of the contract, and internal control practices, consistently applied;
 - e. be adequate to enable accurate and timely determination of the contract cost in accordance with the Cost Principles; and
 - f. provide explanations of the basis adopted in discretionary areas, where underlying assumptions used by the contractor can be tested for reasonableness by Defence.
- 4.2 In certain circumstances an Accounting Arrangement (refer Paragraphs 4.23 – 4.27) may be established between Defence and the contractor covering the contractor's cost system.
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Contract Cost

- 4.3 As a guiding principle, Defence will only incur or make payment once for an item of cost and will seek cost reimbursement for any double counting or other duplication of costs. A cost is allowable only when the cost complies with all of the following requirements:
- a. terms and conditions of the contract;
 - b. limitations defined in the Cost Principles;
 - c. attributable to the contract, in accordance with the Cost Principles outlined in Section 3;
 - d. Accounting Arrangement (where applicable); and
 - e. reasonable, in accordance with the Cost Principles outlined in Section 3.
- 4.4 The guides to assist in determining which costs are allowable and which costs are unallowable are at Annexure A: Application of the Cost Principles, Annexure B: Allowable Cost Decision Matrix and Annexure C: Specific Categories of Cost.
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Composition of Total Cost

- 4.5 The total cost of a contract is the sum of the direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits. In ascertaining what constitutes a cost, any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used. This should be supported with sufficient evidence.
- 4.6 While the total cost of a contract includes all costs properly allocable to the contract, the allowable costs are limited pursuant to Annexure A or any applicable Accounting Arrangement.
- 4.7 Costs applicable to one contract may not be allocated to another contract.
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Accounting for Unallowable Costs

- 4.8 Costs that are expressly unallowable or mutually agreed to be unallowable are costs that cannot be charged to Defence, either as a direct cost, indirect cost, or in a cost recovery rate. This includes mutually agreed unallowable directly associated costs, which shall be identified and excluded from any claim or proposal applicable to a Defence contract.

- 4.9 A directly associated cost is any cost that is generated solely as a result of incurring another cost, and that would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated cost is also unallowable. Unallowable cost categories are listed at Annexure B – Allowable Cost Decision Matrix.

Direct Cost

- 4.10 Direct costs should be easily traced and attributable to the performance of a contract statement of work. The classification of items of cost as direct cost shall be in accordance with sound accounting principles, appropriate for the purposes of the contract, and consistently applied. That is:
- a. no final cost objective shall have allocated to it as a direct cost any cost that, if incurred for the same purpose in like circumstances, would have been included in an indirect cost pool to be allocated to that or another final cost objective;
 - b. direct costs of the contract shall be charged directly to the contract where it is a cost incurred for completing work under the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly; and
 - c. for reasons of practicality, the contractor may treat any direct cost of a minor dollar amount as an indirect cost if the accounting treatment:
 - i. is consistently applied to all final cost objectives; and
 - ii. produces substantially the same results as treating the cost as a direct cost.

Indirect Cost

- 4.11 It shall not be permissible to charge part of an allowable cost as a direct cost to a final cost objective and the balance to indirect expense unless:
- a. specifically provided for in the Cost Principles; or
 - b. Paragraph 4.12 applies and is the subject of an Accounting Arrangement.
- 4.12 It shall be permissible to charge part of an allowable cost as a direct cost to a final cost objective and the balance to indirect expense where:
- a. the cost includes an economically traceable element which can be identified as a direct cost of a final cost objective;
 - b. the amount of the cost charged to indirect expense excludes any elements similar in nature to that charged as a direct cost, which are applicable to other final cost objectives; and
 - c. the practice is applied consistently
- 4.13 Direct cost items for which the cost of identifying them separately would be uneconomic may be classified as indirect expense items provided that practice is applied consistently and produces substantially the same results as those which would have been obtained if such costs had been treated as direct costs.
- 4.14 Indirect costs (for example, shared services) are apportioned to the cost object using relevant and appropriate cost drivers. Some indirect costs are included in overhead recovery rates, which are allocated to contracts via an appropriate recovery basis which has or is subject to agreement between the contractor and Defence.

Indirect Cost Pool

- 4.15 Indirect costs shall be accumulated by logical cost groupings into indirect (overhead) cost pools and allocated to cost objectives or where appropriate, other indirect cost pools for subsequent allocation, subject to practical considerations. Commonly, manufacturing overhead, selling

costs, marketing, business development, and general and administrative costs are separately grouped. If a cost is not an allowable direct or indirect cost under the Cost Principles, it should not be passed to Defence, including through an indirect cost pool.

4.16 The basis on which an indirect cost pool is allocated shall:

- a. be consistently applied;
- b. be in accordance with sound accounting principles, appropriate for the purposes of the contract and consistently applied;
- c. result in equitable distribution; and
- d. be calculated and allocated in a way that avoids over recovery

4.17 An indirect cost pool may be the subject of an Accounting Arrangement (refer 4.23 - 4.27).

Credits to the Contract Cost

4.18 Subject to Paragraph 4.19, and provided the contract does not specifically provide for an alternate procedure, the contract cost where practical shall be credited with the applicable portion of:

- a. all discounts, rebates, commissions, support, grants, price reductions of any kind received or receivable by the contractor from International, Federal, State or Territory and Local Governments or any other party including but not limited to the purchase of equipment, facilities, intellectual property materials or services that are allowable contract costs;
- b. the proceeds of sales of any secondary products resulting from manufacture relating to the performance of the contract. The proceeds shall be net of expenditures incurred for these purposes provided such expenditures are not otherwise recoverable as an element of the contract cost;
- c. With respect to insurance:
 - i the proceeds from any insurance claim received by the contractor or would be expected to be received under an insurance policy held or is required to be held by the contractor under the contract with Defence;
 - ii where costs allowed into the contract cost by Defence are recoverable under a 'consequential loss' insurance policy, the recoverable amount of the cost originally allowed shall be credited to contract cost;
- d. the agreed value of any such products and materials that are not sold by the contractor;
- e. the amounts of costs allowed into the contract cost under the Cost Principles which are recoverable from any source other than from Defence under this contract, excluding costs, expenses, damages or other compensation recovered through litigation or settlement of claims or disputes (the costs of which are not passed to Defence); and
- f. gains arising from the sale, retirement or exchange of machinery, plant or equipment as outlined in Section 8 of Annexure C.

4.19 The contractor shall not be required to credit Defence with:

- a. the proceeds of the sale of any material when the cost of such material has been excluded from the contract cost; or
- b. settlement discounts for prompt payment consistent with normal commercial levels, other than trade discounts or discounts in excess of normal commercial levels, in respect of which the difference shall be credited to contract cost.

Avoidable Costs and Unnecessary Costs

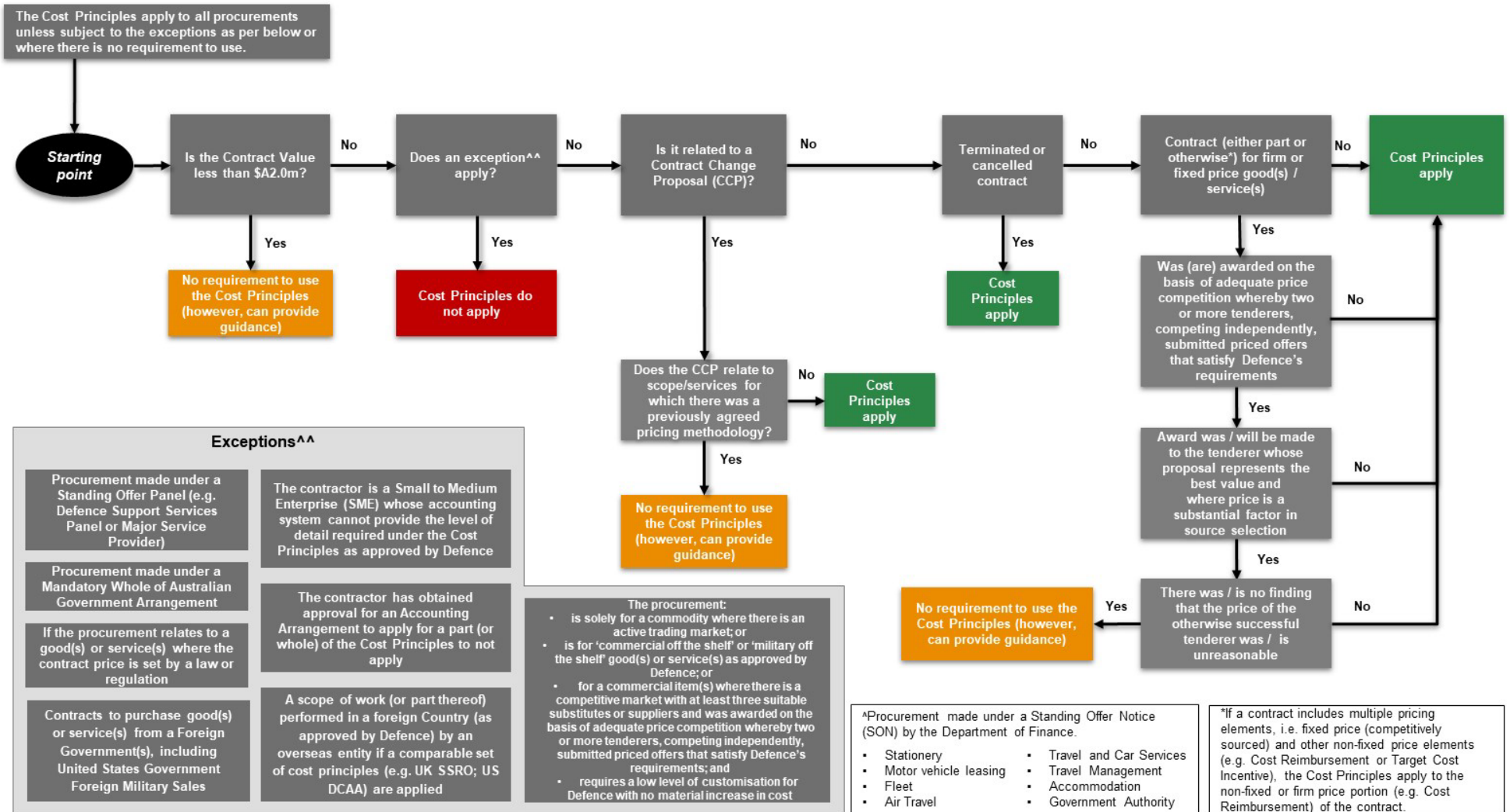
- 4.20 Costs which may be avoided or reduced by the exercise of reasonable standards of skill, care and efficiency, shall be subject to the reasonableness test and, to the extent that such costs may have been avoided or reduced, shall not be allowable as a contract cost. This means outcomes should be achieved in an economical manner that minimises costs and avoids waste.
- 4.21 Unless an Accounting Arrangement has been established to the contrary, where prudent business practice would require the contractor to seek competitive tenders or quotes, net additional costs caused by the failure or omission of the contractor to call for tenders, or to obtain competitive quotes, subject to the reasonableness test, may result in the net additional costs to be unallowable as a contract cost.
- 4.22 The cost in excess of a reasonable allowance for faulty materials, faulty workmanship and rejected components shall be unallowable as a contract cost.

Accounting Arrangement

- 4.23 To eliminate any uncertainty regarding the allowance of items of cost, other than items of cost specifically unallowable as set out at Annexure B and C, (prospective) contractors may seek an Accounting Arrangement in respect of those items of cost where reasonableness or allocability may be difficult to determine. Defence may also initiate such Accounting Arrangement. The contractor in some circumstances may obtain approval from Defence that part or whole of the Cost Principles do not apply.
- 4.24 An Accounting Arrangement will be in writing and may relate to a particular contract or a number of contracts with Defence. An Accounting Arrangement may be entered into during the course of the contract.
- 4.25 An Accounting Arrangement may be established between Defence and the contractor covering the contractor's cost system before accumulation of any costs under the contract. An Accounting Arrangement shall be used as the exception though it may be used to agree a standardised approach between Defence and a contractor, where this is likely to be a recurrent requirement.
- 4.26 Defence, in exceptional circumstances, may make allowance for other specified costs within each cost pool providing a business case is made clearly demonstrating value for money to the project(s). Once Defence is satisfied with the cost basis, it may elect to impose a "cap" on each cost category. If such a "cap" is applied, the contractor must seek approval from Defence for any reimbursement of expenditure over the "capped" amount. When seeking such an increase, a business case must be provided by the contractor to clearly demonstrate value for money to Defence. Any additional cost approvals will be at Defence's sole discretion.
- 4.27 If required by Defence, the contractor must furnish a statement of the contract cost and related information in such detail as Defence may reasonably request. Reasonable additional costs incurred in producing such statements shall be allowable into contract cost.

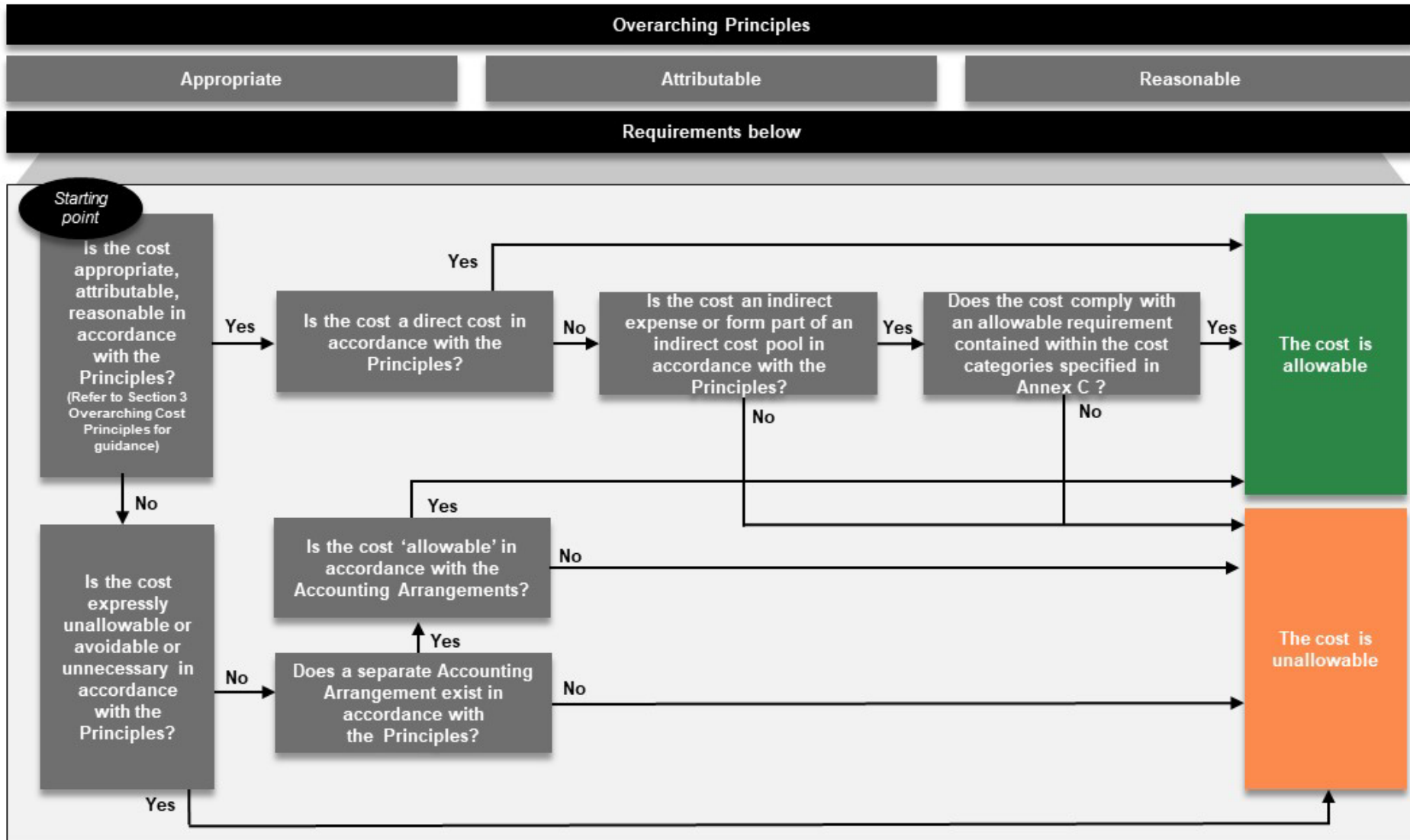
Annexure A

Application of the Cost Principles



Annexure B

Allowable Cost Decision Matrix



Annexure C

Specific Categories of Cost

1	Advertising and Public Relations	34	Litigation
2	Alcoholic Beverages	35	Lobbying and Political Activity
3	Bad or Doubtful Debts	36	Long Service Leave
4	Bank Guarantees	37	Losses on Business Activities
5	Bonuses (Bonuses to Employees)	38	Manufacturing and Production Engineering
6	Bonuses (Hire on Bonuses)	39	Organisation
7	Bonuses (Retention Bonuses)	40	Other Business
8	Capital Assets - Gains or Losses	41	Patent and Royalty
9	Commissions to Agents	42	Professional and Trade Associations - Membership Fees
10	Communication	43	Property Not Used in Relation to Contract
11	Conditions of Employment (Other than Rates of Pay)	44	Rates of Pay in Excess of Certified Employees Agreement
12	Consultant and Professional Services	45	Re-arrangement of Facilities or Plant - Australian Defence Purposes
13	Contingency and Management Reserve	46	Redundancy
14	Cost of Raising and Servicing Capital	47	Related Party
15	Depreciation of Buildings, Property, Plant and Equipment	48	Remuneration of Chief Executive Officer, Directors and Non-Certified Agreement Employees
16	Direct Material	49	Repairs, Operation and Maintenance
17	Donations	50	Research and Development (R&D)
18	Employee Health, Welfare	51	Security
19	Entertainment	52	Selling and Promotional
20	Environmental	53	Service and Warranty
21	Fines or Penalties	54	Sub-Contracts
22	Goodwill	55	Superannuation Fund Payments
23	Government Assistance	56	Taxes
24	Head Office	57	Tendering
25	Hedging Foreign Exchange Risk	58	Termination of Employment
26	Hire Purchase	59	Termination or Cancellation of Contracts
27	Idle Capacity	60	Trade Exhibitions
28	Incorporation or Amalgamation	61	Training and Education
29	Industrial Disputes	62	Transfer Pricing or Inter-Entity Pricing
30	Insurance	63	Travel
31	Investment Allowances	64	Travelling or Living Overseas
32	Joint Ventures or Alliance Arrangements	65	Work Health and Safety
33	Lease or Rental - Land, Buildings, Machinery, Plant or Equipment		

NOTE: The treatment of specific categories of cost in this section below is not intended to be exhaustive but rather to indicate those items of cost which, for varying reasons, warrant special mention. Failure to treat a particular item of cost does not imply that it is either allowable or unallowable, and if in doubt prospective contractors should seek clarification from Defence or seek an Accounting Arrangement or both.

1. Advertising and Public Relations

1.1 Advertising costs and related administrative costs incurred in relation to:

- a. staff recruitment; or
- b. purchase or disposal of materials; or
- c. an insertion in the telephone or trade directories and similar publications; or
- d. the requirements of any applicable Federal, State, Territory or Local government legislation,

shall be allowable to the extent that the costs are within the definition of contract cost and are reasonable in both size and nature and must clearly demonstrate a benefit to the contract.

- 1.2 Unallowable contract costs include the following:
 - a. expenses associated with advertising through any media for other than Annexure C Paragraph 1.1 above. For this purpose, advertising media includes: magazines, newspapers, television and radio programs or “commercials”, brochures direct mail, outdoor advertising, conventions, exhibits, free goods and samples, the internet and telecommunications; or
 - b. the cost of contractor branding, including (but not limited to) hats, pens, banners, shirts, pants, jackets, buildings and signs unless pre-approved by an authorised representative from Defence.
- 1.3 Unallowable costs also include sponsorship of sporting teams/events or similar activities.
- 1.4 Allowable costs include activities to promote sales of products normally sold to the Australian Defence Department, including trade shows and Defence sponsored exhibitions, which contain a significant effort to promote exports from Australia are allowable. Allowable costs are limited to the Australian entity cost. However, such costs do not include the costs of memorabilia (e.g., models, gifts, and souvenirs), alcoholic beverages, entertainment, and physical facilities that are used primarily for entertainment rather than product promotion. The costs of overseas representatives attending, and overseas demonstration equipment provided, are unallowable.

2. Alcoholic Beverages

- 2.1 Costs of alcoholic beverages are unallowable. Where these costs cannot be identified and excluded by the accounting system, a reasonable estimation of the alcohol costs will be considered. This cost does not refer to beverages (which may be alcoholic) purchased by individuals as a result of their normal meal and incidental travelling allowance (refer Annexure C Paragraph 63.3 Travel).

3. Bad or Doubtful Debts

- 3.1 Bad debts, including losses (whether actual or estimated) or provision for doubtful debts arising from uncollectable customer accounts and other claims, related collections costs, and related legal costs are unallowable as a contract direct or indirect cost.

4. Bank Guarantees

- 4.1 Costs of bank guarantees or financial securities required pursuant to the terms of a Defence contract shall be allowable as direct cost.
- 4.2 Costs of bank guarantees or financial securities incurred in the general conduct of the contractor's business and not directly related to other final cost objectives shall be allowable to the extent the costs are within the definition of indirect costs, provided the rates and premiums are reasonable under the circumstances.

5. Bonuses (Bonuses to Employees)

- 5.1 Subject to Annexure C Paragraph 7.1 Bonuses (Retention Bonuses), bonuses (including eligible Employee Share Schemes) allocated for payment to employees shall be allowable as a contract cost to the extent that:
 - a. the bonus is due to productivity improvement or achieved Defence contract Key Performance Indicators (KPIs);
 - b. the bonus agreement is entered into in good faith between the contractor and employee and is a plan established and consistently followed;
 - c. the amount when added to the other remuneration of the recipient results in a reasonable total remuneration;
 - d. provided similar bonuses are paid in respect of similar commercial work; and

- f. the maximum bonus that the Commonwealth will pay, will be the maximum bonus available under the contractor's bonus policy or the amount paid by the contractor, whichever is the lowest amount.
- 5.2 Allowable bonuses not associated with Defence contract specific KPIs are to be included in the indirect cost pool. Such bonuses cannot be a provision but must be an amount that is allocated and proposed to be paid to employees.
 - 5.3 Bonuses due solely to achievement of agreed profit benchmarks shall be unallowable as a contract cost, however bonuses as a result of achieving the criteria for multiple KPIs (which may include profit) are allowable. The sharing of company profits with employees is not considered a relevant labour cost (direct or indirect).
 - 5.4 In a cost reimbursement arrangement or where it is proposed to treat the bonus as a direct cost, the services of the recipient must relate to the contract. Where an employee bonus pool has been approved under the contract, then it must be tied to and paid in proportion with the achievement of contracted KPIs.

6. Bonuses (Hire on Employees)

- 6.1 Hire on Bonuses shall be allowable as a contract cost to the extent that:
 - a. the services of the recipient relate to the contract; and
 - b. the bonus is due to filling of a key staff position pursuant to the terms of a Defence contract and allowable as a direct cost; and
 - c. the amount when added to the other remuneration of the recipient results in a reasonable and appropriate total remuneration.

7. Bonuses (Retention Bonuses)

- 7.1 Retention Bonuses shall be allowable as a contract cost to the extent that:
 - a. the services of the recipient relate to the contractual obligation of the contractor; or
 - b. the bonus is due to retention of a key person pursuant to the terms of a Defence contract and allowable as a direct cost only; and
 - c. the amount when added to the other remuneration of the recipient results in a reasonable and appropriate total remuneration.

8. Capital Assets – Gains or Losses

- 8.1 Gains or losses arising from the sale, retirement or exchange of machinery, plant or equipment shall be credited / allowable as a contract cost, provided that the gains or losses are within the definition of allowable contract cost and are:
 - a. Reasonable and attributable;
 - b. calculated in accordance with applicable Accounting Standards;
 - c. the difference between the sale, retirement, or exchange price and the written-down value resulting from the depreciation allowable under the Cost Principles;
 - d. equitable in that the proportion of gains or losses allocated to Australian Defence work subject to the Cost Principles approximates the proportion of total depreciation charges allocated to such Australian Defence work during previous years in respect of the assets which generated the profits or losses;
 - e. included in the year in which the gains or losses occurred as a credit or charge to an indirect cost pool or as a credit or charge to direct expense;

- f. not the result of mass or extraordinary sales, retirements or other dispositions; and
 - g. impairment losses incurred in accordance with applicable Accounting Standards are not an allowable contract direct or indirect cost.
- 8.2 Gains or losses on the disposal of depreciated machinery, plant or equipment are unallowable as a separate charge or credit where:
- a. such gains or losses are included in a provision for depreciation account and reflected in the depreciation allowable under Annexure C Section 15; or
 - b. the property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into consideration in the depreciation cost basis of the new item.

9. Commission to Agents

- 9.1 Commissions due to appointed agents for the specific supplies and services acquired under the contract are an allowable cost within the definition of contract cost. Such costs must be detailed within the definition of contract cost. The appointment of an agent must be a genuine arms-length third party transaction and must not be a related entity or individual for commissions to be allowable costs.

10. Communication

- 10.1 Communication costs incurred for telephone services, local and long distance telephone calls, internet, postage and similar technologies shall be allowable to the extent they come within the definition of contract cost.

11. Conditions of Employment (Other than Rates of Pay)

- 11.1 Costs relating to conditions of employment (other than rates of pay) should be comparable with available industry/market benchmarks and practice. Where costs are not comparable, they may be considered reasonable where:
- a. the cost is consistent with the contractor's past practice and policy, and Defence has previously agreed to the recovery of these costs; or
 - b. the contractor is able to demonstrate that circumstances have changed sufficiently to justify such costs.

12. Consultant and Professional Services

- 12.1 "Consultant and Professional Services" means those services rendered by persons who are members of a particular profession or possess a special skill and who are not officers or employees of the contractor. Examples include those services acquired by contractors or subcontractors in order to enhance the contractor's legal, economic, financial or technical positions. Consultant and professional services are generally acquired to obtain information, advice, opinions, alternatives, conclusions, recommendations, training or direct assistance such as studies, analyses, evaluations, liaison with Government officials or other forms of representation.
- 12.2 Costs described in Annexure C Paragraph 12.1 shall be allowable to the extent the consultant and professional services are within the definition of contract cost, and are not excluded under Annexure C Paragraph 12.3.
- 12.3 Consultant and professional services performed under any of the following circumstances are unallowable:
- a. services to improperly obtain, distribute or use information or data protected by the contract or applicable legislation;
 - b. services that are intended to improperly influence the contents of solicitations, the evaluation of proposals or quotations, or the selection of sources for contract award, whether award is by the Government or by a prime contractor or subcontractor;

- c. any other services obtained, performed or which otherwise result in the violation of any statute or regulation prohibiting improper business practices or conflicts of interest;
- d. services performed which are not consistent with the purpose and scope of the services contracted for or otherwise agreed to; or
- e. services for which the costs are unallowable under Annexure C Paragraphs 14.4(f) 28.1, and 34.1.

13. Contingency and Management Reserve

- 13.1 Contingency / Management Reserve (may also include alternate terms such as 'risk allowance') are an allowance set aside as a (included in) contract direct cost during the estimation of a contract price. Regardless of the terms used (i.e. a company may use an alternate term to Contingency / Management Reserve), the following principles shall apply in determining whether it is an allowable cost.
- 13.2 Contingencies shall be unallowable as a contract cost for cost reimbursement contracts, unless the costs are labour related or relate to a provision for statistically calculated warranty costs with respect to the goods and services being supplied under the contract.
- 13.3 Contingencies / Management Reserve may only be allowable in cost estimates if the company provides a fully costed risk register estimated reliably from historical or other evidence which identifies the risk events that these reserve elements cover. In determining the value of each risk in the risk register, a probabilistic statistical model may be used to estimate the probabilities of occurrence and consequences. The tenderer's performance risk (i.e. costs associated with non-performance) cannot be included in the costed risk register.
- 13.4 Unless supported by a fully costed risk register, the initial provision or increase of funding for a contingent liability is considered to be a setting aside of earned profits to meet possible liabilities against future profits and not a business operating cost, and therefore is an unallowable cost in Defence contracts.
- 13.5 An allowance set aside as a (included in) contract direct cost in cost estimates for additional reserve for unforeseen events or unknown conditions and the costs cannot be reasonably calculated would be an unallowable cost.

14. Cost of Raising and Servicing Capital & Borrowing Costs

- 14.1 The contractor is expected to have reasonable working capital and therefore, the cost of interest to fund working capital is unallowable unless an Accounting Arrangement has been agreed with Defence in rare circumstances, for example, where significant capital outlay is required. In these circumstances, the allowable interest cost shall be determined with reference to Annexure C Paragraph 14.2(a).
- 14.2 The actual interest component of borrowings (including under a lease) for capital acquisitions (for example property, plant and equipment) approved by Defence, if directly related to the contract activity, is an allowable contract direct cost including interest paid for an allowable lease specified at Annexure C Section 33. The rate of interest allowable on debt (including leases) must be reasonable and shall be in alignment:
 - a. with the interest rate for similar borrowings from a registered Authorised Deposit Institution (ADI) in Australia; or
 - b. the rate of interest that the contractor would have to pay to borrow over a similar term, with a similar security, the funds necessary to obtain an asset of a similar value to the capital acquisition in a similar economic environment.
- 14.3 Where Defence pre-approves the acquisition of stock, inventory, materials and / or other items directly related to the contract activity, significantly (more than 12 months) in advance to when is required for use and payment is required by the vendor (as evidenced by Defence) prior to being used and paid for by Defence, then the cost of funding this acquisition may in some circumstances be an allowable contract direct cost. In these circumstances, the allowable interest cost shall be determined with reference to Annexure C Paragraph 14.2(a).

- 14.4 The following costs are unallowable as a contract cost:
- a. interest on borrowings (including unallowable leases as specified at Annexure C Section 33), except as specified at Annexure C Paragraph 14.1 and 14.2;
 - b. share and debenture issue costs;
 - c. capital re-organisation costs;
 - d. debenture discounts;
 - e. staff equity schemes; and
 - f. professional charges and other costs incurred in connection with Annexure C Paragraphs 14.2 a) to e).
- 14.5 Costs relating to conditions of employment (other than rates of pay) should be comparable with available industry/market benchmarks and practice. Where costs are not comparable, they may be considered reasonable where:
- a. the cost is consistent with the contractor's past practice and policy, and Defence has previously agreed to the recovery of these costs; or
 - b. the contractor is able to demonstrate that circumstances have changed sufficiently to justify such costs.

15. Depreciation of Buildings, Property, Plant and Equipment

- 15.1 Depreciation of buildings, property, plant and equipment (tangible assets) owned by the contractor, to the extent they are used for or in connection with the contract, are allowable in accordance with the applicable Accounting Standard or where no Accounting Standard is used, AASB 116. Notwithstanding the depreciation model adopted by the contractor under AASB 116, the allowable depreciable amount shall be based on using the Cost Model rather than the Revaluation Model in accordance with AASB 116. Where an entity is using a Revaluation Model as the basis of its accounting, then any revaluation adjustments (up or down) shall be disregarded and be reverted to the Cost Model for the purposes of calculating the allowable Depreciation. If an asset has been disposed of during the period, then the remaining Depreciation as at the date of sale shall not be recognised as an allowable Depreciation cost as the contractor will have received this amount in the proceeds for the sale of the item. Impairment gains or losses recorded against Buildings, Property, Plant and Equipment in accordance with AASB 136 are not an allowable Depreciation cost.
- 15.2 Where an asset described in Annexure C Section 15 has been fully depreciated, depreciation on revaluation of the asset is unallowable.
- 15.3 Depreciation costs on any Buildings, Property, Plant and Equipment or part thereof which has been funded or gifted from any government source be it International, Federal, State, Territory or Local Government, as part of the current or previous contract, grant or other appropriation or third party donor is unallowable.
- 15.4 In circumstances where a Building, Property, Plant and Equipment is required for a specific contract only and has no useful purpose thereafter, then, if agreed to in advance, the Building, Property, Plant and Equipment may be depreciated over the life of the contract as an allowable depreciation cost only if the proceeds for the Building, Property, Plant and Equipment is credited to the contract direct cost.
- 15.5 Depreciation for assets recognised as Investment Property in accordance with AASB 140, shall not be an allowable as a contract direct or indirect cost unless the Investment Property (or portion thereof) is being used directly for contract activities and has not been charged to the contract in accordance with Annexure C Section 33 at which time Depreciation is allowable as a direct contract cost. However, the maximum amount allowed as Depreciation shall be based on a Cost Model basis and exclude any revaluation adjustments.
- 15.6 Amortisation of assets recognised as Intangible Assets in accordance with AASB 138, is an unallowable contract direct or indirect cost except if allowable under Annexure C Paragraph 50 of

these Cost Principles for R&D Amortisation. However, amortisation of Goodwill is unallowable in accordance with Annexure C Paragraph 22 of these Cost Principles.

- 15.7 Depreciation of assets arising from a Government Grant in accordance with AASB 120, is unallowable to the extent that there is no offset credit to contract or indirect costs for the deferred receipt of grant revenue in accordance with AASB 120. (I.e. If an asset is purchased as a result of the receipt of a government grant or granted to the contractor from a government or third party, then no depreciation cost is an allowable contract or indirect cost either in the period the grant or asset was provided to the contractor or any subsequent period).
- 15.8 Where the Australian Tax Office tax depreciation rates are used, the contractor must exclude any depreciation allowances for special purposes (e.g. investment allowances, rebates, accelerated depreciation or similar schemes), which are unallowable.
- 15.9 Please refer to Annexure C Section 47 for allowable Depreciation cost associated with Buildings, Property, Plant and Equipment owned by a Related Party.

16. Direct Material

- 16.1 Material costs are allowable and include the costs of raw materials, parts, subassemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and in-transit insurance.
- 16.2 In calculating allowable material costs, the contractor may consider including reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work).
- 16.3 Hedging commodities may be an allowable cost where the hedge arrangement provides a risk reduction and is not recoverable by other means and therefore, would not be subject to contract price adjustment mechanisms. This does not include foreign exchange hedging which is an unallowable cost – refer to Annexure C Section 25.
- 16.4 Standard components or accessory materials manufactured by the contractor and used for the purpose of the contract need not be separately costed. Such manufactured items may be charged at prices not in excess of the most favourable prices for which the items could have been purchased by the contractor from an outside or independent supplier. If the components are not available from an independent supplier the components may be allowable as a contract cost at cost of manufacture calculated in accordance with the Cost Principles.
- 16.5 Adjustments need to be made for the following:
- a. Costs of material for payment and other credits, including without limit available trade discounts, refunds, rebates, allowances; and
 - b. Credit such income and other credits either directly to the cost of the material or allocate such income and other credits as a credit to indirect costs.
- 16.6 Costs relating to materials and parts chargeable to a cost reimbursement contract are Unallowable as a contract cost until the costs are physically identifiable with the items to be supplied under the contract, unless:
- a. the conditions of contract provide otherwise; or
 - b. an Accounting Arrangement to the contrary has been established with Defence.

17. Donation

- 17.1 Subject to Annexure C Section 17, donations, payments and / or contributions either through cash or in-kind arrangements (e.g. bona fide time, advertising, public relation costs, materials or any other non-monetary service, goods, building space and / or property plant and equipment) to in-house charitable organisations (e.g. foundations), external charitable organisations registered with the Australian Charities and Not For Profits Commission (ACNC) or not registered with the ACNC but are established to advance and / or promote a social cause including political parties, unions, religious, sporting, cultural, social welfare and / or any other cause, are unallowable as a contract cost.

- 17.2 Donations to an institution capable of rendering assistance to the contractor or the contractor's employees in the case of an emergency, such as a local hospital or blood bank drives, may be allowable to the extent that the costs are reasonable in accordance with the Cost Principles, and:
- the action has been the contractor's past practice to make contributions consistent with those sought to be admitted; or
 - the contractor is able to demonstrate that circumstances have changed sufficiently to justify such donations.
- 17.3 Donations of a private nature or to institutions such as political parties and foundations are unallowable as a contract cost.
- 17.4 Annexure C Paragraph 17.1 above applies to Sponsorships and / or Advertising. Please refer to Annexure C Paragraph 1.1 for further details.

18. Employee Health, Welfare

- 18.1 Costs incurred on activities designed to improve working conditions, employer-employee relations, and employee performance (less income received, credit, rebate received or entitled to receive for these activities) which are for the purposes of improving employee health, wellbeing or welfare are allowable, to the extent that:
- the costs are reasonable in accordance with the Cost Principles; and
 - the costs are attributable in accordance with the Cost Principles; and
 - the action has been the contractor's past practice to incur costs consistent with those sought to be admitted; or
 - where the contractor is able to demonstrate that circumstances have changed sufficiently to justify such costs.
- 18.2 Costs shall only be allowable in accordance with Annexure C Paragraph 18.1 to the extent that these costs are not deemed to be contrary to other Cost Principles.

19. Entertainment

- 19.1 Entertainment costs are unallowable as a contract cost, to the extent that they are:
- costs of or incidental to, sale, distribution or promotion of its products;
 - costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities;
 - costs of membership in social, dining, or country clubs or other organisations having similar purposes; or
 - gifts (external parties or internal staff) guest speakers, sponsorships (in accordance with Annexure C Paragraph 1.1), alcohol (in accordance with Annexure C Paragraph 2.1).
- 19.2 Costs made specifically unallowable under this Principle are unallowable under any other Cost Principle.
- 19.3 Expenses associated with meetings arranged by the contractor upon direction and approval by an authorised representative of the Commonwealth are allowable as a meeting cost provided that they do not contradict any Cost Principle. The cost of hiring a facility may be included as an allowable cost if it is for a facility that is ordinarily hired by the contractor for similar meetings, is not attached to a casino, but may be held at a community venue with poker machines and is reasonable in nature. Food and catering costs associated with these meetings shall be allowable to the extent that the meeting is held during the hours of 6am to 6pm and does not include any alcohol. Any rebates or other benefits accruing to the contractor as a result of the meeting being undertaken must be credited to the contract cost.

- 19.4 Expenses associated with an industry conference which the contractor has been directed and approved to attend by an authorised representative of the Commonwealth, shall be allowable provided that the costs are reasonable, and do not contradict any Cost Principle.

20. Environmental

- 20.1 Environmental costs are the costs incurred by a contractor to prevent, abate, or remediate damage to the environment or to deal with the conservation of renewable and non-renewable resources.
- 20.2 Allowable environmental costs are generally those that are incurred for planned known environmental and compliance activities. Costs may include operational or amortised capital items. The following types of environmental costs may be allowable as a contract cost:
- known environmental and compliance costs;
 - planned remediation costs; and
 - emerging legislative compliance requirement costs.
- 20.3 Unallowable environmental costs will include items such as environmental rework, fines, penalties and related rectification activities. For example environmental rectification costs resulting from defective work or accidental damage are unallowable.

21. Fines or Penalties

- 21.1 Fines or penalties and associated costs resulting from violations of, or failure of the Contractor to comply with applicable International, Federal, State, Territory, or Local Government legislation are unallowable as a contract cost.
- 21.2 For the purpose of Annexure C Paragraph 21.1, “associated costs” includes costs incurred in defence of actions relating to the fines and penalties.

22. Goodwill

- 22.1 Goodwill, an intangible asset, originates under a business combination when the price paid by the acquiring company exceeds the sum of the identifiable individual assets acquired less liabilities assumed, based upon their fair values. The excess is commonly referred to as goodwill. Goodwill may arise from the acquisition of a company as a whole or a portion thereof. Any costs associated with goodwill (however represented) are unallowable contract direct or indirect costs.

23. Government Assistance

- 23.1 The Commonwealth should receive the benefit from the receipt of any payments, or in-kind contributions received by the contractor by an International, Federal, State, Territory or Local Government or any other third party for the acquisition of assets or other costs directly or indirectly associated with the contract on the basis that the contractor has not incurred any cost and any amount received would be deemed to be additional profit. In accordance with Annexure C Paragraphs 15.2 and 16.4, depreciation is unallowable for any asset gifted or acquired from funds received from a third party (as outlined above). (I.e. contract or indirect costs should include a credit in the period the payment was received or subsequent periods in accordance with AASB 120). Where a contractor does not apply AASB 120, the contractor should apply the revenue and expense matching rule whereby income and expenditure is matched off in the period the expense is incurred. If no expense is required by the payment to be incurred, then the revenue shall be recognised in the period the payment was received either through cash or in-kind receipt of assets or other services and goods.

24. Head Office

- 24.1 Head office costs shall be allowable to the extent the costs are within the definition of an indirect cost pool, provided that the amount is allowable in accordance with the Cost Principles and are reasonable and attributable to the contract.

25. Hedging Foreign Exchange Risk

- 25.1 Costs incurred for the purpose of hedging foreign exchange risk (including for example forward rate agreements, the cost of derivatives, pre-purchase of foreign currency) are unallowable as a contract direct or indirect cost, in accordance with the Australian Government foreign exchange risk management guidelines RMG 120 May 2021.
- 25.2 If the component of the total price payable in source currency is significant, the contract should be written in source currency in accordance with the Australian Government foreign exchange risk management guidelines RMG 120 May 2021. Where the component of the total contract price payable in source currency is 'not significant' (less than \$1 million AUD) the contract may be written in Australian dollars, and the contract may allow for adjustment in the price due to exchange rate fluctuations. For costs incurred in other currencies than Australian dollars, the invoice may be converted at the spot rate on the date that the payment is made however this must not lock in an exchange rate prior to payment becoming due or lock in a future rate.
- 25.3 Defence will work with the contractor to establish payment schedules under each contract to facilitate the formation of a natural hedge for foreign exchange risks, such that revenue received from Defence in a foreign currency is available in a timely manner to pay known commitments in the same foreign currency to subcontractors and suppliers.

26. Hire Purchase

- 26.1 Assets (plant, equipment, machinery) purchased under a financing arrangement (such as Chattel Mortgage, Hire Purchase, Finance Lease or Operating Lease) shall be allowable to the extent that the cost is allowable under Annexure C Sections 15 and / or 33).

27. Idle Capacity

- 27.1 Idle capacity means the unused capacity, both human and mechanical, and including land and buildings which occurs when, through causes other than usual shut-downs, the normal productive capacity of the contractor's plant is not fully utilised.
- 27.2 Idle capacity costs shall be allowable to the extent that:
- a. such costs come within the definition of an indirect cost pool, unless covered under 27.3; and
 - b. the period for which the idle capacity exists is reasonable having regard to the initiative taken by the contractor to reduce or eliminate it in accordance with sound business, economic or security practices, for example by:
 - i. subletting;
 - ii. renting;
 - iii. sale;
 - iv. redeployment of labour; or
 - v. standing down of labour, and
 - c. the capacity is necessary to meet fluctuations in workload, or if not, the capacity was necessary when acquired and is now idle because of changes in program requirements, contractor efforts to produce more economically, reorganisation, termination, or other causes which could not have been reasonably foreseen; and
 - d. An agreement has been made with Defence that the idle capacity is of a strategic nature to allow for the Commonwealth to draw on the idle capacity.
- 27.3 Where idle capacity relates to the Commonwealth's Surge requirements, it may be allowable as part of relevant contract pricing methods (such as Task Priced Services or Survey & Quote) and cannot be double-counted with any indirect cost pool recovery.
- 27.4 The contractor's accounting system or framework is to record idle capacity separately to enable the contractor to submit to Defence the necessary facts relating to the amount involved and reasons for the idle capacity, to enable a determination to be made.

27.5 The cost of maintaining unused land and buildings, or any other fixed assets are unallowable unless an Accounting Arrangement to the contrary has been established with Defence.

28. Incorporation or Amalgamation

28.1 Costs incurred for the purpose of incorporation or amalgamations of companies are unallowable as a contract direct or indirect cost.

28.2 Costs covered by Annexure C Paragraph 28.1 include incorporation fees and costs of solicitors, accountants, brokers, promoters and organisers, management consultants and investment counsellors, whether or not employees of the contractor.

29. Industrial Disputes

29.1 The cost, either direct or as a consequence of an industrial dispute is allowable to the extent that the costs are reasonable in accordance with the Cost Principles, however loss of profit as a result of industrial dispute is unallowable.

30. Insurance

30.1 Premiums, including statutory imposts incurred by the contractor in relation to risks usually insured against in the contractor's industry are allowable to the extent the costs are within the definition of contract cost, and include:

- a. the portion of the premium for the standing charges element of consequential loss insurance cover which relates to items of indirect expense allowable under the
- b. Cost Principles;
- c. reasonable cost for Directors Liability for the local entity only; and
- d. premiums (or the applicable portion, as appropriate) for insurance on the lives of named key executives, for the benefit of the contractor to the extent that the costs are reasonable and attributable in accordance with the Cost Principles.

30.2 The following premiums are unallowable as a contract cost (or the applicable portion, as appropriate) for insurance:

- a. against risks in respect of which the contractor does not effect insurance in the ordinary course of business (unless the conditions of contract provide otherwise or an Accounting Arrangement to the contrary has been established with Defence);
- b. against that element of "consequential loss" insurance which relates solely to loss of profit and protection of income (as distinct from standing charges insurance cover see Paragraph (a)); and
- c. against risks in respect of which the conditions of the contract provide that Defence accepts liability for loss or damages.

30.3 Premiums for insurance may be allowable to the extent the costs are within the definition of contract cost and are allowable under Annexure C Paragraph 30.1. when:

- a. paid to a related entity in accordance with Annexure C Section 47.; or
- b. allocated from a global policy on a reasonable basis as part of a global overhead allocation; or
- c. charged by the contractor for risk carried by the contractor (provided any loss is to be borne by the contractor).

30.4 The contract cost shall be credited with the applicable portion of any recovery under a consequential loss insurance policy, to the extent that the amount received relates to costs allowed under Paragraph 4.18 a) to f) of the Cost Principles.

31. Investment Allowances

- 31.1 Investment allowances or similar arrangements granted by the Australian Taxation Office are unallowable as a contract cost.

32. Joint Ventures or Alliance Arrangements

- 32.1 Joint Ventures or Alliance Arrangements are allowable costs and may include ongoing operational costs related to such arrangements and are acceptable to the extent that:
- the costs are considered reasonable; and
 - are directly attributable to the contract.
- 32.2 These arrangements must not submit a price proposal based on average rates. Each 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.
- 32.3 For non-competitive contracts, i.e. single supplier limited tender, intended to be awarded to a joint venture or alliance, special costs that may be attributed to such arrangement alone, such as legal, accounting and consulting fees in connection with the setting up of the joint venture, are unallowable contract direct or indirect costs.

33. Lease or Rental – Land, Buildings, Machinery, Plant or Equipment

- 33.1 The actual cost of lease(s) or rental(s) , if directly related to the contract activity, is / are an allowable contract direct cost.
- 33.2 For allowable lease(s) and rental(s) in accordance with Annexure C Paragraph 33.1, the allowable cost of the lease or rental of land, building, machinery, plant or equipment shall be limited to and not exceed the following:
- The depreciation expense (or portion thereof) of the 'Right of Use' asset in accordance with AASB 16 and AASB 116 using the Cost Model methodology. (Note: in accordance with AASB 16, the Right of Use asset shall be measured at the commencement date at the value of the lease liability less any lease incentives received, value of initial direct costs incurred, value of estimated costs of dismantling or to 'make good'); and
 - If the lease is under a sale and leaseback arrangement, the allowable cost shall be only up to the amount that would have been allowed if the contractor retained title, computed based on the net book value of the asset on the date the contractor became or becomes the lessee of the asset adjusted for any gain or loss.
- 33.3 If a lease is with a related entity of the contractor, then refer to Annexure C Section 47.
- 33.4 The depreciation cost of leases pooled in indirect costs must be attributable to the contract and not related to another contract and apportioned to the contract using an appropriate cost driver in accordance with Paragraph 4.14.
- 33.5 The actual cost of interest in an allowable lease (as per Annexure C Paragraph 33.2 or 33.4), is an allowable direct contract cost subject to the conditions contained in Annexure C Section 14.

34. Litigation

- 34.1 Litigation costs are unallowable.

35. Lobbying and Political Activity

- 35.1 Costs, either directly or indirectly, associated with lobbying or political activity are unallowable. Such costs include the following:
- cost of employee labour or third party labour employed specifically or principally to conduct such activity;
 - cost of gaining access to Ministers, including dinners and events; and

c. donations to political parties, political party related institutions and election costs.

35.2 The labour cost of employees, who in the normal course of business, meet with Government representatives or provide representation to Government are allowable contract direct or indirect costs.

36. Long Service Leave

36.1 Provisions made, or costs incurred, relating to long service leave are allowable to the extent that the costs are within the definition of a direct cost or an indirect cost pool, provided that:

- a. the method used by the contractor for accounting for long service leave is equitable, consistently applied and based on sound accounting practice; and
- b. is accrued at the minimum statutory amount in each State and Territory of Australia and is based on a historical average based on payroll records for the relevant business unit to determine the relevant probability factor of employees becoming entitled to Long Service Leave.

37. Losses on Business Activities

37.1 Losses incurred in business activities, either as a trading or investment activity are unallowable costs.

38. Manufacturing and Production Engineering

38.1 The costs of the following kinds of manufacturing and production engineering effort are allowable contract costs for contract related products, services and / or materials:

- a. developing and deploying new or improved materials, systems, processes, methods, equipment, tools and techniques that are or are expected to be used in producing products or services; and deploying pilot production lines;
- b. developing and deploying pilot production lines;
- c. improving current production functions, such as plant layout, production scheduling and control, methods and job analysis, equipment capabilities and capacities, inspection techniques, and tooling analysis (including tooling design and application improvements); and
- d. material and manufacturing production analysis for production suitability and to optimise manufacturing processes, methods and techniques.

38.2 This Principle does not cover:

- a. basic and applied research effort related to new technology, materials, systems, processes, methods, equipment, tools and techniques. Such technical effort is governed by R&D; and
- b. development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques that are intended for sale is also governed by R&D, refer to Annexure C Section 50.

38.3 Where manufacturing or production development costs are capitalised or required to be capitalised, allowable cost will be determined in accordance with the requirements of depreciation.

39. Organisation

39.1 Costs related to the following matters, which are not exhaustive, are unallowable:

- a. planning or executing the organisation or reorganisation of the corporate structure of a business, including mergers and acquisitions;
- b. resisting or planning to resist the reorganisation of the corporate structure of a business or a change in the controlling interest in the ownership of a business; and
- c. raising capital (net worth plus long-term liabilities).

39.2 Expenditure related to the above matters includes incorporation fees and costs of attorneys, accountants, brokers, promoters and organisers, management consultants and investment counsellors, whether or not employees of the contractor.

40. Other Business

40.1 Other business costs shall be allowable to the extent that the costs are considered a normal cost of conducting business operations.

40.2 Other business costs should be reasonable in both size and nature and must be equitably apportioned across relevant business activities or contracts, and may include:

- a. recurring expenses such as registry and transfer charges resulting from changes in ownership of securities issued by the contractor;
- b. cost of shareholders' meetings;
- c. costs of normal proxy solicitations;
- d. costs of preparation and publication of reports to shareholders or employees;
- e. costs of preparation and submission of required reports and forms to taxing and other regulatory bodies but excluding costs incurred in disputations concerning taxes;
- f. incidental costs of directors' and committee meetings; and
- g. cost similar to those covered by Paragraphs (a) to (f) of this Section above.

41. Patent and Royalty

41.1 Amounts claimed in respect of use of a contractor's own patents or patents owned fully or partially by a related company or individual that are part of the same tax consolidation group are unallowable contract costs. This does not apply to amortisation of research and development costs, which are allowable contract costs.

41.2 Patent and royalty costs include costs incurred by the contractor:

- a. in relation to investigating the state of the current trends, identifying current patents and making necessary application for use thereof;
- b. for royalties, fees or lump sum acquisition costs to acquire industrial property rights; and
- c. for legal, accounting and consulting services in connection with Paragraphs (a) and (b) of this Section.

41.3 Costs covered by Annexure C Section 50 shall be allowable to the extent the costs are within the definition of direct expense and provided that:

- a. Defence has no entitlement to use free of royalty or other charges; and
- b. except as otherwise agreed, lump sum acquisition costs shall be allowed into direct expense by way of amortisation using sound accounting principles.

41.4 A prospective contractor should seek an Accounting Arrangement with Defence before incurring costs, if there is any doubt concerning the allowability of the cost as a contract cost.

42. Professional and Trade Associations – Membership Fees

42.1 Corporate membership fees of industry or trade associations, which benefit and are reasonably necessary to the conduct of the contractor's business, shall be allowable as a contract cost.

42.2 Membership fees of clubs or associations of a non-business or social nature are unallowable as a contract cost.

42.3 The cost of a membership to a professional or trade association or the cost of trade periodicals shall be an allowable indirect contract cost as it is not expected that a membership to a professional or

trade association or the cost of trade periodicals would be incurred specifically for one contract unless preapproved under an Accounting Arrangement.

43. Property Not Used in Relation to Contract

- 43.1 Any rent, rates, taxes and depreciation charged in respect of land, buildings, plant, equipment or other property which is not used for or in relation to the subject matter of the contract and any expenses of protecting and maintaining such may be allowable to the extent the costs are within the definition of an indirect cost pool, provided that the amount is reasonable.

44. Rates of Pay in Excess of Certified Employees Agreement

- 44.1 Rates of pay, in excess of certified agreements, agreed by the contractor shall be allowable provided the costs are within the definition of contract cost and meet the following criteria:
- a. the contractor's approach to wage determination is acceptable to Defence and is consistent with the contractor's past practice;
 - b. the payments applied to Defence work;
 - c. the payment was reasonable in terms of:
 - i. other payments being made in the same geographic area for similar classifications of labour;
 - ii. the level of payment is necessary to attract and preserve the workforce or to retain the skill base necessary to the contractor's operations;
 - d. the need for the contractor to provide special or unusual skills for the purposes of the contract; and
 - e. there is a benefit to Defence.

45. Re-Arrangement of Facilities or Plant – Australian Defence Purposes

- 45.1 Where Defence has approved the re-arrangement of machinery and plant to facilitate the execution of a specific Defence contract and an Accounting Arrangement to this effect has been established with Defence, related costs shall be allowable to the extent the costs are within the definition of direct expense. Such costs include the costs of installing machinery and plant supplied at no charge by Defence for the purpose of the contract.
- 45.2 Re-arrangement and installation costs, which are not directly attributable to a specific contract, shall be allowable to the extent the costs are within the definition of an indirect cost pool. Rearrangement and installation costs for non-Australian Defence purposes are unallowable.
- 45.3 Costs incurred in re-arranging the contractor's machinery and plant to the same condition existing immediately prior to an approved re-arrangement (as in Annexure C Paragraph 45.1 above) are unallowable as a contract cost unless an Accounting Arrangement to the contrary has been established with Defence.
- 45.4 In circumstances other than those described in Annexure C Paragraphs 45.1 to 45.2, the costs of installing machinery and plant shall be allowable as a depreciable charge to the extent the costs are within the definition of an indirect cost pool.

46. Redundancy

- 46.1 Redundancy costs will be unallowable as a direct cost in a Defence contract unless specifically agreed, for example at completion of projects in remote geographical locations, and is provided for in the contract. In such cases the scope and quantum of the redundancy payment shall be consistent with the relevant clauses in the Conditions of Contract and the payment should only relate to the period of service of the recipient against the contract.
- 46.2 Redundancy costs are only allowable into an indirect cost pool such as company General & Administrative (G&A) or overheads, to the extent they are part of an approved plan for the purpose of obtaining ongoing cost reductions for the organisation as a result of restructuring an inefficient

workforce and / or work practice. Provisions for redundancy shall not be included in labour cost recovery rates.

- 46.3 Where the Commonwealth allows for redundancy costs as a direct contract cost it is not permissible to claim any element of the cost, such as the balance of the costs not recovered directly, as an indirect cost.
- 46.4 Allowability of payments made to employees under a Certified Agreement on severance or termination of employment shall be determined in accordance with Annexure C Section 11.1 (Conditions of Employment (Other than Rates of Pay) of the Cost Principles. Redundancy payments made to non-certified agreement employees should not be excessive or unreasonable. In considering the reasonableness of redundancy payments they will be benchmarked against the Fair Work Australia / National Employment Standards employee entitlements.
- 46.5 Defence is not liable for redundancies costs that could be avoided or reduced by the effective management of the workforce.
- 46.6 Defence is not liable for redundancy payments made to employees in respect of time spent by the employee working on non-Defence contracts.
- 46.7 Redundancy costs will only be allowable where the claim is reasonable, does not over-recover actual redundancy costs paid, and is in accordance with the Cost Principles.

47. Related Party

- 47.1 A related party shall be defined in accordance with AASB 124 and / or other entities included within the contractor's tax consolidation group.
- 47.2 The contract price payable to the contractor for goods or services which are provided by a related party must not exceed a reasonable contract price which would be payable to the contractor if the contractor were to acquire those goods or services under an arms-length transaction with a non-related company, and in compliance with Annexure C Section 62. Reasonable contract price shall be determined by reference to the definition of "reasonableness" in this Cost Principles document Paragraphs 3.7 to 3.11. See below for some additional guidance relating to goods or services provided by a related party:
- a. Where an active market exists, then the allowable cost shall be limited to the lesser of the amount paid to the related party or the amount which would have been paid to an unrelated party for which an active market exists.
 - b. Where no active market exists, then the allowable cost shall be limited to the lesser of the amount paid to the related party or the amount which:
 - i. For goods - the actual cost of production in accordance with these Cost Principles as if the related party was the contractor.
 - ii. For the acquisition of property - the lesser of market value or written down value.
 - iii. For services - the actual cost of services in accordance with these Cost Principles as if the related party was the contractor.
 - iv. For leases or rental of plant, buildings, land and other assets - the depreciation cost of the underlying asset.
 - v. For transfers of R&D - the cost of R&D in accordance with these Cost Principles as if the related party was the contractor.
 - vi. For licences - the allowable cost of licences in accordance with these Cost Principles as if the related party was the contractor.
 - vii. For other liabilities - no allowable contract cost unless expressly allowed for in the Cost Principles as if the related party was the contractor.
- 47.3 Any payment to, a related company to, the extent that such exceeds an amount which is reasonable is unallowable as a contract cost.
- 47.4 Where a contractor pays a related company for the use of machinery, plant or equipment, the amount allowable as a contract cost may be equivalent to depreciation which the owner would be allowed for

income tax purposes as provided in Annexure C Section 15 of the Cost Principles, provided the cost is within the definition of contract cost.

- 47.5 Where a contractor pays a related company for the use of land or buildings the amount allowable as a contract cost may be equivalent to the amount allowable under Annexure C Section 15 of the Cost Principles as if the contractor owned or leased the land or buildings .
- 47.6 Where charges made by a related company are proposed as direct cost, the related company shall be deemed to be a sub-contractor and Annexure C Paragraph 54.2 shall apply in addition to Annexure C Paragraphs 47.1 to 47.5.

48. Remuneration of Chief Executive Officer, Directors and Non-Certified Agreement Employees

- 48.1 Subject to Annexure C Paragraph 48.2 remuneration of the CEO, directors and non-certified agreement employees, may be allowable to the extent the costs are within the definition of contract cost provided the contractor's approach to the fixing of the remuneration of such personnel is reasonable and is consistent, having regard to:
- a. the size and character of the contractor's business;
 - b. the nature of the services rendered by the personnel; and
 - c. the remuneration usually paid for such services in businesses of a similar nature and risk profile.
- 48.2 Allowability of severance payments made to the CEO, directors and non-certified agreement employees, shall be determined in accordance with Annexure C Paragraph 58.2.
- 48.3 The cost of long term share-based incentive schemes as part of Executive Employees and Non-Executive Directors and Non-Certified Agreement Employees are an unallowable cost.

49. Repairs, Operation and Maintenance

- 49.1 The costs of repairs, operation and maintenance include those costs that have been incurred by the contractor's central service organisation or at the departmental level for the administration, supervision, operation, maintenance, preservation and protection of the contractor's physical plant. Repairs, operation and maintenance costs may include costs normally incurred for items such as janitorial and utility services; repairs and ordinary or normal alterations of buildings, furniture and equipment; and care of grounds and maintenance and operation of buildings and other plant and facilities. The repairs, operation and maintenance category may also include on-costs applicable to the salaries and wages included therein, and depreciation.
- 49.2 Incurred costs relating to repairs, operation and maintenance, or reasonable provisions for the costs, may be allowable to the extent the costs are within the definition of contract cost. Where provisions are allowed, actual costs are unallowable as a contract cost so as to avoid double counting of those costs.

50. Research and Development (R&D)

- 50.1 R&D costs for the purposes of the Cost Principles are categorised as:
- a. specific – that is, associated with the development of a specific product or products; or
 - b. fundamental and general – that is, of a general nature which cannot be related to any specific product but have general application and benefit various types of work including that subject to the Cost Principles.
- 50.2 Specific R & D costs should, wherever possible, be allocated or charged direct to the cost of the products concerned for specific contracts and included as a contract direct cost and not to be included in indirect costs.
- 50.3 Fundamental and general research and development costs may be allowable into an indirect cost pool, provided the amount and method of allocated cost is reasonable and attributable to the contract:
- a. to the extent it is not sponsored by a contract, grant or like arrangement;
 - b. is net of any realised eligible tax offset or R&D deduction; and

- c. is accepted by Defence as being of potential benefit to Defence.

51. Security

- 51.1 Security costs, subject to Annexure C Paragraph 51.2, may be allowable to the extent the costs are within the definition of an indirect cost pool. These costs may include: wages, uniforms and equipment of personnel engaged in security of premises, plant or equipment; and
- a. wages, uniforms and equipment for the security of premises, plant or equipment;
 - b. depreciation of the equipment for the security of premises, plant or equipment; and
 - c. costs incurred relating to security clearances and maintaining accreditation with Defence Industry Security Program requirements.
- 51.2 Security costs incurred in excess of the contractor's normal level of security, may be allowable to the extent the costs are within the definition of:
- a. direct expense, when the contract necessitated or stipulated the additional security; or
 - b. an indirect cost pool allocable only to the final cost objectives which necessitated the additional security, when more than one final cost objective is involved.

52. Selling and Promotional

- 52.1 Selling and promotional costs which are common to the marketing of the contractor's products to Defence and to other commercial customers, may be allowable to the extent the costs are within the definition of contract cost (in accordance with Annexure C Section 1), and are of the nature of:
- a. providing technical data and specifications;
 - b. disseminating printed matter containing instructions for operating and maintaining the contractor's products; and
 - c. liaison between customer representatives and the contractor's personnel; and
 - d. other similar activities.
- 52.2 Selling and promotional costs other than the sort of costs covered by Annexure C Paragraphs 52.1 and 52.3 are unallowable as a contract cost, and include:
- a. entertainment expenses, i.e. expenses for amusement, diversion, social activities and incidentals; and
 - b. unreasonable commissions to selling agents or related parties.
- 52.3 Expenses associated with meetings and industry conferences, when called for the dissemination of technical information or discussion of production problems and the like, may be allowable as a meeting cost in accordance with Annexure C Paragraphs 19.2 and 19.3. The latter expenses may include the cost of meals, transportation, rental of meeting places and other incidentals provided the costs are reasonable and attributable to the contract.

53. Service and Warranty

- 53.1 Service and warranty costs include those costs arising from fulfilment of any contractual obligation of a contractor to provide services such as:
- a. installation;
 - b. training;
 - c. correcting defects in the products;
 - d. replacing defective parts; and

e. making refunds in cases of inadequate performance.

53.2 Costs described in Annexure C Paragraph 53.1 or provisions for the costs, may be allowable to the extent the costs are within the definition of contract cost unless the costs are inconsistent with the conditions of the contract or Paragraphs 4.20 to 4.22 of the Cost Principles (Avoidable Costs and Unnecessary Costs).

54. Sub-Contracts

54.1 Sub-contract costs are allowable, subject to any relevant special conditions of contract.

54.2 Where the sub-contractor is paid on the basis of a cost-reimbursable contract, including Target Cost Incentive Model (TCIM) contract based on a cost-reimbursable arrangement, the contractor is to take reasonable steps to ensure that any agreement between the contractor and the sub-contractor specifies that:

- a. the cost basis of such payment shall include only those amounts which may be allowable under all relevant provisions of the Cost Principles;
- b. the sub-contractor will, on request, furnish to Defence cost statements; and
- c. Defence shall be given right of access to the sub-contractor's records for the purpose of verifying any claim. Defence shall not be entitled to exercise its rights under this paragraph without prior notification to the contractor.

54.3 Where a holding, subsidiary or related company is a sub-contractor, Annexure C Paragraph 47.2 shall apply in addition to Annexure C Paragraphs 54.1 and 54.2.

54.4 To the extent appropriate, the Cost Principles will serve as guidance in the compilation and evaluation of cost estimates forming the basis of Sub-contracts where market competition does not occur.

55. Superannuation Fund Payments

55.1 Contributions to superannuation funds shall be allowable to the extent the costs are within the definition of an indirect cost pool and provided that:

- a. payments to the fund are allowable deductions for taxation purposes;
- b. company contributions to superannuation funds of employees are an allowable cost if the payments do not exceed the statutory entitlements. The only exception is where a higher percentage is consistent with past practice and contractor policy and only if agreed by Defence; and
- c. the amount when added to the other remuneration of the recipient results in a reasonable total remuneration.

56. Taxes

56.1 Taxes, however described, which are assessed on income or profits, and any costs incurred in controversies concerning these taxes are unallowable as a contract cost.

56.2 Fringe Benefits Taxes are allowable costs only in accordance with these Cost Principles, provide the taxed activity:

- a. is an Allowable cost; and
- b. is incurred specifically for the contract; or
- c. benefits the contract, and is otherwise related to costs that are within the definition of an indirect cost pool.

57. Tendering

- 57.1 Tendering costs are the costs incurred in preparing, submitting or supporting formal tenders, quotations, offers, registrations of interest or other approaches to the market in relation to potential Government or non-Government contracts.
- 57.2 Tendering cost will be unallowable as a direct cost in a Defence contract unless specifically provided for in the contract or in the request for tender and shall be consistent with the relevant clauses in the Conditions of Contract or Conditions of Tender.
- 57.3 Tendering costs maybe allowable as a direct cost to the extent that:
- the costs directly relates to the tender/contract;
 - the contractor consistently applies sound practices when accounting for tendering costs; and
 - the costs are reasonable and attributable to the contract.
- 57.4 Tendering costs maybe allowable as a indirect cost to the extent that:
- the costs come within the definition of an indirect cost pool;
 - the contractor consistently applies sound practices when accounting for tendering costs;
 - costs are reasonable and attributable to the contract;
 - Defence does not incur an unreasonable amount of non Defence tendering costs; and
 - where Defence accepts tendering costs into direct costs, costs of a like nature are unallowable as an indirect cost.

58. Termination of Employment

- 58.1 Allowability of payments made to certified agreement employees on severance or termination of employment shall be determined in accordance with Annexure C Section 11 (Conditions of Employment (Other than Rates of Pay)) of the Cost Principles.
- 58.2 Where payment are made to an employee or contractor engaged under a fixed term agreement, then any termination / severance payment shall be allowable to the extent that:
- such payments are within the definition of contract cost;
 - the remuneration of such employees is allowable under Annexure C Paragraph 48.1;
 - the payments are not in excess of the conditions of entitlement which would be allowable under the provisions of Annexure C Section 11;
 - the circumstances of the severance of employment are allowable under the provisions of Annexure C Section 11;
 - the payment is the minimum amount payable under the agreement with the employee or contractor;
 - the payment only relates to the period of service of the recipient against the contract; and
 - the payment is not for redundancy which is covered by Annexure C Section 46.

59. Termination or Cancellation of Contracts

- 59.1 These Cost Principles apply to a contract that is terminated for convenience or by agreement.
- 59.2 The contractor may submit a claim for compensation and Defence shall pay to the contractor such sums as are fair and reasonable in respect of the termination or cancellation. All claims or provision for payment need to be substantiated to the satisfaction of Defence, noting that:

- a. the contractor is not entitled to claim compensation in respect of any work done or expenditure made contrary to the provisions of the contract;
- b. the contractor is not entitled to claim for loss of anticipated profits;
- c. Defence is not liable to pay any sum which, in addition to any sums paid or due or becoming due to the contractor under the contract, would together exceed the full price of the complete work ordinarily payable under the contract by Defence;
- d. initial or advance payments made by Defence are to be offset against the total amount payable in respect to the terminated contract by Defence; and
- e. the contractor is entitled to payments for work undertaken under the contract prior to the effective date of the termination and any other costs incurred that are directly attributable to the termination.

60. Trade Exhibitions

- 60.1 Trade exhibition costs include the reasonable cost of attendance at relevant international trade shows and are allowable as an indirect cost, providing the reassignment of a share of cost from an indirect cost pool results in equitable distribution of this indirect cost item.

61. Training and Education

- 61.1 Training and education costs include the reasonable costs, which are related to the field in which the employee is working or may reasonably be expected to work, and are allowable.
- 61.2 Training or education costs for non bona fide employees (e.g. SMEs, Defence employees) are allowable if undertaken in conjunction with an existing employee-training program.
- 61.3 The inclusion of overseas education, as either a direct or an indirect cost, is allowable where reasonable and justifiable by the contractor.

62. Transfer Pricing or Inter-Entity Pricing

- 62.1 Transfer or Inter-entity pricing must meet the requirements of relevant Commonwealth Income Tax Legislation and Regulations regarding Transfer Pricing at Arm's Length. All documentation held by the company to meet the legislative requirements must be made available to Defence for review should this be requested.
- 62.2 The costs associated with defending a claim or litigation against the ATO is unallowable either as a direct or indirect contract cost.

63. Travel

- 63.1 Allowable travel contract costs specifically exclude the cost of spouse/partner and other parties travel costs and travel and living costs of a private nature. Travel and living costs related to travel within Australia, which are incurred by a contractor in the ordinary course of business, shall be allowable to the extent they come within the definition of an indirect cost pool.
- 63.2 Travelling and living costs necessarily incurred in the performance of the contract shall be allowable to the extent they come within the definition of direct contract cost, unless the conditions of the contract provide otherwise. The following should apply for different travel and living costs:
- a. For food – the costs shall not exceed the reasonable travel amounts published by the Australian Taxation Office (Note: for example in the 2021-22 income tax year, the relevant publication was TD 2021/6), and may include alcohol with a meal;
 - b. For accommodation – the costs should have regard to the reasonable travel amounts published by the Australian Taxation Office (Note: for example in the 2021-22 income tax year, the relevant publication was TD 2021/6); or
 - c. For air travel – commercial airlines should be used and shall not exceed economy class.

- 63.3 Where travelling and living costs shall be allowable into direct expense of the contract, costs of a similar nature, which are direct expense items applicable to other final cost objectives, shall not be allowable into indirect expense.
- 63.4 Travelling costs (including any Fringe Benefit Tax payable) shall not be an allowable contract cost if Fringe Benefit Tax was payable on the travelling cost.

64. Travelling or Living – Overseas

- 64.1 Overseas travel and living costs of a private nature are unallowable into contract cost. Travel costs specifically exclude the cost of spouse/partner travel costs, except where travel is a result of family relocation due to work requirements or family reunion.
- 64.2 Defence reserves the right to disallow travelling and living costs or part thereof related to travel overseas that are not covered by:
- a contract requirement or, if there is a requirement, not in support of the contract requirement; or
 - an Accounting Arrangement, which, if established with Defence, may relate to a specific journey or may be of general application to overseas travel.
- 64.3 Where travel is related to the contract, the cost allowable shall be included in direct expense to the extent, if applicable, of the amount specified in the contract or the Accounting Arrangement for each particular instance of travel. For food and accommodation – the costs shall not exceed the reasonable travel amounts published by the Australian Taxation Office (Note: for example in the 2021-22 income tax year, the relevant publication was TD 2021/6), and may include alcohol with a meal. For air travel – commercial airlines should be used and shall not exceed business class.
- 64.4 In cost reimbursement contracts, the contractor shall make a submission for approval by Defence detailing:
- the purpose of the journey;
 - the benefit to accrue to Defence from the travel;
 - the information and reports which shall be made available to as a consequence of the travel;
 - an estimate of travel, living and associated costs;
 - an estimate of any amount received or receivable in respect to the overseas travel, for example, a grant; and
 - the proposed basis/bases for allocating the costs.

65. Work Health and Safety

- 65.1 Work Health and Safety (WH&S) costs are the costs incurred by an entity to meet the requirements of the Work Health and Safety Act 2011 (Cth) (WH&S Act), and other applicable Federal, State, Territory, or Local Government WH&S legislation.
- 65.2 Allowable WH&S costs are generally those costs that are incurred for planned known WH&S legislative compliance activities. Costs may include operational or amortised capital items. The following types of WH&S costs may be allowable as a contract cost:
- known WH&S legislative compliance costs; and
 - emerging legislative compliance requirement costs.
- 65.3 Unallowable WH&S and compliance costs includes items such as WH&S rework, fines, penalties and related rectification costs of non-compliances. For example WH&S rectification costs resulting from accidents or defective work are unallowable.

Annexure D

Definitions

For the purposes of the Cost Principles, **unless** the contrary intention appears, the definitions set out in this Annexure D apply.

Term	Definition
Accounting Arrangement	means an agreed approach to the application of the Cost Principles as outlined in writing and approved by Commercial and Financial Analysis (CFA). This may be achieved by an exchange of letters as directed by CFA.
allocate	means to assign an item of cost or part thereof to contract cost, and includes both direct assignment of cost and the reassignment of a share of cost from an indirect cost pool. "allocated" or "allocating" have a corresponding meaning.
allow (allowed or allowable)	means that the cost may be allocated in accordance with the Cost Principles to the contract cost. "allowed" or "allowable" have a corresponding meaning.
company	includes an individual, trust, a partner, or a corporate entity.
contract cost	means the sum of all or any of the following allowable costs: <ul style="list-style-type: none"> a. direct cost; b. indirect-expense; and c. appropriate credits as hereinafter defined or as otherwise explained.
contract price	means the sum of the allowable cost plus profit.
cost objective	means a functional or organisational subdivision or work unit for which provision is made to accumulate costs. Producing, operating, processing departments or cost centres are examples of cost objectives.
direct cost	means the sum of: <ul style="list-style-type: none"> a. direct expense; b. direct labour cost; c. direct material cost; and d. direct sub-contract cost.
direct expense	means any incurred cost that: <ul style="list-style-type: none"> a. relates to and is economically traceable to the contract; b. can be charged directly to the contract in accordance with sound accounting principles, appropriate for the purposes of the contract, consistently applied; c. is allowable in accordance with the Cost Principles; and d. is reasonable;

Term	Definition
	other than direct material cost, direct labour cost and direct subcontract cost.
direct labour cost	<p>means a cost that is:</p> <ul style="list-style-type: none"> a. incurred on wages and salaries paid by the contractor for labour performed on and directly applicable to the product, process or service to be supplied under the contract; b. allowable in accordance with the Cost Principles; and c. reasonable.
direct material cost	<p>means a cost incurred by the contractor on materials and fabricated parts that are incorporated in the end product or service, (but not including those materials and parts received from sub-contractors) provided such cost:</p> <ul style="list-style-type: none"> a. relates to and is economically traceable to the contract; b. can be charged directly to the contract in accordance with sound accounting principles, appropriate for the purposes of the contract, consistently applied; and c. is reasonable.
direct sub-contract cost	<p>means a cost incurred by the contractor under a contract with a supplier for the supply, in accordance with design and specifications supplied by the contractor or Defence, of goods or services, and which cost:</p> <ul style="list-style-type: none"> a. relates to and is economically traceable to the contract; b. can be charged directly to the contract in accordance with sound accounting principles, appropriate for the purposes of the contract, consistently applied; c. is allowable in accordance with the Cost Principles; and d. is reasonable.
final cost objective	<p>means a cost objective to which are allocated both direct and indirect costs and which, in the contractor's cost accumulation system, is a final accumulation point. Products, contracts, capitalised projects and Defence cost reimbursement contracts are examples of final cost objectives.</p>
incur	<p>means</p> <ul style="list-style-type: none"> a. in relation to a direct cost or indirect expense, to expend funds to reduce a financial obligation; and b. in all other cases, to accept a legal liability to reduce a financial obligation at some time in the future. <p>"incurred" has a corresponding meaning.</p>

Term	Definition
indirect cost pool	means a group of indirect expenses incurred by the contractor which: <ol style="list-style-type: none"> a. can be logically aggregated, and b. can be allocated to cost objectives, or where appropriate, to another indirect cost pool, on an equitable basis in accordance with sound accounting principles, appropriate for the purposes of the contract, consistently applied.
indirect expense	means any incurred cost which: <ol style="list-style-type: none"> a. can be charged to the contract in accordance with sound accounting principles, appropriate for the purposes of the contract, consistently applied; b. is not chargeable as direct cost to any final cost objective; c. is allowable in accordance with the Cost Principles; and d. is reasonable.
military off the shelf	Systems, hardware or software that already exists and have been developed and produced to military standards and specifications, are in service with one or more other customers for an equivalent purpose and requires no, or minimal change.
related company	means a company that is connected with or owned by another, company.
secondary products	means goods or services produced by an industry other than the primary product of that industry, including any second grade product, material wasted, scrapped, spoiled or otherwise discarded or left over in the process of manufacture.
small to medium enterprise (SME)	a small to medium enterprise is an Australian or New Zealand firm with fewer than 200 full time equivalent employees.
surge	means a short to medium term change in the rate of effort as per the respective definition within a contract.
total cost incurred	means total costs of operation during the period, of the specific unit of the contractor's business to which Defence's interest is confined, including general and administrative expenses but excluding exceptions specified at Annexure C.
unallowable	means that the cost may not be allocated in accordance with the Cost Principles to the contract cost.