

Good DCAA Audit Guidance or Bad DCAA Audit Guidance?

Written by Nick Sanders
Monday, 02 March 2015 00:00



Recently DCAA issued two pieces of guidance to its auditors aimed at assisting them in distinguishing between “expressly” unallowable costs and the normal, run-of-the-mill, unallowable costs. It matters and there are financial implications involved. As we noted in our [first article](#) (on the first piece of audit guidance)—

... 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 that certification, then penalties and interest may be imposed.

In the first piece of DCAA audit guidance, DCAA issued a list of 103 individual costs it asserted were expressly unallowable pursuant to the FAR Part 31 Cost Principles, plus another seven costs it asserted were expressly unallowable pursuant to the DFARS Supplementary Cost Principles.

We unequivocally stated in that first article that we expressed no opinion as to whether we agreed with DCAA’s position on the nature of the listed costs. However, we did note that we thought it was a step in the right direction. In particular we applauded the clear DCAA position that costs asserted to be unreasonable in accordance with FAR 31.201-3 (“Determining Reasonableness”) could not be expressly unallowable. That was a good thing, in our view.

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With respect to the second piece of audit guidance, we wrote (in the [subsequent article](#)) that there were a number of positive aspects and we generally liked it a lot. Among the positive aspects, we noted the following statements with approval—

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In order for a cost to be expressly unallowable, the Government must show that it was unreasonable under all the circumstances for a person in the contractor's position to conclude that the costs were allowable.

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The standard for whether a cost is expressly unallowable is objective and the Government bears the burden of proof in assessing a penalty.

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The Government should not assess a penalty where there are reasonable differences of opinion about the allowability of costs and that the Government must show that it was 'unreasonable under all the circumstances for a person in the contractor's position to conclude that the costs were allowable.' In situations where it is not directly stated in a cost principle, in order for a cost or type of cost to be expressly unallowable, the cost principle must identify it clearly enough that there is little room for difference of opinion as to whether a particular cost meets the criteria.

But while we were busy congratulating DCAA on a couple of pieces of audit guidance that we thought would be helpful and which we expected would reduce disputes between government and contractor, the respected and knowledgeable government contract attorneys at the firm of Crowell & Moring didn't quite see it the way we did. They [published](#) a client alert expressing the opinion that the DCAA audit guidance was "troubling" and "will likely lead to confusion in the audit process and undoubtedly result in DCAA auditors assessing more penalties against contractors on dubious grounds."

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The crux of the attorneys' concerns seems to be that DCAA is misinterpreting the CAS 405 definition of "expressly unallowable cost" (which we quoted in our first article, [link above](#)). If we can paraphrase the learned practitioners at Crowell & Moring, their beef is that CAS 405 says that an "expressly unallowable cost" is just that – a cost that is *expressly named* in the regulations as being unallowable. In contrast, DCAA's audit guidance says "In order for a cost to be expressly unallowable, the Government must show that it was unreasonable under all the circumstances for a person in the contractor's position to conclude that the costs were allowable."

That's an interesting nuance and we agree that DCAA's definition expands the CAS 405 definition. Continuing that thought a bit, it's certainly not the first time that DCAA and the FAR Councils have reinterpreted the CAS regulations to their advantage. (Anybody else remember the rewrite of FAR 30.6?) We have opined on more than one occasion that interpretation of the CAS regulations is, by statute, reserved exclusively for the CAS Board. So in that light, DCAA's interpretation is an unlawful action because the audit agency is interpreting CAS 405 when it lacks the statutory authority to do so.

The line of thought expressed above does not address the authority to interpret FAR 31.201-6 ("Accounting for Unallowable Costs"). That Cost Principle discusses expressly unallowable costs—though it carefully does not define them. It seems to us that it would be tough to argue that the FAR Councils and/or DCAA lack authority to interpret FAR 31.201-6. However, should their interpretation conflict with the CAS definition, then of course the CAS definition would control.

In sum, while we thought the two pieces of DCAA audit guidance were good things that would tend to reduce disputes over what is and what is not an expressly unallowable cost, the attorneys at Crowell & Moring thought they were fatally flawed and would tend to lead to more disputes.

Only time will tell which outcome will come to pass.