



GC Newsletter

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YEAR-END WARNING – BEWARE OF UNALLOWABLE COSTS

With year-end right around the corner many contractors are preparing to develop their annual indirect rate proposals or the actual billing rates to be used on cost reimbursable contracts. If your cost accounting system is not well suited to identify and segregate FAR Part 31 unallowable costs or those costs made expressly unallowable by contract you are open for the significant risk of penalties as specified in FAR 52.242-3, Penalties for Unallowable Costs. Generally, contracts that are covered by this clause are the ones that include: FAR 52.216-7, Allowable Cost and Payment; FAR 52.216-7, Allowable Cost and Payment – Facilities; FAR 52.216-16, Incentive Price Revision – Firm Target; and FAR 52.216-17, Incentive Price Revision – Successive Targets.

If unallowable costs are included in your year-end certified indirect rate proposal, and the inclusion of these costs are identified by the government, the penalty clause allows the government to recover a penalty equal to the value of the unallowable amount plus interest. In other words, if the government identifies the inclusion of \$100,000 of unallowable cost the contractor must reimburse the government not only the \$100,000, but also another \$100,000 in penalties, plus interest on the total amount. If the unallowable costs identified had been determined, in writing, by the contracting officer to be unallowable the penalty is twice the value of the unallowable cost identified.

The penalties clause may be applied even though the unallowable costs have not been billed or the indirect rate proposal has not been audited or the final indirect rates established. Once the certified indirect rate proposal is submitted to the contracting officer and/or the DCAA the penalties clause takes effect. The clause can also take effect even if it is determined that unallowable costs were included in final negotiated rates that were not caught in the audit process.

Conclusion! If any of the clauses above apply to your contracts make sure your cost accounting system has proper controls in place to ensure that unallowable costs captured and segregated when incurred and not included in your cost claims at year-end.



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