Many (most?) government contractors know that the Federal government has rules regarding the types of costs it will pay for. The “Part 31 Cost Principles” are a fundamental part of government contract compliance, and people who don’t know much about government contracting at least know that the rules exist, even if they don’t know where to find them in the FAR. People commonly think those rules only apply to cost-type contracts (aka “cost reimbursement” type), so they tend not to worry about them unless they are bidding or performing on such contracts. People who have Time-and-Materials (“T&M”) contracts probably know that the rules apply to costs billed under the “M” part of the T&M equation, but that’s rarely the predominant part of the invoice being billed, so compliance typically is not considered to be a big deal. But those rules can also apply to cost proposals submitted for firm fixed-priced contract types. (See FAR 31.102, which states “The applicable subparts of Part 31 shall be used in the pricing of fixed-price contracts, subcontracts, and modifications to contracts and subcontracts whenever (a) cost analysis is performed, or (b) a fixed-price contract clause requires the determination or negotiation of costs.”)

Thus, unless you are doing sealed bids or competitive FFP contracts 100% of the time, you will probably be dealing at some point with the FAR Part 31 Cost Principles and trying to figure out how to properly identify and segregate the **various flavors** of unallowable costs. It would be nice to be prepared to do that but, alas, too many companies simply gloss over that aspect of contract compliance. As we’ve noted **before**, the compliance risk assessment tends to be skewed because contractors tend to not appreciate or understand the true risks they are facing.

There are plenty of consultants—including some ex-DCAA auditors who have retired and set up consultancies—available to assist small contractors with the subject. There are Procurement Technical Assistance Centers— **PTACs** —who will do the same thing, for free (donations are always appreciated). Larger contractors hire the best experts they can find, either as employees or as consultants (or both), because the larger the contractor the larger the impact of a sustained questioned costs (aka “cost disallowances”). There are lawyers in law firms, big and small, expensive and *really expensive*, who can provide assistance. (We here at Apogee Consulting, Inc. think we know a thing or two about the topic, but this is not the place to tout our expertise.) You can even buy expensive books on the subject, some written by the top government contracts attorneys or top-notch practitioners, each author with impeccable pedigrees. There are lots of resources available, depending on the depth of one’s pocketbook and the appetite for compliance.

The point is that there is little, if any, excuse for not complying with at least the fundamental aspects of the FAR Part 31 Cost Principles when they are applicable to your company or to your contract.

That being said, some of the nuances are tricky and it is—quite frankly—difficult to know everything about everything in the Cost Principles. To learn the nuances requires a lot of effort, and many people don't care to delve that deeply into government regulation trivia and case law. If you are a small business owner, you spend most of your time worrying about cash flow and proposals and executing the contracts you've already won; there is precious little time left to worry about things like allowable costs and unallowable costs and proper calculation of indirect cost rates.

Even government contracting officers often don't have the time to get into the topic to the necessary depth. They take their DAWIA-mandated courses at DAU or wherever, and then they get back to the business of trying to make the nearly broken Federal acquisition system work. They are so busy trying to get stuff done that they don't have the time to become experts on government contract cost accounting, even if they would otherwise be inclined to do so.

Yet those some government contracting officers are required by their warrants to referee disagreements between government auditors and contractors regarding the allowability of certain costs, costs subject to tricky and nuanced rules. Rules that are hard to understand, and to apply, and to get right.

This blog article is about one of those rules: FAR 31.205-44 ("Training and Education Costs"). That Cost Principle seems easy to master at first glance, but a deeper dive reveals difficulties that one would be wise to avoid.

Pretty much everybody can read the first phrase: "Costs of training and education that are related to the field in which the employee is working or may reasonably be expected to work are allowable …" because it makes sense and seems logical and reasonable, and it is very similar to IRS rules on the tax deductibility of such expenses. However, many people stop there and miss the important next phrase: "*except as follows:*"—which sets forth circumstances in which training and education costs would
not
be allowable.

There are six circumstances in which the costs of employee training and/or education would not be allowable. The first circumstance is what we want to focus on today: "***Overtime compensation for training and education is unallowable.***" Does that sentence mean what it seems to mean? Does that sentence say that, even if the cost of tuition is allowable, the attending employee's labor is unallowable if it is overtime labor?

Yes. Yes it does.

The next questions usually gets into what the definition of "training and education" might be. Does it apply to outside seminars? To college and graduate school classes? What about internal training? Does it apply to all kinds of training and education without limitation?

Yes. Yes it does.

What about salaried, exempt, employees? They don't get premium overtime pay, but sometimes they get "extended work weeks" (or something similar) and they get paid straight-time rates for hours recorded in excess of their standard 40-hour workweek. Does the rule apply to those labor hours as well?

Yes. Yes it does.

What about training exercises? What if you are working at a Government-Owned, Contractor-Operated (GOCO) site and you run a terrorist attack simulation or an earthquake simulation or a forest fire simulation, the intent of which is to train employees on how to handle a crisis—and that training runs into the night (because terrorists don't always attack during the daytime), which requires overtime to be paid? Is that overtime labor made unallowable by this Cost Principle?

Well, *maybe*. And that's where it gets nuanced and that's where a dispute between auditor and contractor may arise.

Which is why the Department of Energy issued Acquisition Letter **AL 2016-005** on May 3, 2016.

We have written several blog article applauding the DOE's attempt to provide written guidance to its contracting officers to help them with tricky issues. From our point of view, **the guidance** we have seen has been reasonable and equitable. The guidance helps ensure consistency and makes it easier for the DOE contracting officers to adjudicate disputes between auditor and contractor. Further, such guidance helps DOE contractors establish proactive compliance strategies. When the contractors know the DOE's policy on a particular subject, they can focus their processes and resources on complying with it, which tends to decrease a lot of the disputes between auditor and contractor that would otherwise arise. AL 2016-005 is another example of smart, reasonable, equitable guidance that helps all parties avoid disputes and, potentially, litigation. We can only wish the DOD would emulate DOE's approach.

AL 2016-005 is actually kind of remarkable in its format and content. It is filled with such gems of wisdom as "The selected costs in FAR 31.205 deal primarily with the issue of when costs are specifically unallowable. When the language in a discussion in FAR 31.205 states the 'cost is unallowable' it means the cost is always unallowable. The converse is not true." What that last part means is that a cost if allowable only if it complies with the requirements of FAR 31.201-2. There are five requirements of cost allowability set forth in that FAR Cost Principle. So even if a cost is not called-out as being expressly unallowable, it can't be said to be allowable unless it can be determined that the cost has satisfied all five requirements.

After a bit of helpful background, the AL gets into the meat of the topic: 31.205-44. It states—

FAR 31.205-44 is one of the FAR 31.205 selected costs. Its paragraph (a) states that an overtime cost incurred during training or education related to the field in which the employee is working or may reasonably be expected to work is specifically unallowable. (In addition to the FAR 31.205-44's absolute ban on overtime costs for training or education, FAR 22.103 makes it clear that overtime costs in general merit special scrutiny. Contractors should normally not incur them, and contracting officers may normally not specify delivery or performance schedules that require them. In negotiating contracts, contracting officers should, consistent with the Government's needs, attempt to negotiate prices without overtime premiums or obtain the requirements from other sources. If overtime is required, FAR 22.103 provides procedures to follow and approvals to obtain.)

The AL also addresses the nuances. It addresses the situation where training/education is a byproduct of a training simulation and/or exercise. And it gives the same advice to DOE contracting officers that we have often given to clients: *The intended purpose helps inform the cost allowability determination.* In other words, when you understand *why* a cost has been incurred, you will then be prepared to make a call as to that cost's allowability. In fact, we devoted most of a **blog article** to that topic. We said "If you tell us what you are doing and (more importantly) *why you are doing it*, we can give you an allowability determination with a high degree of confidence. But it you mislead us, or withhold certain crucial facts, then our determination may well be wrong. And that error may end up costing the company millions of profit dollars."

In the DOE AL, the contracting officer is given guidance as follows—

When overtime costs are incurred for purposes other than training or education, and some training or education occurs as a side effect, the overtime costs are not specifically unallowable per FAR 31.205-44. Any portion of the overtime costs incurred solely for the purpose of FAR 31.205-44 training or education, however, would be specifically unallowable per FAR 31.205-44. As an example, assume a contractor conducts a 48 hour continuity of operations exercise or force on force exercise that requires guard service personnel to participate after standard shift hours. During the exercise employees gain knowledge that is related to the field in which the employees are working or may reasonably be expected to work. Continuity of operations exercises and force on force exercises are not generally training as that term is used in the cost principle. The exercises are usually conducted to test operational procedures, not for the purposes of training or education, and therefore overtime costs are usually not specifically unallowable. (Any portion of the overtime costs incurred solely for the purpose of FAR 31.205-44 training or education, however, would be specifically unallowable per FAR 31.205-44.) This does not mean the overtime costs meet all of the five requirements listed in FAR 31.201-2, that is, it does not mean the overtime costs are necessarily allowable. The contracting officer should always analyze why the exercise could not be conducted during the employees' normal working hours to determine if the overtime costs are reasonable.

That is some great policy guidance, right there. Have we mentioned that we wish DOD would take a similar approach?

In addition to the policy guidance quoted above, the DOE AL also provides the flexibility to permit DOE contractors to make a business case for the allowability of otherwise unallowable overtime labor associated with training and education. The AL states—

If before overtime costs for FAR 31.205-44 training or education are incurred a contractor believes that training on overtime would lower the overall costs to the Government or is necessary to meet urgent program needs, it should submit a detailed cost benefit analysis and appropriate rationale to make the business case for the contracting officer to seek deviation authority and await a deviation approval. The business case must include an analysis of alternative approaches that the contractor could take, including training on regular time, that might possibly meet contract objectives and avoid training on overtime. If the contractor demonstrates to the contracting officer's satisfaction that overtime cost incurrence would significantly reduce the overall cost to the Government or is necessary to meet urgent program needs, the contracting officer may, at his or her discretion, consider a contractor's request for a deviation.

Finally, the AL also includes the reminder (which we hope our readers will consider) that paying employees overtime is not the preferred approach to performing government contracts. The AL reminds DOE contracting officers that the FAR has something to say about the issue, stating—

FAR 22.103 states, 'Contractors shall perform all contracts, so far as practicable, without using overtime, particularly as a regular employment practice, except when lower overall costs to the Government will result or when it is necessary to meet urgent program needs. Any approved overtime, extra-pay shifts, and multi-shifts should be scheduled to achieve these objectives.'

In these days of sequestration, budget constraints and lowest-price technically-acceptable contract awards, and Baby Boomer retirements and normal attrition, it's become harder and harder for contractors to get the job done with the workforce they have in place. (This is fundamentally a leadership problem abetted by a failed HR function, but we've ranted on that subject before.) Overtime, especially for experienced direct-charging employees, has become the new normal. The quote from FAR 22.103, above, should remind us all that use of systemic overtime—as a regular employment practice—leaves a company vulnerable to allegations by

disgruntled employees of violations of the False Claims Act (via the implied certification theory). Something to consider, perhaps?

All in all, an excellent piece of policy guidance by the Department of Energy. Clearly, DOE is moving forward and trying to manage contracts without the benefit of DCAA's audit assistance. We think the Department is doing a great job of it so far, and we look forward to the next piece of policy guidance. In the meantime, we don't have many nice things to say about DOD and DCAA.