

# UNIT 62: ALLOWABILITY OF COSTS

October 2003

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**Overall Duty**      Make decisions related to allowability of contract costs.

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**Overall Conditions**      Given a contract and question(s) about the allowability of contract costs.

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**Overall Standard**      Payments are not made for unallowable costs. Contractors are given proper notice of disallowance.

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## Part A: Disallowance of Costs

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**Sub-Duty**      Disallow unallowable costs.

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**Additional Conditions**      Given an invoice and incurred costs or costs planned for incurrence.

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**Sub-Duty Standard**      Assure that payments are not made for unallowable costs. Contractors are given proper notice of disallowance.

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## Part B: Payment of Indirect Costs

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**Sub-Duty**      Determine billing and final indirect cost rates.

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**Additional Conditions**      Given a contract for which contractor billing and/or final indirect cost rates will affect the amount paid the contractor.

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**Sub-Duty Standard**      Authorize payment of the amount to which the contractor is entitled under the terms and conditions of the contract. Assure that payment conforms to agency policies.

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# UNIT 62: ALLOWABILITY OF COSTS

October 2003

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## Part C: Limitation of Costs, Funds, or Total Payment Amount

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**Sub-Duty** Take appropriate action when notified that contract cost will exceed a limitation on costs, funds, or total payment amount set in the contract.

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**Additional Conditions** Given a contract with a limitation on costs, funds, or total payment amount and available information on contract performance and cost.

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**Sub-Duty Standard** Select the course of action that minimizes risk to the Government of incomplete performance and obtains maximum performance within the dollars available. Correctly prepare the proper documentation to notify and instruct the contractor on the selected course of action.

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# UNIT 62: ALLOWABILITY OF COSTS

October 2003

## Policies

<i>FAR</i>	<i>Agency Suppl.</i>	<i>Subject</i>
31		Contract cost principles and procedures.
32.702		Policy on contract funding.
32.704		Limitation of costs or funds.
32.705-2		Clauses for limitation of cost or funds.
42.7		Indirect cost rates.
42.8		Disallowance of costs.
52.216-7		Allowable cost and payment.
52.216-15		Predetermined indirect cost rates.
52.216-16		Incentive price revision – firm target.
52.216-17		Incentive price revision – successive targets.
52.216-26		Payments of allowable costs before the definitization.
52.232-1		Payments.
52.232-2		Payments under fixed-price research and development contracts.
52.232-3		Payments under personal service contracts.
52.232-7		Payments under time-and-materials and labor-hour contracts.
52.232-16		Progress payments.
52.232-20		Limitation of cost.
52.232-22		Limitation of funds.
52.242-1		Notice of intent to disallow costs.
52.242-3		Penalties for unallowable costs.
52.242-4		Certification of final indirect costs.
Appendix B		Cost accounting standards preambles and regulations.

## Other KSAs

1. Knowledge of accounting.
2. Knowledge of the Anti-Deficiency Act.
3. Ability to remain open to change and new information.
4. Ability to identify the need for additional data, gather that data, and organize it to support decisions on cost allowability.
5. Ability to make sound, well informed, and objective business decisions related to cost allowability.
6. Ability to maintain the honesty and integrity of the acquisition process.

# UNIT 62: ALLOWABILITY OF COSTS

*October 2003*

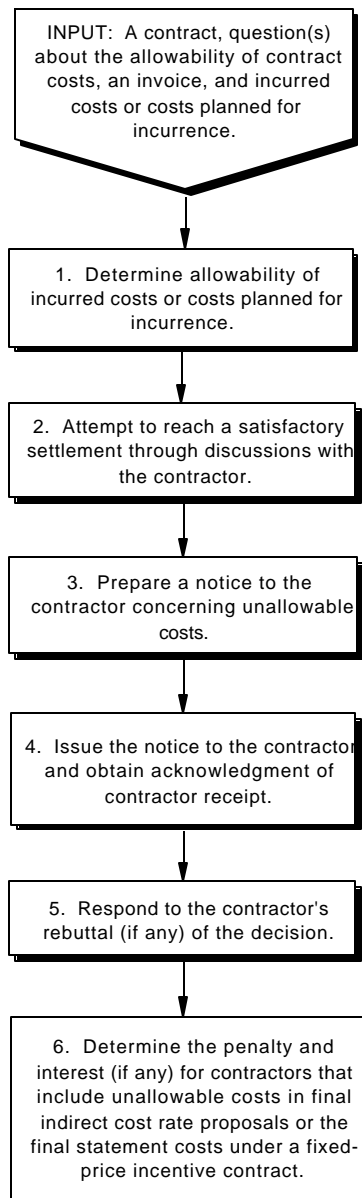
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**Other Policies and References (Annotate As Necessary):**

# UNIT 62: ALLOWABILITY OF COSTS

## Part A: Disallowance Of Costs

October 2003



# UNIT 62: ALLOWABILITY OF COSTS

## Part A: Disallowance Of Costs

October 2003

Tasks	Related Standards
<p>1. Determine allowability of incurred costs or costs planned for incurrence.</p> <p>(In agencies where auditors are responsible for reviewing vouchers, the auditor may perform this step unilaterally for cost vouchers.)</p>	<p>When monitoring contract costs, reviewing cost vouchers, or reviewing requests for progress payments, recognize incurred costs or costs planned for incurrence under a contract that are apparently unallowable.</p> <ul style="list-style-type: none"><li>• Factors to consider include:<ul style="list-style-type: none"><li>– Cost reasonableness;</li><li>– Cost allocability to the contract;</li><li>– Standards promulgated by the Cost Accounting Standards Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the particular circumstances;</li><li>– Terms of the contract; and</li><li>– Any limitations set forth in FAR 31.</li></ul></li><li>• Obtain input from the cognizant auditor when there is question as to whether the cost is allowable.</li><li>• Prepare a position and supporting data on allowability for discussions with the contractor</li></ul>
<p>2. Attempt to reach a satisfactory settlement through discussions with the contractor.</p> <p>(In agencies where auditors are responsible for reviewing vouchers, the auditor may perform this step unilaterally for cost vouchers.)</p>	<p>Obtain any additional information from the contractor that may bear on the decision of cost allowability.</p> <p>Do not accept any agreement that would result in the Government paying an unallowable cost.</p>

# UNIT 62: ALLOWABILITY OF COSTS

## Part A: Disallowance Of Costs

October 2003

### Tasks

### Related Standards

<p>3. Prepare a notice to the contractor concerning unallowable costs.</p> <p>(In agencies where auditors are responsible for reviewing vouchers, the auditor may perform this step unilaterally for cost vouchers.)</p>	<p>If anticipatory (prior to receiving invoices or vouchers for incurred costs), prepare notice of intent to disallow costs. As a minimum, the notice must:</p> <ul style="list-style-type: none"><li>• Refer to the contract's Notice of Intent to Disallow Costs clause;</li><li>• State the contractor's name and list the numbers of the affected contracts;</li><li>• Describe the costs to be disallowed, including estimated dollar value by item and applicable time periods, and state the reasons for the intended disallowance;</li><li>• Describe the potential impact on billing rates and forward pricing rate agreements;</li><li>• State the notice's effective date and the date by which written response must be received;</li><li>• List the recipients of copies of the notice; and</li><li>• Request the contractor to acknowledge receipt of the notice.</li></ul> <p>If a notice of intent to disallow costs involves elements of indirect cost, never issue it without coordination with the Contracting Officer or auditor responsible for final indirect cost settlement.</p> <p>If after receipt of a voucher, prepare a notice of contract costs suspended and/or disapproved. Follow agency procedures to assure that allowable costs are paid while unallowable costs are not.</p> <p>In agencies (e.g., DoD) where an auditor may perform this step independently, assure that the notice is properly prepared to disallow only unallowable costs.</p>
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# UNIT 62: ALLOWABILITY OF COSTS

## Part A: Disallowance Of Costs

October 2003

### Tasks

### Related Standards

<p>4. Issue the notice to the contractor and obtain acknowledgment of contractor receipt.</p> <p>(In agencies where auditors are responsible for reviewing vouchers, the auditor may perform this step unilaterally for cost vouchers.)</p>	<p>In addition to the contractor, distribute a:</p> <ul style="list-style-type: none"><li>• Notice of intent to disallow costs to:<ul style="list-style-type: none"><li>– All Contracting Officers cognizant of any segment of the contractor’s organization; and</li><li>– Others required by agency and office policy (e.g., the cognizant auditor and disbursing officer).</li></ul></li><li>• Contracting-prepared notice of contract costs suspended and/or disapproved in accordance with agency procedures. In addition to the copy sent to the contractor, a copy is normally sent to the:<ul style="list-style-type: none"><li>– Disbursing officer; and</li><li>– Cognizant auditor.</li></ul></li><li>• Auditors should send an audit-prepared notice of contract costs suspended and/or disapproved to the cognizant contracting, finance, or disbursing officer, as appropriate under agency procedures.</li></ul>
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# UNIT 62: ALLOWABILITY OF COSTS

## Part A: Disallowance Of Costs

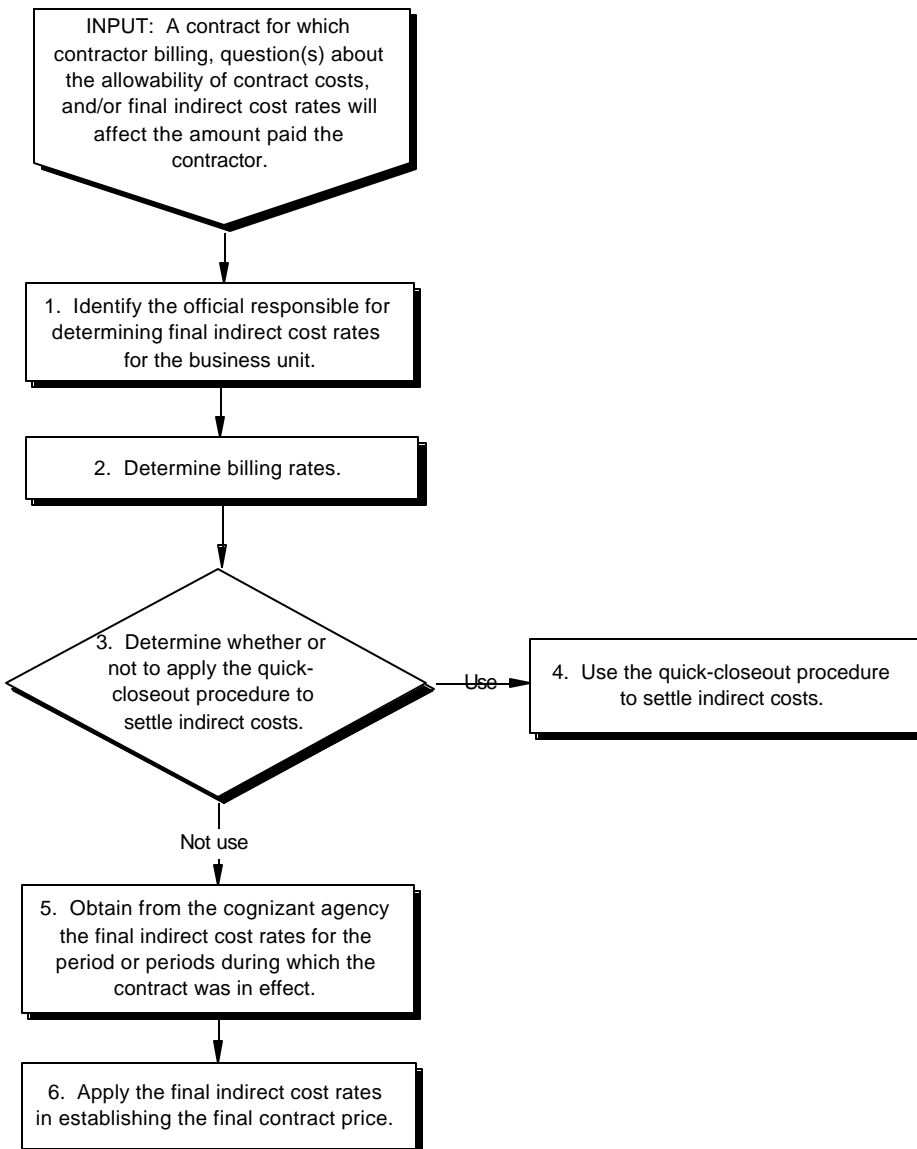
October 2003

Tasks	Related Standards
<p>5. Respond to the contractor's rebuttal (if any) of the decision.</p>	<p>Consider the following:</p> <ul style="list-style-type: none"> <li>• If the contractor disagrees in writing within 60 days to a notice of intent to disallow costs:               <ul style="list-style-type: none"> <li>– Issue a written decision to withdraw the notice, sustain the original decision, or allow part of the costs unless elements of indirect costs are involved; or</li> <li>– Request the Contracting Officer responsible for determining final indirect cost rates to issue a decision when indirect costs are involved.</li> </ul> </li> <li>• If the contractor disagrees with the deduction from current payments, respond based on the form of rebuttal. The contractor may:               <ul style="list-style-type: none"> <li>– Submit a written request to the cognizant Contracting Officer to consider whether the unreimbursed costs should be paid and to discuss the findings with the contractor;</li> <li>– File a claim under the Disputes clause, which the cognizant Contracting Officer will process in accordance with agency procedures; or</li> <li>– Do both of the above.</li> </ul> </li> </ul> <p>Make a decision on the appropriate response after consulting the auditor. Keep the finance office abreast of any changes in the status of the disallowed or suspended costs.</p>
<p>6. Determine the penalty and interest (if any) for contractors that include unallowable costs in final indirect cost rate proposals or the final statement costs under a fixed-price incentive contract.</p>	<p>This requirement applies to all contracts in excess of \$500,000, except fixed-price contracts without cost incentives or any firm fixed-price contracts for the purchase of commercial items.</p> <p>Follow the guidelines in FAR 42.709 for determining the applicability and assessment of penalties and interest.</p>

# UNIT 62: ALLOWABILITY OF COSTS

## Part B: Payment Of Indirect Costs

October 2003



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## Part B: Payment Of Indirect Costs

*October 2003*

### Tasks

### Related Standards

1. Identify the official responsible for determining final indirect cost rates for the business unit.	Follow the guidance in FAR 42.705-1 and 42.705-2 to determine whether the Contracting Officer or auditor is responsible for final indirect cost rates.
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# UNIT 62: ALLOWABILITY OF COSTS

## Part B: Payment Of Indirect Costs

October 2003

Tasks	Related Standards
2. Determine billing rates.	<p>The Contracting Officer or auditor responsible for establishing the final indirect cost rates must also determine the billing rates. When determining billing rates:</p> <ul style="list-style-type: none"><li>• Base them on information from:<ul style="list-style-type: none"><li>– Recent review;</li><li>– Previous rate audits or experience; or</li><li>– Similar reliable data or experience of other contracting activities.</li></ul></li><li>• Ensure that they are as close as possible to the final indirect cost rates anticipated for the contractor's fiscal period, adjusted for any unallowable costs.</li><li>• If the dollar value of contracts requiring use of billing rates does not warrant submission of a detailed billing rate proposal, rates may be established by making appropriate adjustments from the prior year's cost experience to:<ul style="list-style-type: none"><li>– Eliminate unallowable and nonrecurring costs; and</li><li>– Reflect new or changed conditions.</li></ul></li><li>• Once established, billing rates may be prospectively or retroactively revised by mutual agreement of the parties involved at either party's request, to prevent substantial overpayment or underpayment.</li><li>• When agreement cannot be reached, the Contracting Officer may unilaterally determine rates.</li><li>• Never construe the elements of indirect costs and the base or bases used in computing billing rates as determinative of those to be used in final rate calculations.</li><li>• When the contractor provides the certified final indirect cost rate proposal, the contractor and the Government may mutually agree to revise billing rates to reflect the proposed indirect cost rates adjusted to reflect historically disallowed amounts, until the proposal has been audited and settled.</li></ul>

# UNIT 62: ALLOWABILITY OF COSTS

## Part B: Payment Of Indirect Costs

October 2003

### Tasks

### Related Standards

<p>3. Determine whether or not to apply the quick-closeout procedure to settle indirect costs.</p>	<p>Use the quick close-out procedure at FAR 42.708 to settle indirect costs for a specific contract in advance of a determination of final indirect cost rates, when the following conditions are met:</p> <ul style="list-style-type: none"><li>• The contract is physically complete.</li><li>• The amount of unsettled indirect cost to be allocated to the contract is relatively insignificant. Indirect cost amounts will be considered insignificant when:<ul style="list-style-type: none"><li>– The total unsettled indirect cost to be allocated to any one contract does not exceed \$1,000,000; and</li><li>– Unless otherwise provided in agency procedures:<ul style="list-style-type: none"><li>? The cumulative unsettled indirect costs to be allocated to one or more contracts in a single fiscal year do not exceed 15 percent of the estimated, total unsettled indirect costs allocable to cost-type contracts for that fiscal year; or</li><li>? The Contracting Officer waives the 15 percent restriction based upon a risk assessment that considers the contractor's accounting, estimating, and purchasing systems; other concerns of the cognizant contract auditors; and any other pertinent information.</li></ul></li></ul></li><li>• Agreement can be reached on a reasonable estimate of allocable dollars.</li></ul>
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# UNIT 62: ALLOWABILITY OF COSTS

## Part B: Payment Of Indirect Costs

October 2003

Tasks	Related Standards
<p>4. Use the quick-closeout procedure to settle indirect costs.</p>	<p>Steps for use of quick-closeout procedures:</p> <ul style="list-style-type: none"> <li>• Obtain the contractor's proposed indirect cost rates and supporting data;</li> <li>• Prepare the Government's position on the proposed rates;</li> <li>• Negotiate quick-closeout rates and other allowable costs for the contract; and</li> <li>• Modify the contract for closeout.</li> </ul> <p>Determination of final indirect rates using the quick-closeout procedure is final for the contract it covers and there must not be any adjustment to other contracts for over- or under-recovery of costs allocated or allocable to the contract covered by the procedure.</p>
<p>5. Obtain from the cognizant agency the final indirect cost rates for the period or periods during which the contract was in effect.</p>	<p>The Contracting Officer or auditor responsible for final indirect cost rate determination must execute a written understanding setting forth the final cost rates. The understanding must specify:</p> <ul style="list-style-type: none"> <li>• The agreed-upon final annual indirect cost rates;</li> <li>• The bases to which the rates apply;</li> <li>• The periods for which the rates apply;</li> <li>• Any specific indirect cost items treated as direct costs in the settlement; and</li> <li>• The affected contract and/or subcontract, identifying any with advance agreements or special terms and the applicable rates.</li> </ul> <p>The responsible official must:</p> <ul style="list-style-type: none"> <li>• Promptly distribute executed copies of the indirect cost rate agreement to the contractor and to each affected contracting agency;</li> <li>• Provide copies of the agreement for the contract files; and</li> <li>• Furnish copies of the negotiation memorandum prepared under Contracting Officer determination or audit report prepared under auditor determination, as appropriate, to the contracting offices and Government audit offices.</li> </ul>

# UNIT 62: ALLOWABILITY OF COSTS

## Part B: Payment Of Indirect Costs

October 2003

### Tasks

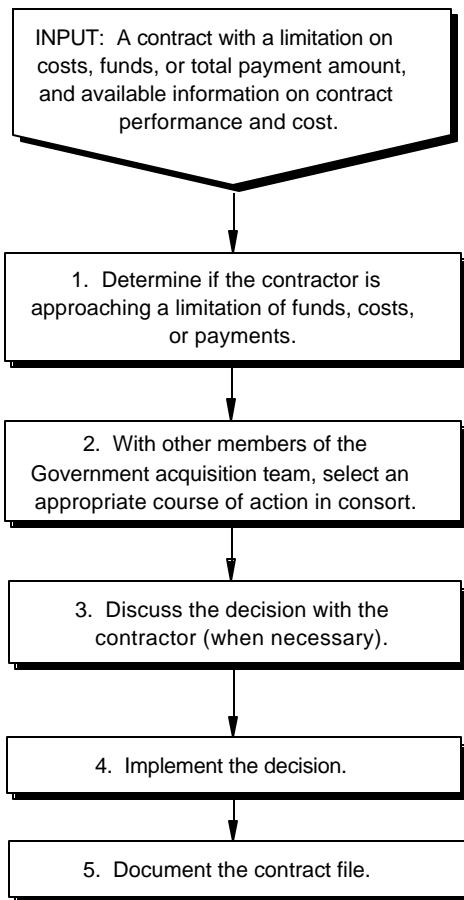
### Related Standards

<p>6. Apply the final indirect cost rates in establishing the final contract price.</p>	<p>Within 120 days after settlement of the final indirect cost rates (or longer, if approved in writing by the Contracting Officer), the contractor must submit a completion invoice or voucher reflecting the settled amounts and rates on all contracts physically completed in the year covered by the proposal.</p> <p>That submission will be used as a basis for establishing final costs.</p>
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# UNIT 62: ALLOWABILITY OF COSTS

## Part C: Limitation Of Costs, Funds, Or Total Payment Amount

October 2003





# UNIT 62: ALLOWABILITY OF COSTS

## Part C: Limitation Of Costs, Funds, Or Total Payment Amount

October 2003

### Tasks

### Related Standards

<p>1. Determine if the contractor is approaching a limitation of funds, costs, or payments.</p>	<p>Cost-reimbursement, time-and-materials, and labor-hour contracts each include a limit on the Government's financial obligation under the contract:</p> <ul style="list-style-type: none"><li>• A fully funded cost-reimbursement contract (for other than facilities) must include the Limitation of Cost clause (FAR 52.232-20). That clause limits the Government's obligation to reimburse the contractor for incurred costs to the established contract cost.</li><li>• An incrementally funded cost-reimbursement contract must include the Limitation of Funds clause (FAR 52.232-20). That clause limits the Government's obligation to reimburse the contractor for incurred costs to the current level of funding on the contract.</li><li>• A time-and-materials or labor-hour contract must include the Payments Under Time-and-Materials or Labor-Hour Contracts clause (FAR 52.232-7) which limits the Government's obligation to the ceiling price or limitation on payments set in the contract.</li></ul> <p>When the limitation is reached the contractor entitled to stop work.</p> <p>As a result, each of these contract types should be monitored considering contract performance and related cost. In addition, each of the clauses identified above requires the contractor to notify the Contracting Officer if it expects to reach a stated percentage of the financial limit within the next 30 days.</p>
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# UNIT 62: ALLOWABILITY OF COSTS

## Part C: Limitation Of Costs, Funds, Or Total Payment Amount

October 2003

Tasks	Related Standards
2. With other members of the Government acquisition team, select an appropriate course of action in consort.	<p>With other members of the Government acquisition team:</p> <ul style="list-style-type: none"><li>• Review the alternative courses of action, such as:<ul style="list-style-type: none"><li>– Take no action, if the contractor is on schedule in terms of time and money;</li><li>– Provide additional funds to complete the contract as is;</li><li>– Notify the contractor that no further funds are available and allow work to continue as is until the current funding is expended;</li><li>– Downscope contract item requirements (e.g., eliminate some the statement of work requirements) to fit the remaining funds;</li><li>– Terminate one or more items of a multiple-item contract for convenience (partial termination); or</li><li>– Terminate the contract for convenience.</li></ul></li><li>• Review related information, such as:<ul style="list-style-type: none"><li>– The Government’s best estimate of the cost to complete the contract as is;</li><li>– Available funds;</li><li>– The Government’s continuing need for the contract supply or service;</li><li>– Tasks or other requirements that might be changed to reduce cost and the related effect of the changes;</li><li>– Items that might be terminated and the related effect; or</li><li>– The effect of contract termination.</li></ul></li><li>• Select the best alternative or range of alternatives, given the Government requirement and the funding available.</li><li>• If negotiations will be necessary to implement the selected action, prepare a Government negotiation position.</li></ul>

