Written by Nick Sanders Wednesday, 04 February 2015 00:00



We love it when DCAA issues audit guidance that clarifies a tricky subject and eliminates a potential dispute. MRD 14-PAC-022 ("Audit Alert on Identifying Expressly Unallowable Costs") is another piece of guidance that should help the parties navigate the murky waters of unallowable costs and penalties thereon.

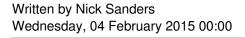
As we discussed in <u>our article</u> on the previous DCAA MRD that dealt with this topic, distinguishing between relatively benign unallowable costs and their evil cousins, expressly unallowable costs, is something contractors want to get right, because most cost-type prime contracts with the Department of Defense contain a "penalty clause" that allows the Contracting Officer to assess penalties (and perhaps interest) if any expressly unallowable costs are inadvertently included in the annual proposal to establish final billing rates. And there are other rules connected to expressly unallowable costs, such as potential waivers of said penalties and interest. So it behooves us all to understand what causes a cost to be expressly unallowable.

First and foremost, we want the auditors to get this right. We don't want them mistakenly recommending penalties and interest on costs that should not be subject to the rules of the penalty clause. Thus, this MRD and its precursor piece of audit guidance are good things and, generally, going to lead to easier negotiations and fewer disputes.

This MRD had some really helpful guidance. For example, it said—

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

DCAA Continues to Issue [GOOD] Audit Guidance on Expressly Unallowable Costs



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.' [Ed. Note: Quoting the ASBCA.] 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.

As with the previous MRD, this MRD clearly states that costs questioned as being unreasonable in amount are not expressly unallowable costs. Similarly, it states that costs questioned as being unallocable are not expressly unallowable. In addition, the guidance notes that penalties can only be assessed against expressly unallowable indirect costs, and thus costs that are questioned as being noncompliant with contract terms can never be expressly unallowable costs, because they must (by definition) always be direct costs.

The foregoing is going to be helpful to those contractors negotiating with their cognizant Federal agency officials. If you've had a DCAA audit report addressing your final billing rate proposal (aka "incurred cost proposal") in the past couple of years, there's a good chance certain costs have been identified as being expressly unallowable, and penalties (and perhaps interest) have been recommended. If that's the case, you will find immediate value in highlighting certain parts of this MRD (and its predecessor), and showing those parts to your CFAO.

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Certain commenters – including us! – have <u>all but accused</u> DCAA of generating questioned costs of a dubious nature in order to create a perception that the agency was saving taxpayers money when, in fact, little if any of the questioned costs had merit or were being sustained by Contracting Officers. Issuing audit guidance such as this MRD goes a long way to dispelling such suspicions. This kind of audit guidance not only helps DCAA auditors do their jobs better, but it also defuses antagonism between the contractor and auditor. It helps to make the audit process just a little bit less adversarial.

And we daresay such audit guidance increases the confidence that Contracting Officers have in the audit reports they receive from DCAA. Since any costs questioned as being expressly unallowable will be grounded in this guidance, it will be seen as being more objective. Negotiations will be more straightforward and perhaps go more smoothly.

These are all good things, and they stem from this type of audit guidance.