31.201-6 Accounting for unallowable costs.

(a) Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable *directly associated costs*, *shall* be identified and excluded from any billing, *claim*, or *proposal* applicable to a Government contract. A *directly associated cost* is any cost that is generated solely as a result of incurring another cost, and that would not have been incurred had the other cost not been incurred. When an *unallowable cost* is incurred, its *directly associated costs* are also unallowable.

(b) Costs that specifically become designated as unallowable or as unallowable *directly associated costs* of *unallowable costs* as a result of a written decision furnished by a *contracting officer shall* be identified if included in or used in computing 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 paragraph (a) of this subsection.

(c)

(1) The practices for accounting for and presentation of *unallowable costs must* be those described in 48 CFR 9904.405, Accounting for *Unallowable Costs*.

(2) Statistical sampling is an acceptable practice for contractors to follow in accounting for and presenting *unallowable costs* provided the criteria in paragraphs (c)(2)(i), (c)(2)(ii), and (c)(2)(iii) of this subsection are met:

(i) The statistical sampling results in an unbiased sample that is a reasonable representation of the sampling universe.

(ii) Any large dollar value or high risk transaction is separately reviewed for *unallowable costs* and excluded from the sampling process.

(iii) The statistical sampling permits audit verification.

(3) For any *indirect cost* in the selected sample that is subject to the penalty provisions at 42.709, the amount projected to the sampling universe from that sampled cost is also subject to the same penalty provisions.

(4) Use of statistical sampling methods for identifying and segregating *unallowable costs should* be the subject of an advance agreement under the provisions of 31.109 between the contractor and the cognizant administrative *contracting officer* or Federal official. The advance agreement *should* specify the basic characteristics of the sampling process. The cognizant administrative *contracting officer* or Federal official *shall* request input from the cognizant auditor before entering into any such agreements.

(5) In the absence of an advance agreement, if an initial review of the facts results in a challenge of the statistical sampling methods by the *contracting officer* or the *contracting officer's representative*, the burden of proof *shall* be on the contractor to establish that such a method meets the criteria in paragraph (c)(2) of this subsection.

(d) If a *directly associated cost* is included in a cost pool that is allocated over a base that includes

the *unallowable cost* with which it is associated, the *directly associated cost shall* remain in the cost pool. Since the *unallowable costs* will attract their allocable share of costs from the cost pool, no further action is required to assure disallowance of the *directly associated costs*. In all other cases, the *directly associated costs*, if material in amount, *must* be purged from the cost pool as *unallowable costs*.

(e)

(1) In determining the materiality of a *directly associated cost*, consideration *should* be given to the significance of-

(i) The actual dollar amount,

(ii) The cumulative effect of all *directly associated costs* in a cost pool, and

(iii) The ultimate effect on the cost of Government contracts.

(2) Salary expenses of employees who participate in activities that generate *unallowable costs shall* be treated as *directly associated costs* to the extent of the time spent on the proscribed activity, provided the costs are material in accordance with paragraph (e)(1) of this subsection (except when such salary expenses are, themselves, unallowable). The time spent in proscribed activities *should* be compared to total time spent on company activities to determine if the costs are material. Time spent by employees outside the normal working hours *should* not be considered except when it is evident that an employee engages so frequently in company activities during periods outside normal working hours as to indicate that such activities are a part of the employee's regular duties.

(3) When a selected item of cost under 31.205 provides that *directly associated costs* be unallowable, such *directly associated costs* are unallowable only if determined to be material in amount in accordance with the criteria provided in paragraphs (e)(1) and (e)(2) of this subsection, except in those situations where allowance of any of the *directly associated costs* involved would be considered to be contrary to public policy.

Parent topic: 31.201 General.