A Big Step in the Right Direction – DCAA's Updated Guidance on Expressly Unallowable Costs

Litigation Alert
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For the first time since 2015, the Defense Contract Audit Agency (DCAA) has updated its "expressly unallowable costs" guidance. DCAA MRD 19-PAC-002(R) (May 14, 2019). The new guidance significantly narrows those costs that will be presumed expressly unallowable and, thus, subject to penalties under FAR 42.709-1(a). This guidance is a much-needed course correction resulting from recent Board decisions that emphasize that "expressly unallowable costs" must be just that—expressly stated as unallowable. See, e.g., Raytheon Company, 17-1 BCA ¶36,724 (Apr. 17, 2017). The update provides clarity to both auditors and contractors by removing all references to expressly unallowable costs that are "not stated in direct terms." This change will enable contractors to better predict those costs that will be identified as expressly unallowable in an audit and subject to significant, sometimes mandatory, penalties.

The Federal Acquisition Regulation (FAR) and the Cost Accounting Standards define an "expressly unallowable cost" as "a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable." FAR 31.001 (emphasis added); 48 CFR 9904.405-30(a)(2) (emphasis added). The distinction between unallowable and expressly unallowable is critical because expressly unallowable costs included in a final indirect cost rate proposal or final statement of costs are subject to significant monetary penalties under FAR 42.709-1(a).

DCAA provides auditors guidance on determining whether FAR and Defense Federal Acquisition Regulation Supplement (DFARS) cost principles amount to "expressly unallowable costs" through Memorandums for Regional Directors (MRD). The guidance is a useful tool for contractors to understand how auditors will treat various costs. The MRDs include a non-exhaustive list of FAR and DFARS cost principles that DCAA presumes to be "expressly unallowable." DCAA’s 2014 MRD included multiple FAR and DFARS cost principles that did not include costs that were "specifically named or stated to be unallowable." See DCAA MRD 14-PAC-021(R) (Dec. 18, 2014) (e.g., 31.205-13(d)(1), 31.205-11(h)(1), etc.). DCAA even went so far as to issue an amplifying MRD in 2015 that explained that “[t]he mere fact that the cost principle does not include the word unallowable or phrase not allowable does not mean that costs questioned based on that cost principle are not expressly unallowable.” DCAA MRD 14-PAC-022(R) (Jan. 7, 2015) at 2. The explanation purported to rely on Emerson Electric Co., ASBCA No. 30090, 87-1 BCA ¶19,478 (Nov. 19, 1986) as evidenced by the reference to Emerson throughout the list of 110 cost principles DCAA deemed "expressly unallowable." See DCAA MRD 14-PAC-021(R) (Dec. 18, 2014).

DCAA’s 2014 and 2015 interpretation, of course, directly contradicts the title and definition of "expressly unallowable costs," which both plainly require some level of "express" or specific naming to be deemed express. The May 2019 MRD update fixes the most obvious discrepancies. DCAA MRD 19-PAC-002(R) (May 14, 2019). The new guidance completely eliminates the 2015 page-long explanation about how to determine whether an unallowable cost that is not expressly stated may still be found to be "expressly unallowable." It also reduces its list of presumptively expressly unallowable cost principles from 110 to 91 and removes all references to Emerson as a basis for finding an implicit expressly unallowable cost.

This update is a welcome change and will hopefully leave contractors better equipped to more accurately predict which specific costs principles will be considered expressly unallowable.

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