

# **UNALLOWABLE COSTS**

## US GOVERNMENT CONTRACTS MANAGEMENT

FAR Part 31, specifically FAR Part 31.205, extracted from 48CFR9004.405 and promulgated by the Cost Accounting Standards Board (CASB), defines **Cost Accounting Standard 405 – Accounting for Unallowable Costs** as follows:

The purpose of this Cost Accounting Standard is to facilitate the negotiation, administration, audit and settlement of contracts by establishing guidelines covering:

- Identification of costs specifically described as unallowable, at the time such costs first become defined or authoritatively designated as unallowable.
- The cost accounting treatment to be accorded such identified unallowable costs in order to promote the consistent application of sound cost accounting principles covering all incurred costs.

The Standard is predicated on the proposition that costs incurred in carrying out the activities of an enterprise regardless of the allowability of such costs, are allocable to the cost objective with which they are identified. This Standard does not govern the specific allowability of costs; it serves as a guideline for this type of cost application. This is a function of the appropriate government procurement or reviewing authority.

### **Unallowable Cost Overview**

- Costs expressly unallowable or mutually agreed to be unallowable, including costs mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim or proposal applicable to a Government contact.
- Costs which specifically become designated as unallowable as a result of a written decision furnished by a Contracting Officer (CO), pursuant to contract disputes procedures shall be identified if included in or used in the computation of any billing, claim or proposal

applicable to a Government contract. This identification requirement applies also to any costs incurred for the same purpose under like circumstances as the costs specifically identified as unallowable under either this paragraph or the proceeding paragraph.

- Costs which, in a contracting officer's written decision furnished pursuant to contract disputes procedures, are designated as unallowable directly associated costs of unallowable costs covered by the above paragraphs shall be accorded the identification of unallowable.
- The costs of any work projects not contractually authorized, whether or not related to performance of a proposed or existing contract, shall be accounted for, to the extent appropriate, in a manner which permits ready separation from the costs or authorized work projects. These costs are unallowable by definition.
- All unallowable costs covered by the above paragraphs shall be subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they should remain in those base costs or cost bases. Where a directly associated cost is part of a category of costs normally included in an indirect-cost pool that will be allocated over a base containing the unallowable cost which it is associated, such a directly associated cost shall be retained in the indirect-cost pool and be allocated through the regular allocation process.
- Where the total of the allocable or otherwise allowable costs exceeds a limitation-of-cost or ceiling price provision in a contract, full direct and indirect cost allocation shall be made to the contract cost objective, in accordance with established cost accounting practices, and Standards which regularly govern an entity's allocations to Government contract cost objectives. In any determination of unallowable cost overrun, the amount thereof shall be identified in terms of the excess of allowable costs over the ceiling amounts, rather than through specific identification of particular cost items or cost elements.

If this entire issue of unallowable costs is deemed to be a question of materiality, the Government and the contractor may reach an agreement on an alternative method that satisfies this Standard.

**There is no exception or exemption to this standard, for either full or modified CAS covered operations/contracts.**

### **EXAMPLES OF POTENTIAL UNALLOWABLE COST TYPES**

- Bad Debts
- Contingencies
- Contributions and donations
- Dividends
- Entertainment
- Fines, penalties and mischarging costs
- Interest and other financial costs
- Idle or excess facilities
- Losses on other contracts
- Organization costs
- Plant reconversion costs
- Special funds construction
- Deferred R&D
- Lobbying Costs (legislative & executive)
- Defense of fraud
- Goodwill
- Alcoholic beverages
- Advertising promoting the contractor or its products
- Special compensation as a result of changes in management
- Direct selling efforts for Foreign Military Sales
- Costs of promotional items
- Memberships in social, dining or country clubs
- Commercial air travel in excess of standard fares
- Gifts
- Recreation Costs – that are not specifically identified in a contract such as R&R costs associated with foreign assignment.