

# AUDIT INFORMATION FOR CONTRACTORS



**LOS ANGELES UNIFIED SCHOOL DISTRICT  
OFFICE OF THE INSPECTOR GENERAL  
CONTRACT AUDIT UNIT**



# Los Angeles Unified School District Office of the Inspector General

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## FOREWORD

This booklet has been prepared to assist LAUSD contractors in understanding applicable requirements for audits conducted by the OIG's Contract Audit Unit and to help ease the contract audit process. The information and examples in the booklet are intended solely to provide better insight into the audit process and should not be construed as uniform mandatory guidelines. This booklet also should not be considered a substitute for the applicable rules, regulations and contractual terms, since not all requirements are contained herein. Each contractor must tailor its responses to its individual situation.

The Contract Audit has moved to electronic documentation in order to capture the efficiencies that information technology offers us. This necessitates obtaining source information in an electronic format. Therefore, contractors are encouraged to submit information electronically. Submitting information electronically will aid in reducing disruption to your staff during the audit, allow you to transmit information instantaneously, increase the accuracy of submissions and updates, automatically record events for later retrieval, and increase the overall productivity of all involved in the audit cycle.

All inquiries for additional information should be directed to the Contract Audit Unit at the address and telephone number below and on the OIG website <http://achieve.lausd.net/Page/775>. Individuals having concerns or suggestions about the contract audit process should bring these to the attention of the Deputy Inspector General, Contract Audit.

The Contract Audit Unit encourages the use of this booklet by all individuals interested in increasing their knowledge of the requirements of the audits conducted by the Contract Audit Unit. Additional copies can be downloaded from our website. User comments and suggestions are welcome. All correspondence should be addressed to:

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# AUDIT INFORMATION FOR CONTRACTORS

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# **CHAPTER 1**

## **INTRODUCTION TO THE CONTRACT AUDIT UNIT**

The Office of the Inspector General (OIG) reports directly to the Los Angeles Unified School District (Board of Education). This reporting structure gives the OIG significant independence from LAUSD managers and staff. The Deputy Inspector General, Contract Audit heads the OIG's Contract Audit Unit (Unit) and is a direct report to the Inspector General. The Deputy Inspector General serves as the strategic thinker and subject matter expert in contract audits and related issues within the OIG. The Unit is comprised of 12 auditors, 1 architect, 2 administrative staff and external auditors from 7 Certified Public Accounting (CPA) firms who perform audits on an as needed basis. The OIG auditors are comprised of Audit Managers, Principal Auditors and Senior Auditors. The architect serves as a Project Manager for the Technical Evaluation Team.

The Unit conducts audits of the District's procurement system which include procurement contracts for goods and services as well as contracts for the construction and modernization program. The Unit is responsible for conducting pre-award and post-award audits of all contracts and also provides support to District procurement officials in areas such as conducting rate surveys, claims and litigation support. The Unit conducts audits of contracts to ensure that District vendors and contractors comply with the requirements of their contracts and that contracted funds, especially bond funds, are expended as intended and that the District received what it paid for. Contract Audit activities also help to ensure that all District programs and Units using or managing bond funds have adequate internal controls in place. Furthermore, hundreds of professional audits and investigations completed by the OIG have resulted in saving the LAUSD millions of dollars which are redirected to students in the classroom.

### **Auditing Standards**

The Unit conducts its audits primarily in accordance with Government Auditing Standards issued by the Comptroller General of the United States. The Federal Acquisition Regulation provides the guidelines regarding allowability of costs invoiced by contractors. The Unit also conducts reviews, surveys and other services in accordance with the Statement on Standards for Attestation Engagements and Statement on Standards for Consulting Services issued by the American Institute of Certified Public Accountants.

## **CHAPTER 2**

### **PRE-AWARD AUDITS**

Pre-award audits are typically conducted pursuant to a Request for Proposal (RFP), a Request for Quotation (RFQ) or a Request for Qualification (RFQ). Usually the pre-award audits are conducted of contractors who have gone through the Facilities Services Division (FSD) prequalification process or the proposal review process by the Procurement Services Division (PSD) and are considered to be responsible and responsive. The auditor initiates the audit by contacting the contractor's representative and establishing a date and time for an entrance conference. The contact is established after the contractor has been sent an audit notification letter from the OIG. The entrance conference is intended to be an opportunity for the auditor to explain the purpose of the audit to the contractor and to obtain any and all information the auditor would need to complete the audit objectives. The entrance conference is also an opportunity for the contractor to ask any questions related to the proposed audit and seek any clarifications regarding the type, duration and amount of documentation the audit would require.

The actual audit time at a contractor location will vary depending on the size and complexity of the audit and availability of data. The quality of the proposal package submitted will also have a big impact on audit time. If the proposal is adequate, the auditor will complete the audit as quickly as possible with minimum disruption to the company's operations.

If for any reason during the audit, the auditor is not granted access to required information or the necessary people, the auditor would notify FSD or PSD of the problem. If the auditor determines that the refusal to grant access to certain data or persons would constitute a scope limitation the auditor may be forced to withdraw from the engagement and terminate the audit. In such cases the OIG would recommend that the contractor not be considered for the award of a contract pursuant to the RFP.

In order for the Unit to perform the audit, and to provide a timely, adequate, and fair evaluation of the contractor's proposal, the contractor should have available detailed schedules of the labor and overhead rates used in the proposal (if applicable). The schedules should show computations and tie into the contractor's existing accounting system. The schedules should also present the historical data and the rationales used in deriving any future projections, and exclude all unallowable costs. The accounting method used in estimating, and accumulating proposed costs should be the same as the method used to report the costs. Whenever possible, the proposal and supporting data should be provided in an electronic format. Submission in an electronic format is more efficient and conserves resources for both the contractor and the Unit. The contractor and auditor should work together to address software compatibility issues if they occur.

During the audit, the auditor will notify the contractor of any deficiencies noted and provide the contractor with an opportunity to either explain the deficiencies or provide additional information to clarify them. Upon completion of the audit, the auditor will notify the contractor that the audit is completed. During the exit conference for pre-award audits, the auditor will not

disclose conclusions relative to audit findings or amounts that may be questioned. The auditor's conclusions would only be made available to LAUSD contract and procurement officials for contract negotiations.

**Examples of DATA requested during a pre-award audit:**

The contractor is responsible for justifying and fully supporting all items in the proposal so that the audit will not be prolonged or negotiations delayed. The auditor may request the following data at the beginning of the audit but keep in mind that this list is not all inclusive.

1. Breakdown of the proposed fully burdened billing rate of each employee (e.g., base labor rate, overhead and fringe).
2. Supporting documentation for the labor rates of the proposed personnel or the proposed labor categories.
3. Overhead and fringe rate calculations, if applicable.
4. A schedule or list of expenses in the overhead or G&A pool
5. If any escalation was factored into the rates, the company should provide for the applied escalation
6. Access to or copy of the company's payroll register.
7. Where payroll records are not available the company should provide access to personnel records showing the individuals pay rates and if recently promoted, the dates of the promotion
8. Financial statements (including the Balance Sheet and Income Statement) for the most recent fiscal year.
9. Trial Balance and General Ledger Summary for the most recent fiscal year.
10. A copy of the Chart of Accounts.
11. A copy of the organization's most recent federal income tax return (if unaudited financials are provided).
12. A copy of the following policies:
  - a. accounting policies and procedures
  - b. pay raises and year-end bonuses (if applicable)
  - c. vacation and other paid absences
  - d. use of automobile – business or personal
  - e. business travel

13. A copy of recent audit/review report issued by an independent CPA firm or other governmental agencies (such as DCAA).

14. Record of bonus and pensions distributed, if applicable.

# CHAPTER 3

## ACCOUNTING SYSTEM REVIEW

### Overview

A review of a prospective contractor's accounting system is an examination of the contractor's accounting system prior to a contract award in relation to a pre-award audit.

### Accounting System Survey

a. The accounting system survey is an audit to determine the adequacy of a contractor's accounting system for accumulating costs under a prospective LAUSD contract. The audit scope would be limited to obtaining an understanding of the design of the contractor's accounting system and to determine whether or not the design of the accounting system is acceptable for accumulating costs under an LAUSD contract.

b. The contractor will be required to complete and return an Accounting System Survey and Internal Control Questionnaire. The contractor will also be required to provide written policies and procedures on timekeeping and billing and provide or make available data for testing the reliability of the accounting system.

c. If the accounting system is inadequate, the auditor will promptly notify both the contractor and the LAUSD of the deficiencies and will usually identify recommendations for correcting the deficiencies.

### Elements of an adequate accounting system:

1. **Proper segregation of costs.** (i) Review of the accounting system to determine if direct costs are segregated from indirect costs. (ii) Does the contractor maintain a Chart of Accounts defining direct and indirect functions? (iii) Are there controls in place to preclude direct charging of indirect expenses? (iv) Are there controls in place to preclude indirect charging of direct expenses?

2. **Identification and accumulation of direct costs by contract** (i) Did the contractor establish a Chart of Accounts defining various contracts? (ii) Determine if the accounting system can accumulate costs by contract. (iii) Does the contractor maintain a job cost ledger or project detail report which accumulates costs by contract and is reconciled to the general ledger? (iv) Are these controls in place to preclude mischarging of one contract effort with another contract?

3. **A logical and consistent method for the allocation of indirect costs** (i) Are there policies and procedures in place for the accumulation and billing of indirect expenses? (ii) Are indirect costs allocated to cost objectives based upon relative benefits received, or equitable relationships,



as required by FAR 31.201-4 & 31.203. (iii) Is the cost accounting system formally documented with a written description of the contents of the bases and pools?

**4. Accumulation of costs under general ledger control.** (i) Does the contractor maintain a general ledger? (ii) Are the contractor's job cost ledger, labor distribution, and other books of account reconcilable to the general ledger? (iii) Are postings to the books of account and the reconciliations done on a current basis?

**5. A timekeeping system that identifies employees' labor by intermediate or final cost objectives.** (i) Does the contractor's timekeeping system have the ability to track employees' time spent on each work activity? (ii) Does the contractor require employees to maintain timesheets?

**6. Interim (at least monthly) determination of costs charged to a contract through routine posting to books of account.** (i) Does the accounting system produce appropriate reports that show the results of charges to contracts? These reports should be produced at least monthly. (ii) How often does the contractor post to general ledger?

**7. Exclusion from costs charged to LAUSD contracts of amounts that are not allowable pursuant to FAR Part 31, Contract Cost Principles.** FAR identifies some costs as expressly unallowable: e.g., bad debts (FAR 31.205-3), contingencies (FAR 31.205-7); contributions or donations (FAR 31.205-8); and entertainment (FAR 31.205-14), and requires that they be excluded from proposals and billings. Does the contractor exclude unallowable costs from proposed or incurred costs?

## **CHAPTER 4**

### **TIMEKEEPING PROCEDURES**

Timekeeping procedures and controls on labor charges are areas of utmost concern because these charges form the basis for computation of the indirect cost rates and a major portion of billings. Unlike other costs, labor is not supported by external documentation or physical evidence to provide an independent check or balance. The key link in any sound labor time charging system is the individual employee. It is critical to any labor charging internal control system that management indoctrinates employees on their independent responsibility for accurately recording time charges. This is the single most important feature management can emphasize in recognizing its responsibility to owners, creditors, and customers to guard against fraud and waste in the labor charging function. To be effective, the internal controls over labor charging should meet the following criteria:

1. There should be a segregation of responsibilities for labor related activities; for example, the responsibilities for timekeeping and payroll accounting should be separated. In addition, the supervisors who are accountable for meeting contract budgets should not have the opportunity to initiate changes to employee time charges. It is recognized that for a very small company this type of segregation may not be possible, whereas for a larger company this type of segregation would be required in order to have good internal controls over labor costs.
2. Procedures must be evident, clear-cut, and reasonable so there is no confusion concerning the reason for controls or misunderstanding as to what is and what is not permissible.
3. Maintenance of controls must be continually verified and violations must be remedied through prompt and effective action, which serves as a deterrent to prospective violators.
4. Individual employees must be constantly, although unobtrusively, made aware of controls that act as an effective deterrent against violations. Many businesses accomplish this by emphasizing the importance of timecard preparation in staff meetings, employee orientation, and through the posting of signs throughout the workplace that remind employees of the importance of accurate and current timecards.

#### **Timecard Preparation**

Detailed instructions for timecard preparation should be established through a timekeeping pamphlet and/or company procedure. An automated timekeeping system uses remote data entry terminals to record labor charging data directly to the computer for processing. Supporting documentation normally consists of machine printouts or reports showing data that, in a manual system, appears on source documents. When a manual system is in place, instructions should indicate that the employee is personally responsible for:

1. Recording his/her time on a daily basis.

2. Recording time on the timecard in ink.
3. The correct distribution of time by project numbers, contract number or name, or other identifiers for a particular assignment. To ensure accuracy, a listing of project numbers and their description should be provided in writing to the employee.
4. All changes to timecards should be lined through, with the employee's initials beside the change indicating the employee personally made the change and that the change is correct. Automated systems should include provisions to provide an audit trail that records reasons for changes made to original entries.
5. Recording all hours worked whether they are paid or not. This is necessary because labor costs and associated overheads are affected by total hours worked, not just paid hours worked. Therefore labor rate computations and labor overhead costs should reflect all hours worked. Unpaid hours worked are termed "uncompensated overtime".
6. Signing the timecard at the end of each work week.

#### **Recommended Timekeeping Policy (Manual)**

- a. Timesheets should be preprinted with name and ID number.
- b. The supervisor should approve and cosign all timecards.
- c. The supervisor is prohibited from completing an employee's timecard unless the employee is absent for a prolonged period of time on some form of authorized leave. If the employee is on travel status, the supervisor for the employee may prepare a time sheet. Upon his or her return, the employee should turn in his/her time sheet and attach it to the one prepared by the supervisor.
- d. The company policy should state that the nature of the work determines the proper distribution of time, not availability of funding, type of contract, or other factors.
- e. The company policy should state that the accurate and complete preparation of timecards is a part of the employee's job. Careless or improper preparation may lead to disciplinary actions under company policies, as well as applicable statutes.

#### **Recommended Timekeeping Policy (Electronic)**

- a. Employee badge issuance should be controlled. There should be no duplications or issuance to unauthorized persons.
- b. There should be a procedure in place requiring the reporting of lost badges.
- c. All revisions should be documented via electronic passwords.
- d. Provide the same audit trail as in a manual system.

# CHAPTER 5

## FINANCIAL CAPABILITY REVIEW

### Overview

A review of a prospective contractor's financial capability is an assessment of the contractor's financial situation prior to a contract award in order to determine if the contractor is financially capable of performing on LAUSD contracts. This review is conducted in conjunction with a pre-award audit when the contractor is new to LAUSD business or when more than 2 years have passed since the last review.

### Financial Capability

A financial capability review involves a review of key financial data, balance sheet, income statement and cash flows to ensure that the contractor has the financial resources to complete the contract. In a financial capability review, the auditor attempts to get an understanding of the financial difficulties facing the contractor which might disrupt schedules and result in contract nonperformance. An early assessment of the contractor's financial difficulties allows the LAUSD to avoid loss of critical services, protects LAUSD property and inventory and helps the LAUSD develop alternative sources. An early assessment also allows the contractor the flexibility to borrow funds, liquidate assets, reduce capital expenditures or reduce its workforce.

In a financial capability review various financial data is evaluated including the following:

- a. 3 to 5 years of audited financial statements.
- b. Analytical review utilizing key financial ratios.
- c. Evaluation of cash flow projections.
- d. Review of off balance sheet items.
- e. Review of related party transactions

RATIO	FORMULA
Current Ratio	Current Asset/Current Liabilities
Acid Test (Quick Ratio)	Liquid Assets/Current Liabilities
Return on Investment (ROI)	Net Income/ Total Assets
Debt to Equity Ratio	Total Debt/Stockholders Equity
Cash Flow to Debt	Cash Flow (Net Income + Depreciation +Depletion +Amortization)/Total Debt
Cash Flow Return on Assets	Cash Flow from Operations/Total Assets
Cash Flow to Sales	Cash Flow from Operations/Sales
Cash Flow Adequacy	Cash from Operations/(Long term Debt Paid + Purchases of Assets + + Dividends Paid)
Debt Coverage	Total Debt/Cash from Operations

## CHAPTER 6

### INCURRED COST AUDITS

The Contract Audit Unit performs incurred costs audits of both professional services and construction contracts. The type of contracts may be cost reimbursable or fixed priced. The audit will include an evaluation of both direct and indirect costs (if applicable) and the technical aspects of the contract (if required). The audit objective is to determine whether the contractor performed on the contract as agreed and to examine the contractor's cost representations (i.e., invoices/billings) to determine whether such costs are: allowable, reasonable and allocable to the contract. The Unit ensures that the costs incurred by the contractor are in accordance with Generally Accepted Accounting Principles (GAAP), FAR and the provisions of the contract. The technical aspect of the contract is performed by the technical evaluation team. During the audit, the auditor will discuss the audit findings with the contractor. The contractor is expected to provide feedback on these findings on a timely basis.

At the completion of the audits, the auditor will address all factual aspects of the audit including all audit findings. Audit conclusions discussed at an exit conference are subject to final review; therefore, changes may occur in the draft or final reports. Subsequent to the exit conference the OIG will issue a draft report to the contractor. The contractor will be given the opportunity, usually 30 days, to respond to the draft report. Once received, an attempt would be made to resolve any outstanding issues raised in the contractor's response. Any agreements or disagreements between the audit conclusions and the contractor's response will be reflected in the final report. The contractor's comments will be paraphrased and included in the final report. Once finalized, the final report will be issued and posted on the Unit's website with the contractor's verbatim comments.

#### **Fixed Priced or Lump Sum contracts**

A fixed priced or lump sum contract provides for a single price for the total amount of work on a particular project. Normally, no adjustment to the price is made regardless of the actual cost experience or level of performance of the contractor except through a change order. Fixed priced contracts are audited mainly because non-performance of specified contract work, quality and scope of work overcharges are easily hidden behind lump sum contracts. In auditing fixed priced construction contracts the OIG normally looks for the following information:

1. Whether the Contractor completed major portions of the work or major building systems as required by the contract.
2. For ongoing contracts, whether the percentage of the total payments made was consistent with the percentage of work completed, minus the retention and withholds.
3. Whether the contractor met the bonding and insurance requirements.

4. Whether the contractor complied with the prevailing wage and certified payroll requirements.
5. Whether the contractor used the subcontractors proposed in its bid documents.
6. Whether there were any improper substitutions, assignments, and subletting of subcontractors as prohibited under Public Contract Code, Sections 4104, 4107 & 4110)
7. Whether change orders to the contract were priced in accordance with the contract provisions.
8. Whether the contract or change orders contained any charge backs, allowances or contingencies.
9. If the contract involved work in a school with the possibility of contact with students, whether the contractor was in compliance with California Education Code 45125.1 and 45125.2 (fingerprinting).

### **Guaranteed Maximum Contracts and 17406 Contracts**

The Guaranteed Maximum Contract (GMAX) is a hybrid between the lump sum and time and materials/cost reimbursable contract. It provides for the contractor to be reimbursed for cost of the work plus a fee which together shall not exceed the established GMAX price. The GMAX price is subject to adjustment by change order. GMAX contracts usually include a savings sharing provision whereby the contractor and the LAUSD share in the savings on a specified percentage basis. 17406 contracts are GMAX type contracts. In auditing GMAX contracts the OIG looks for the items specified under lump sum contracts and the following information:

1. Whether there were any construction contingency disbursements. If so, whether they were disbursed in accordance with contract provisions.
2. On completed projects, whether there was construction contingency remaining and whether it was shared pursuant to the split indicated in the contract.
3. Whether there were any LAUSD contingency disbursements and if they were disbursed in accordance with contract provisions.
4. Whether there were any allowances used and if so, whether they were used in accordance with contract provisions.
5. Whether there were any value engineering savings and if so, whether they were used in accordance with contract provisions.
6. Whether the contractor complied with the PSA requirements.
7. Whether the contractor staffed the project in accordance with the contract requirements.

## **Cost Reimbursable Contracts**

In cost type contracts, costs must be accumulated by contract in order to determine their allowability per LAUSD requirements, FAR and all applicable regulations. All costs (both direct and indirect) of producing goods or providing services should be identified to a final cost objective. FAR 31.001 defines a final cost objective as “a cost objective that has allocated to it both direct and indirect costs and, in the contractor’s accumulation system, is one of the final accumulation points”. Generally, a final cost objective is a contract. Accordingly, costs of a contract are comprised of direct costs and the contract’s allocable share of indirect costs.

A major part of accounting for costs by contract is the classification of costs as either direct costs or indirect costs.

### **Direct Cost**

FAR 31.202 defines direct costs as “any cost that can be identified specifically with a particular final cost objective” (i.e., cost incurred for a specific contract). FAR 31.202 also supplements this broad definition with the following:

- Costs identified specifically with a contract are direct costs of the contract and are to be charged directly to the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives.
- No final cost objectives shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective.

Contractors should make every effort to identify all costs that are direct, and by default, what remains is indirect.

### **Indirect Cost**

FAR 31.203 defines an indirect cost as “any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. It is not subject to treatment as a direct cost.” Further, an indirect cost shall be allocated to a final cost objective if other costs incurred for the same purpose in like circumstances have been included as a direct cost of that or any other final cost objective.

Because of their nature, indirect costs cannot be charged to final cost objectives on an individual basis. Therefore, indirect costs must be classified and grouped together into indirect cost pools, typically either an overhead cost pool or the general and administrative expense (G&A) cost pool. The pools in turn are allocated to final cost objectives using an indirect cost allocation base that best links the cost pool to the cost objectives.

## **Overhead Cost**

Costs that are incurred for or that only benefit an identifiable unit or activity of the contractor's internal organization such as an engineering or manufacturing department are considered overhead costs. It is common to find separate overhead pools for engineering, manufacturing and for certain off-site activities. Yet, it is conceivable that some contractors could have only one overhead pool.

Overhead rates are developed by dividing the overhead pool costs by the selected allocation base, e.g., direct labor dollars. See Chapter 8 for example of an overhead rate calculation.

To allocate means to distribute overhead pool costs to contracts. In order to distribute overhead pool cost, the contractor must select an allocation base. There must be a relationship between the selected allocation base and the pool of costs to be allocated to contracts. For example, an engineering overhead pool would logically be allocated over total engineering direct labor dollars. Additional information regarding the allocation of indirect costs to contracts can be found at FAR 31.203, Indirect costs.



# CHAPTER 7

## FAR 31 COST PRINCIPLES

The following extract of Federal Acquisition Regulation (FAR) 31-201 provisions is intended for use as a quick reference guide to determine if cost proposed or incurred by a contractor is allowable or not. The FAR provides guidance on how cost allowability is determined and identifies certain costs to be unallowable for government entities. Keep in mind that in many cases, a provision may make a cost allowable or unallowable but then again, there may be certain exceptions. The FAR states that generally a cost is allowable if it is: Reasonable, Allocable, Allowed by the terms of the contract, and Complies with FAR 31-205 provisions.

**Reasonableness:** Generally, a cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of a competitive business.

**Allocable:** A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received. However, it should be noted that cost may be allocable and at the same time be unallowable if it is not reasonable, not allowed by the terms of the contract, or is unallowable based on FAR 31-205 provisions.

**Contract terms:** Contract terms that address allowability of costs are generally more restrictive than FAR provisions. Some examples of such costs are State and Local taxes, salary costs that may be more restrictive than prescribed by FAR or more restrictive limits on travel costs.

FAR 31-205 contains 52 provisions that identify which costs are allowable and which are not. The following is a listing of each provision and a brief description of each cost.

FAR	ALLOWABLE	UNALLOWABLE
<b>FAR 31.205-1</b> <i>Public Relations and Advertising Costs</i>	Advertising costs is only allowable if it is required by the contract for acquiring scarce items or disposition of scrap or surplus material. Help wanted advertising is also allowable.	Cost of air shows; other events such as conventions and tradeshow; sponsoring meetings when the principal purpose is other than dissemination of technical information; corporate celebrations; new product announcements; promotional material designed to call favorable attention to the contractor; souvenirs, models, imprinted clothing, and buttons provided to customers or the public.

<b>FAR</b>	<b>ALLOWABLE</b>	<b>UNALLOWABLE</b>
<b>FAR 31.205-3</b> <i>Bad Debts</i>		Actual or estimated losses arising from uncollectible accounts and any directly associated costs such as collection costs or legal fees are unallowable.
<b>FAR 31.205-4</b> <i>Bonding</i>	Bonding costs required by the general conduct of a contractor's business or by contract terms are generally allowable.	
<b>FAR 31.205-6</b> <i>Compensation for Personal Services</i>	The main points to remember are that salaries must be reasonable and that there is a limitation on the salary cost for the five highest paid employees in a company.	Distribution of profits.
<b>FAR 31.205-7</b> <i>Contingencies</i>	Costs that are based on known and existing conditions such as rejects or rework in a production environment are generally allowable.	Future costs which cannot be estimated with any degree of accuracy cannot be included in cost estimates and are unallowable.
<b>FAR 31.205-8</b> <i>Contributions or Donations</i>		All contributions or donations including cash, property or services are unallowable.
<b>FAR 31.205-10</b> <i>Cost of Money</i>	This cost is computed on the basis of the cost of the facilities and equipment employed to perform on a contract. The rate applied is published quarterly by the US government.	
<b>FAR 31.205-11</b> <i>Depreciation</i>	Normal depreciation is generally allowable.	
<b>FAR 31.205-12</b> <i>Economic Planning Costs</i>	This cost consists of long-range management planning that is concerned with the future overall development of the business.	
<b>FAR 31.205-13</b> <i>Employee Morale, Health, Welfare, Food Service, and Dormitory Costs</i>	Generally these costs are allowable. Exceptions are gifts, cost of recreation and some losses from operation food and dormitory services.	

<b>FAR</b>	<b>ALLOWABLE</b>	<b>UNALLOWABLE</b>
<i>and Credits</i>		
<b>FAR 31.205-14</b> <i>Entertainment Costs</i>		All entertainment cost, including tickets to shows, sports events, meals lodging, rentals, transportation, memberships in social, dining or country clubs.
<b>FAR 31.205-15</b> <i>Fines, Penalties, and Mischarging costs</i>		Costs of all fines and penalties resulting from violation of the contractor to comply with Federal, State, local, or foreign laws.
<b>FAR 31.205-16</b> <i>Gains and Losses on Disposition or Impairment of Depreciable Property or Other Capital Assets</i>		With some exceptions, gains and losses resulting from the sale or exchange of assets other than depreciable property is unallowable.
<b>FAR 31.205-17</b> <i>Idle Facilities and Idle Capacity Costs</i>	Allowable when the facilities are necessary for fluctuating workload or were necessary when acquired. If the contractor can demonstrate that it is taking action to dispose of the facilities the cost is usually allowable.	The cost to maintain excess plant or equipment is unallowable.
<b>FAR 31.205-18</b> <i>Independent Research and Development and Bid and Proposal Cost.</i>	Generally allowable if reasonable and allocable.	
<b>FAR 31.205-19</b> <i>Insurance and Indemnification</i>	Generally allowable if reasonable and allocable.	Insurance on the lives of officers, partners, or proprietors are allowable only to the extent that the insurance represents additional compensation.

<b>FAR</b>	<b>ALLOWABLE</b>	<b>UNALLOWABLE</b>
<b>FAR 31.205-20</b> <i>Interest and Other Financial Costs</i>		Interest on borrowings, bond discounts, costs of financing or refinancing capital is always unallowable.
<b>FAR 31.205-21</b> <i>Labor Relations Costs</i>	The costs for maintaining satisfactory relations between the contractor and its employees are allowable.	
<b>FAR 31.205-22</b> <i>Lobbying and Political Activity Costs</i>		Attempts to influence the outcomes of any Federal, State or local elections or establishing, administering, contributing or paying the expenses of a political party are unallowable.
<b>FAR 31.205-23</b> <i>Losses on Other Contracts</i>		The costs of losses on other contracts are always unallowable.
<b>FAR 31.205-24</b> <i>Maintenance and Repair Costs</i>	Generally an allowable cost.	
<b>FAR 31.205-25</b> <i>Manufacturing and Production Engineering Costs</i>	The costs of development and deploying new or improved materials, systems etc. are allowable.	
<b>FAR 31.205-26</b> <i>Material Costs</i>	Costs including transportation and insurance are allowable.	
<b>FAR 31.205-27</b> <i>Organization Costs</i>		Basically all organization costs such planning or executing the organization or reorganization of the corporate structure is unallowable.
<b>FAR 31.205-28</b>	These types of expenses, such as, registry and charges resulting from	

<b>FAR</b>	<b>ALLOWABLE</b>	<b>UNALLOWABLE</b>
<i>Other Business Expenses</i>	changes in ownership, cost of shareholders meetings, proxy solicitation and preparing required reports and forms to taxing and other regulatory agencies are allowable.	
<b>FAR 31.205-29</b> <i>Plant Protection Costs</i>	All reasonable costs are allowable.	
<b>FAR 31.205-30</b> <i>Patent Costs</i>	Patent costs required for performance of a contract are allowable.	
<b>FAR 31.205-31</b> <i>Plant Reconversion Costs</i>	Generally an allowable cost.	
<b>FAR 31.205-32</b> <i>Pre-contract Costs</i>	Costs are allowable to the extent that they would have incurred after the date of the contract.	
<b>FAR 31.205-33</b> <i>Professional and Consultant Service Costs</i>	Costs for these services are generally allowable. However, there should be an agreement that shows the nature and scope of the services provided. In addition, invoices should contain sufficient detail to show what services were performed.	Cost for services that are otherwise unallowable, such as lobbying are also unallowable if performed by a paid consultant.
<b>FAR 31.205-34</b> <i>Recruitment Costs</i>	Generally an allowable cost.	Unallowable when the advertising does not describe specific positions or includes material that is irrelevant for recruitment purposes.
<b>FAR 31.205-35</b> <i>Relocation Costs</i>	Generally, relocation costs for existing and new employees are allowable if the relocated employee stays in the position for at least 12 months. This FAR section contains numerous details on the limitations for various categories of cost.	
<b>FAR 31.205-36</b> <i>Rental Costs</i>	Reasonable rental costs for personal property are generally allowable.	

<b>FAR</b>	<b>ALLOWABLE</b>	<b>UNALLOWABLE</b>
<b>FAR 31.205-37</b> <i>Royalties and Other Costs for Use of Patents</i>	Costs necessary for performance on a contract are generally allowable.	
<b>FAR 31.205-38</b> <i>Selling Costs</i>	These costs are generally allowable except for such costs as advertising (FAR 31.205-1).	
<b>FAR 31.205-40</b> <i>Special Tooling and Special Test Equipment</i>	If required by the contract, the cost of this type of equipment is generally allowable.	
<b>FAR 31.205-41</b> <i>Taxes</i>	Generally an allowable cost.	Federal income and excess profit tax and taxes paid in connection with financing, refinancing, or reorganizations are unallowable.
<b>FAR 31.205-42</b> <i>Termination Costs</i>	These costs are incurred when a contract is terminated for the convenience of the contracting entity. While many of these costs are allowable, each termination has to be individually evaluated to determine which cost is allowable.	
<b>FAR 31.205-43</b> <i>Trade, Business, Technical and Professional Activity Costs</i>	Membership in these organizations is an allowable cost.	In many instances these organizations use a portion of the membership dues for lobbying. This portion is unallowable.
<b>FAR 31.205-44</b> <i>Training and Education Costs</i>	Generally an allowable cost.	
<b>FAR 31.205-45</b> <i>Transportation Costs</i>	Generally an allowable cost.	

<b>FAR</b>	<b>ALLOWABLE</b>	<b>UNALLOWABLE</b>
<b>FAR 31.205-46</b> <i>Travel Costs</i>	Provisions for payment of travel cost for employees are set forth in Federal Travel Regulation, Joint Travel Regulations and Standardized Regulations. Allowability of travel cost has to be established in accordance with these regulations.	Excess per diem.
<b>FAR 31.205-47</b> <i>Costs Related to Legal and Other Proceedings</i>	Generally an allowable cost.	Legal proceedings which result in conviction, debarment, rescinding or voiding of a contract, termination for default or other illegal activity are unallowable.
<b>FAR 31.205-48</b> <i>Deferred Research and Development Costs</i>	Costs incurred before the award of a contract are unallowable except when allowable as pre-contract cost. Also, cost incurred in excess of the contract price or grant is unallowable.	
<b>FAR 31.205-49</b> <i>Goodwill</i>		Goodwill is always unallowable.
<b>FAR 31.205-51</b> <i>Costs of Alcoholic Beverages</i>		Cost of alcohol is always unallowable.

The following FAR clauses do not contain any guidance and are reserved for future use:

- FAR 31.205-2
- FAR 31.205-5
- FAR 31.205-9
- FAR 31.205-50

## CHAPTER 8

### EXAMPLE OF OVERHEAD RATE CALCULATION

<u>Indirect Expenses</u>	<u>Contractor Submitted</u>	<u>Audit Determined</u>	<u>Questioned Costs</u>	<u>Notes</u>
Salaries	\$ 450,000	\$ 450,000		
Employee Benefits	123,000	123,000		
Employer's FICA	148,000	148,000		
Worker's Compensation	16,000	16,000		
Employer Contribution 401 K	22,000	22,000		
Education & Seminars	8,000	8,000		
Professional Registration	5,000	5,000		
Building Rent	124,000	124,000		
Office Supplies, Periodicals	16,000	16,000		
Telephone	32,000	32,000		
Postage/Shipping	3,000	3,000		
Printing & Reproduction	15,000	15,000		
Business Taxes	2,000	2,000		
Legal Expenses	2,000	2,000		
Accounting/Auditing/Tax	20,000	20,000		
Contract Loss	2,000		\$ 2,000	1
Interest Expense	4,000		4,000	2
Professional Liability	38,000	38,005		
Auto Expenses	13,000	2,000	11,000	3
Travel	2,000	2,000		
Hotel & Meals	21,000	10,500	10,500	4
Depreciation	31,000	31,000		
Conferences/Tradeshows	10,000		10,000	5
Civic Contributions	2,400		2,400	6
Bad Debt Expense	30,000		30,000	7
Employee Bonuses	11,000	11,000		
Employee Future Bonuses	85,000		85,000	8
Officer Future Bonuses	122,000		122,000	8
Tax Provision	6,000		6,000	9
Total Indirect Expenses (a)	<u>\$ 1,363,400</u>	<u>\$ 1,080,505</u>	<u>\$ 282,900</u>	
Allocation Base: Direct Labor (b)	<u>\$ 1,500,000</u>	<u>\$ 1,500,000</u>		
Overhead Rate (a / b)	<u>90.89%</u>	<u>72.03%</u>	<u>18.86%</u>	



**Notes Explaining Questioned Costs:**

1. Unallowable per FAR 31.205-23.
2. Unallowable per FAR 31.205-20.
3. Automobile registration and depreciation are not allowed for an auto not owned by the company under FAR 31.201-3.
4. A reasonable 50% of the hotel and meals are questioned as entertainment under FAR 31.205-14, Entertainment costs. The contractor did not screen hotel and meals accounts for FAR unallowables.
5. Unallowable per FAR 31.205-1.
6. Unallowable per FAR 31.205-8.
7. Unallowable per FAR 31.205-3.
8. Contingencies possible future event arising from presently known or unknown causes are disallowed pursuant to FAR 31.205-7.
9. Unallowable per FAR 31.205-41.

**Know about fraud, waste or abuse?**

## **Tell us about it.**

**Maybe you are a School District employee, or maybe you are a private citizen. Either way, you are a taxpayer.**

**Maybe you know something about fraud, or waste, or some other type of abuse in the School District.**

**The Office of the Inspector General has a hotline for you to call. You can also write to us.**

**If you wish, we will keep your identity confidential. You can remain anonymous, if you prefer. And you are protected by law from reprisal by your employer.**

**Call the Hotline:**

**(213) 241-7778**

**or**

**1-866-LAUSD-OIG**

**Write to us:**

**Fraud Hotline Center  
333 S. Beaudry Ave., 12<sup>th</sup> Fl.  
Los Angeles, CA 90017**

**Website:**

**<http://achieve.lausd.net/Page/775>**