

Expressly Unallowable Costs

Written by Nick Sanders

Wednesday, 28 January 2015 00:00

The Cost Principle at FAR 31.201-6, Accounting for Unallowable Costs, requires that “Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract.” The FAR contract clause 52.242-3 (“Penalties for Unallowable Costs,” May 2014) states that—

If the Contracting Officer determines that a cost submitted by the Contractor in its proposal [to establish final billing rates] is expressly unallowable under a cost principle in the FAR, or an executive agency supplement to the FAR, that defines the allowability of specific selected costs, the Contractor shall be assessed a penalty equal to—

(1) The amount of the disallowed cost allocated to this contract; plus

(2) Simple interest, to be computed—

(i) On the amount the Contractor was paid (whether as a progress or billing payment) in excess of the amount to which the Contractor was entitled; and

(ii) Using the applicable rate effective for each six-month interval prescribed by the Secretary of the Treasury pursuant to Pub.L.92-41 (85 Stat. 97).

If the Contracting Officer determines that a cost submitted by the Contractor in its proposal includes a cost previously determined to be unallowable for that Contractor, then the Contractor will be assessed a penalty in an amount equal to two times the amount of the disallowed cost allocated to this contract.

Thus, it is important for contractors to “scrub” their proposals to establish final billing rates (also known as “incurred cost proposals”) to ensure that they are not claiming expressly unallowable costs. They are required to certify that they have excluded such costs and, if the Contracting Officer determines that the proposal contained expressly unallowable costs despite

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that certification, then penalties and interest may be imposed.

The problem is that what costs constitute “expressly unallowable costs” has not been clearly defined in the FAR. CAS 405 has a definition of what types of costs are “expressly unallowable” but does not otherwise list those costs. The Standard states that an expressly unallowable cost is a “particular item or type of cost which, under the express provision of an applicable law, regulation, or contract, is specifically named and stated to be unallowable.”

This is an important concept because the value of the penalty and interest assessed may well exceed the value of the disputed cost itself. As Karen Manos [wrote](#) in her September 2013 article, “not all unallowable costs are expressly unallowable, not all expressly unallowable costs are subject to penalties, and even when the disallowed cost is subject to penalties, a waiver may be required.”

Ms. Manos wrote, “Expressly unallowable costs are a relatively small subset of unallowable costs.” Though she listed conditions that would create an expressly unallowable cost, she did not provide a definitive list of such costs. Nor can any such list be found in FAR or CAS. So what is a Contracting Officer to do? In her article, Ms. Manos takes both DCAA and DCMA to task for an “overbroad interpretation of expressly unallowable costs,” and for imposing penalties and interest when not warranted, and for refusing to grant waivers from penalties and interest when required. Yet guidance in this area has been singularly lacking.

So if not all unallowable costs are expressly unallowable, how can the parties easily distinguish between the two types?

In mid-December, 2014, DCAA attempted to remedy the lack of clear guidance by issuing [MR D 14-PAC-021](#), “Audit Alert Distributing a Listing of Cost Principles That Identify Expressly Unallowable Costs.” The audit guidance is admittedly not comprehensive, but it’s a good step in the right direction. It consists of 103 individual costs that, in DCAA’s view, are expressly unallowable. In addition, there are seven additional DFARS costs that should be similarly treated by auditors.

Importantly, nowhere on the list do we see that a cost questioned as being unreasonable in amount is expressly unallowable.

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We express no opinion regarding whether we agree with DCAA's list, but we do applaud the agency for tightening the audit guidance in this area of frequent dispute.