

# ALLOWABLE COSTS

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# OVERVIEW

- Definitions
- Allowability
- Unallowable Costs
- Examples

# Definitions

- Direct Costs
- Indirect Costs
- Unallowable Costs
- Wrap Rate/Multiplier



# DIRECT COSTS

- Direct costs are costs that can be identified specifically with a particular final cost objective. (FAR 2.101)
- Costs can be direct, but not always billable to the contract.
- Types of direct expenses are labor, materials, subcontractor expenses, travel, other direct costs.

# INDIRECT COSTS

Ø FAR 2.101 – Indirect cost means any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or with a least one intermediate cost objective.

- Examples of indirect costs are rent, corporate salaries, insurances, etc.
- Must recover through the billing process



# UNALLOWABLE COSTS

Ø FAR 2.101 – Unallowable cost means any cost that, under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost-reimbursements, or settlements under a Government contract to which it is allocable.

# MULTIPLIER/WRAP RATE

- Fully Burdened Costs
- Generally Applied to Labor Dollars
- Can be before or after profit/fee



# ALLOWABILITY

- A cost is allowable only when the cost complies with all of the following requirements:
  - (1) Reasonableness.
  - (2) Allocability.
  - (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
  - (4) Terms of the contract.
  - (5) Any limitations set forth in this FAR 31.205.



# ALLOCABILITY

- A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—
  - (a) Is incurred specifically for the contract;
  - (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
  - (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

# REASONABLE COSTS

- A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent business person in the conduct of competitive business.
- Considerations:
  - 1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;
  - (2) Generally accepted sound business practices, arm's-length bargaining, and Federal and State laws and regulations;
  - (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and
  - (4) Any significant deviations from the contractor's established practices.



# EXAMPLES OF UNALLOWABLE EXPENSES

- Some costs are expressly unallowable:
  - Interest
  - Bad Debt
  - Donations/Contributions
  - Entertainment costs
  - Fines/Penalties/Mischarging
  - Federal Corporate Income Taxes
  - Losses on other contracts
  - Organization Costs
  - Lobbying

# ALLOWABLE COSTS TURNED UNALLOWABLE

- Travel exceeding the Federal Travel Regulations
- Executive salaries exceeding a reasonable limit
- Bonuses paid outside of a written policy
- G&A labor associated with unallowable functions such as lobbying, buy/sell of company, etc.



# ACCOUNTING FOR UNALLOWABLE COSTS

- Exclude unallowable costs from billings, claims, or proposal applicable to Government contract
- Unallowable indirect costs may be excluded from rate calculations depending on type of cost
  - Unallowable Labor must get Fringe
- Unallowable direct costs must be included in base when calculating and allocating indirect rates
  - Will be both the direct cost and application of indirects

# OTHER NOTES ON UNALLOWABLE COSTS

- Even though costs may be legitimate business expenses, they must meet allowable criteria
- Unallowable cost go against company profitability
- Don't confuse Unallowable Costs with Non-Deductible from a tax standpoint



# ACCOUNTING FOR UNALLOWABLE COSTS

- A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported – FAR 31.201-2 (d)

# CONCLUSION

- Most costs are deemed allowable unless unreasonable or not allocable
- Expressly unallowable costs are always unallowable
- Allowable costs that can be deemed as unallowable
- Monitor unallowable costs/impact profitability



**QUESTIONS ?**

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**Lunch & Learn**

**Oak Ridge Chamber**

**Incurred Cost Submissions**

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