

SAMPLE AUDIT PROGRAM FOR ALLOWABLE COSTS REVIEWS

I. PURPOSE AND OBJECTIVE

The purpose of the cost allowability audit is to determine whether costs charged to Department of Energy (DOE) contracts are allowable, allocable, and reasonable per contract terms; Federal Acquisition Regulations (FAR) or OMB Circulars, as applicable, and DOE Acquisition Regulations (DEAR); and Cost Accounting Standards as implemented by the contract terms. Specific guidance covering the three criteria for allowability and example audit steps for select cost areas are included in Appendix A.

This program is intended for use by contractor internal audit activities. **The audit steps are general guidance and should be expanded or eliminated as necessary to fit the contractor's audit environment and risk assessment.** The program is intended to provide a logical sequence to the audit fieldwork and to reflect a mutual understanding between the auditor and supervisor as to the scope required to meet auditing standards and the audit's objectives for allowable costs reviews. It is expected that those portions of the audit that are covered in other audits will be referenced and incorporated in this review.

II. AUDIT SCOPE

A. This audit will be accomplished by:

1. Obtaining the criteria for determining the allowability of costs.
2. Assessing internal controls designed to ensure that only allowable costs are claimed under the contract.
3. Testing transactions to determine if unallowable costs were claimed.

III. AUDIT STEPS

A. Preliminary Steps

1. Follow local audit protocol for audit engagement notification.
2. Evaluate operations to determine whether major changes have occurred in:
 - a. Direct/Indirect charging procedures and practices.
 - b. Management culture.
 - c. Organizational structure by comparing current organization charts and charts from the prior year.
 - d. Business volume, employee count, the ratio and number of direct and indirect employees.

- e. Current internal control practices with regard to unallowable costs and the flow of transactions.
 - f. CAS Disclosure Statements, if applicable.
 - g. Direct and indirect labor accounts compared to prior year's budget for evidence of undisclosed changes in labor charging practices.
3. Perform the following Statement of Costs Incurred and Claimed (SCIC) analysis:
- a. Reconcile the amounts in the SCIC to the general ledger (GL), subsidiary ledger, or trial balance. Obtain explanations for significant differences. Costs claimed in excess of amounts recorded in the financial systems would be questioned as unsupported.
 - b. Verify the mathematical accuracy of the SCIC.
4. Analyze operating statement accounts by:
- a. Comparing the current GL or trial balance account balances (and if applicable, within pools and bases) to prior years to identify any changes in accounting practices or unexplained disproportionate changes in relative dollar value and obtain explanations from management.
 - b. Identifying unallowable costs for current and prior year.
 - c. Comparing the ratio of unallowable costs to total costs of related cost elements or groupings (travel, consultants, etc.) for the current and prior year, and obtaining explanations for significant changes.
5. Identify potential vulnerable areas from evaluating the following:
- a. Prior year audit files.
 - b. Board or senior management meeting minutes for major decisions that affect the organization and operations for the year(s) being audited.
 - c. Company website, employee publications, press releases, and such for potential audit issues.
6. Review areas covered under other audits by:
- a. Identifying audit issues from DOE site offices, OIG, external auditors, DCAA, or internal auditors through discussions and reviews of audit reports that may affect the audited costs.
 - b. Identifying the floor checks or other labor audits covering the fiscal year (FY) and performed during the FY.
 - c. Identifying on-going and completed assist labor and subcontract audits pertaining to the FY being audited. Note any findings for follow-up. If needed, coordinate with the subcontract audit authority or contracting officer and request assist audits for labor, subcontract costs, and home office and other intermediate allocations.

- d. Identifying other assignments such as operations/performance, information technology (IT), financial controls, and systems surveys which affect the scope of this audit.
 - e. Determining whether to rely on the work of others such as IG, DCAA, or external auditors and documenting:
 - A copy of the report and/or written confirmation of the work performed.
 - The period and costs covered.
 - A summary of the result(s) of the audit(s).
 - A statement of the degree of reliance placed on the work of others (a statement of the audit scope covered by this reliance).
7. Evaluate contract provisions:
- a. Look for indirect rate ceilings or cost categories that may not be billed directly on the contract(s). Note for comparison to any unexplained changes in charging patterns identified during the preliminary steps.
 - b. Obtain and review the DOE contract and appendices and prepare a listing of (i) expressly unallowable costs, (ii) costs with contractual limitations, which if exceeded, would be unallowable, (iii) costs requiring DOE approval.
8. Conclude on the review of preliminary steps to determine the issues (activities/actions) that have had or may have had an impact of cost allowability.

B. Internal Controls

Internal controls over major disbursement categories should be reviewed periodically, as applicable, to ascertain whether the system of controls established provides (i) reasonable assurance of efficiency and effectiveness of the disbursement process; (ii) for reliable financial reporting; and (iii) that transactions and costs incurred and recorded comply with applicable laws and regulations. Internal controls coverage may be provided by separate audit(s) scheduled and conducted as part of the annual internal audit plan.

The typical major disbursement categories are:

- Payroll
 - Accounts Payable (Purchasing)
 - Non-Purchase Order Areas (Procurement Cards, Check Requests, Special, Petty Cash, Other Process Specific)
 - Travel
1. Review the results from the Internal Controls review(s) over major disbursement areas and determine the risk associated with claiming unallowable costs on the SCIC. Evaluate changes in internal controls over unallowable costs since the last audit. Assess whether an

internal controls review over unallowable costs is needed to be done as part of this cost allowability audit or whether it is sufficient to perform limited or concurrent transaction testing to support the auditor's assessment and understanding of the internal controls over unallowable costs.

2. Obtain an understanding of the applicable internal controls over cost allowability in effect during the FY(s) being reviewed and document the policies, procedures, and systems for identifying costs as unallowable:
 - Document account names, numbers, and descriptions, type of costs charged, and whether the account(s) are used to accumulate unallowable cost.
 - Determine what funding is used to pay for these identified unallowable costs.
 - Document the transaction flow for unallowable costs to determine if the contractor pays directly for the cost or if it is first paid through DOE's letter of credit.
3. Determine which business systems, as defined by the DEAR, are required and have been reviewed and accepted by DOE. Determine the reasons for disapprovals of the systems.
4. Document the conclusions reached on internal controls over unallowable costs and identify any internal control deficiencies that would impact cost allowability. Material internal controls weaknesses over unallowable costs should be reported.

C. Risk Assessment Determination

Based on steps performed at III.A and III.B (preliminary and internal controls), assess risk associated with specific general ledger accounts, group of accounts, or departments. Some areas are considered to have significant inherent risks and should be included annually.

If risk of an unallowable cost is assessed at maximum (the internal controls are non-existent or ineffective to prevent the contractor from claiming unallowable costs), the auditor needs to perform extensive testing of transactions in order to reach a conclusion on the allowability of cost.

Select expense accounts for transaction testing and the sampling methodology to be used. It is expected that a recognized statistical sampling methodology be used to sufficiently reach a conclusion on the allowability of costs and permit the projection of unallowable costs. Valid statistical results can best be achieved when applied to a homogeneous universe. For certain cost categories, a judgmental sampling methodology may be used. In those circumstances, the rationale for using judgmental sampling should be clearly documented in the auditor's workpapers.

Document the sampling technique, including confidence and precision level (if statistical), to be used on each account or group of accounts to obtain efficient use of resources.

D. Transaction Testing

Total costs incurred should be identified, analytically reviewed by transaction type or account/resource category and may be grouped into the following major disbursement categories:

- Payroll
- Accounts Payable (Purchasing)
- Non-Purchase Order Areas (Procurement Cards, Check Requests, Special Disbursements, Petty Cash, Other Process Specific)
- Travel

The major disbursement categories may be further segregated into specific categories as identified in Appendix A. The nature, amount, and extent of the transaction testing as well as the sampling methodology used should be based on the results of the planning, internal control, and risk assessments sections of the program (III.A through III.C). In addition to testing of identified high-risk area, some transaction testing should be performed annually in major disbursement categories where the auditor has determined that the risk of claiming unallowable costs is low. The additional testing should be done to validate the assessment that risk is low and controls are functioning as intended. The nature, amount, and extent of additional transaction testing should be adjusted accordingly.

Appendix A provides guidance on attributes that should be evaluated when performing transaction testing. The Appendix A attributes listing is not intended to be all-inclusive and should be modified to fit the contractor's audit environment and risk assessment. Annual transaction testing should include tests of contractual provisions and limitations for unallowable cost being incurred and claimed.

E. Audit Completion

1. Follow local audit protocol for audit engagement completion.

APPENDIX A

GUIDANCE FOR ALLOWABLE COSTS TRANSACTION TESTING

Appendix A is divided into two sections. Section I provides general guidance for the determination of the allowability of costs and is applicable to any cost selected for review. Section II describes transaction testing for 14 common cost areas in the disbursement processes and **should be modified to fit the contractor's audit environment and risk assessment.**

I. GENERAL GUIDANCE WHEN REVIEWING FOR ALLOWABILITY OF COSTS

The following 5 sections provide general guidance for reviewing any cost selected for determining cost allowability.

A. General

1. Was the cost for an actual item received or service rendered?
 - a. Review supporting documentation to conclude that the cost represents an item received or effort provided.
 - b. Review properly completed and approved vendor invoices, canceled checks, or other documentation to determine if the cost is supported.
 - c. For equipment, confirm that the item exist and review receiving report and equipment inventory record.
 - d. For material, review receiving report, bill of material, logs, quality assurance report, or stockroom records.
 - e. If sufficient documentation cannot be obtained to support a cost, interview personnel to the extent necessary to conclude that the cost was allowable.
 - f. If the auditor cannot be satisfied that the cost was incurred, the cost is considered to be unsupported and therefore unallowable.
2. Is the cost properly classified by expense category?
 - a. Determine if costs are identified and recorded in the appropriate expense category.
 - b. Identify if a portion of the expense should be separately categorized.
3. Are the dollar amounts accurate?
 - a. Recompute extensions, allocations, and formulas to determine if the amount of the cost is accurate.

- b. Determine if the vendor invoice rates agree with prices established in the purchase order.
4. Can the cost be traced to subsidiary and general ledgers?
 - a. Verify that the cost was properly recorded in the general ledger and any supporting subsidiary ledgers.
 - b. Verify that the cost was charged to the fiscal year in which it was incurred.
5. Is the cost's treatment consistent with other similar transactions?
 - a. Evaluate whether the cost was treated consistent with similar costs.
 - b. Evaluate if the cost was recorded against the same expense code and expense category (direct/indirect) as like costs.
6. Is the cost an accrual?
 - a. Determine if accruals are based on supported estimates.
 - b. Determine whether estimates appear to be significantly overstated or understated to compensate for a year-end funding excess or shortfall.
 - c. Determine if any improper accruals impacted the allowability of costs claimed.

B. Applicability to the Contract

1. Does the cost have special terms and requirements per the contract?
 - a. Refer list identified at III.A.7.
 - b. Determine if the cost represents a cost that the contract defines as unallowable.
 - c. Determine if the cost complies with applicable contract ceilings and limitations.
 - d. Determine if prior CO approval was obtained or prior CO approval is required for this cost.
 - e. Determine whether the cost violates CO rulings, interpretations, or guidance.
2. Is the item or service related to the contract effort (allocable)?
 - a. Evaluate whether the item received or service rendered generally appears to be related to the contract effort. Be alert to costs that should have been charged to the other activities outside the scope of the contract.
 - b. Evaluate whether the item received or the service rendered was related to the account to which it was charged.
 - c. Determine whether the cost duplicates the types of costs covered by a management allowance or fee arrangement.

C. FAR 31 – Cost Allowability (OMB Circular)

1. The following costs are expressly unallowable per FAR 31, however, the auditor must check with the FAR for additional information:

- General Advertising/Public Relations
- Alcoholic beverages
- Bad debts
- Contingency reserves
- Contributions and donations
- Dividends or other profit distributions
- Excess depreciation
- Entertainment
- Fines, penalties, and mischarging costs
- First-class/business class air travel
- Goodwill amortization
- Insurance for catastrophic losses
- Interest and related taxes for refinancing
- Certain legal expenses
- Lobbying costs
- Losses on other contracts
- Organization expenses and related taxes for reorganizing
- Certain relocation and
- Certain taxes for federal income and excess profits

D. Cost Accounting Standards (CAS) Allocability

1. Does the accounting treatment comply with applicable CAS?
2. Ascertain whether the cost complies with the applicable CAS requirements.

E. Reasonableness

1. Is the cost reasonable per FAR 31.201-3, *Determining Reasonableness*?
 - a. Ascertain whether the cost exceeds that which would be incurred by a prudent person in the conduct of competitive business or as ordinary and necessary for the conduct of business or the contract performance.
 - b. Determine if the cost followed generally accepted sound business practices, arm's-length bargaining, and Federal and State laws and regulations.
 - c. Determine whether the costs comply with contract clauses and contractor's established policies and procedures.

II. GUIDANCE FOR DETERMINING THE ALLOWABILITY OF COSTS IN SPECIFIC COST AREAS

The following 14 common cost areas are included in disbursement processes where unallowable costs may be claimed. The listing is not intended to be all-inclusive and should be modified to fit the contractor's audit environment and risk assessment. Attributes for each cost area is provided below for use when performing transaction testing of these areas. If it is determined that there is a high risk of incurring an unallowable cost in any of these areas, costs should be grouped into a homogeneous population for the appropriate sampling methodology and transaction testing.

- A. Travel Costs
- B. Relocation Cost
- C. Dues, Memberships, Conferences, and Subscriptions
- D. Public Relations and Advertising Costs
- E. Payroll and Related Costs
- F. Employee Welfare and Morale Expenses
- G. Professional and Consultant Service Costs
- H. Subcontract Costs
- I. Purchased Labor
- J. Lobbying Costs
- K. Costs Related to Legal and Other Proceedings
- L. Procurement Card Purchase
- M. Accounts Payable Purchases
- N. Costs Transfers

The guidance below is applicable and unique to the type of expenses under review:

A. Travel Costs

1. Review travel policies and procedures.
2. Determine if travel costs were computed according to the reimbursement rates and are properly authorized and incurred in accordance with the travel policies and procedures.
3. Determine whether proper documentation exists per FAR 31.205-46(a)(7). Receipts and information should include date and place such as city, town, and/or county, purpose of the trip, and name of person on trip and that person's title or relationship to the contractor.
4. Determine whether costs for lodging, meals, and incidental expenses are consistently followed and are allowable per rates established by government travel regulations.
5. Ensure that airfare costs are limited to the lowest customary standard, coach, or equivalent airfare offered during normal business hours. Exceptions are allowed for special circumstances and are set forth in FAR 31.205-46(d).
6. Contractors may receive cash rebates or free tickets directly from airlines under a prefer vendor arrangement (not individual frequent flyer miles.) Such rebates and refunds should be 'returned' to the government in the same manner in which the original costs were incurred, where practical and be consistent with the contractor's policies for treating refunds and credits.

7. If air travel is via private aircraft, determine whether they comply with FAR 31.205-46(d). Generally, travel via private aircraft in excess of the standard commercial airfare is unallowable unless an advance agreement has been executed.
8. Ensure that proper documentation is maintained for all travel via private aircraft per FAR 31.205-46(e)(2).
9. Review travel outside the Continental United States or any travel of more than 21 consecutive days for documentation of proper authorization.

B. Relocation Costs

1. Review costs for compliance with standards in FAR:
 - a. FAR 31.205-35 defines relocation costs as costs incident to the permanent change of duty assignment for a period of 12 months or more of an existing employee or upon recruitment of a new employee.
 - b. FAR 31.205-46 defines rules for travel related to relocation for the employee and the employee's family to the new duty station and for house hunting trips.
 - c. FAR 31.205-46 allowable maximum government travel regulation per diem rates for lodging, meals and incidental expenses apply to contractor employees while traveling for house hunting trips and travel to the new duty station. These criteria do not apply to temporary quarters allowances because the employee is not considered to be on official business travel while in temporary quarters.
 - d. Certain duty assignments, principally overseas locations, are accompanied by "location allowances." The location allowances represent compensation in addition to normal wages and salaries per FAR 31.205-6. Any travel costs to an overseas location should be considered travel costs in accordance with FAR 31.205-46.
2. Compare the cost to the list in FAR 31.205-35(a) and (c) for specifically allowable relocation costs.
3. Evaluate the contractor's policies and procedures and the employment agreements to determine reasonableness and compliance with FAR requirements.
4. Determine whether relocation costs are reasonable and allocable, and meet the four criteria listed in FAR 31.205-35(b).
5. Verify that a refund or credit was provided to the government if the 12-month requirement of a permanent change of duty assignment agreement for reasons within the employee's control requires was not met per FAR 31.205-35(d) except as waived by FAR 31.205-35(f)(4).

C. Dues, Memberships, Conferences, and Subscriptions

1. Review costs for compliance with standards in FAR:
 - a. FAR 31.205-43 generally allows dues, memberships, conferences, and subscriptions whose primary purpose is the dissemination of trade, business,

- technical, or professional information or the stimulation of production or improved productivity.
- b. FAR 31.205-43 makes the following type of professional and technical activity costs expressly allowable:
- Organizing, setting up, and sponsoring the technical and professional meetings, symposia, seminars, etc., including rental of meeting facilities, transportation, subsistence, and incidental costs.
 - Attending the meetings by contractor employees, including travel costs per FAR 31.205-46.
 - Attending the meetings by individuals who are not contractor employees, provided the costs are reimbursed to them by their own employer and their attendance is essential to achieve the purpose of the meetings.
2. Ensure that costs of memberships in civic and community and lobbying organizations are unallowable.
3. Determine whether the minimum fee for membership in any university's industrial liaison program is reasonable and supported by evidence of bona fide services available or rendered. Under these programs, contractors are usually entitled to the use of university facilities, consultations with faculty members, copies of research reports, attendance at symposiums, and possibly other benefits.
4. Review the primary mission of the organization receiving the payments or benefits of membership fees, association dues, or the costs of donated time or materials from the contractor. Organizations generally fall into the following categories based on their mission:
- Bona Fide Trade or Professional Organizations – Organizations formed for the basic purpose of providing technical services to member contractors.
 - Trade or Nonprofit Organizations Partially Engaged in Lobbying or Charitable Activities – The costs of membership are partially unallowable to the extent such payments are for the portion that is for lobbying or charitable activities.
 - Organizations Dedicated to Lobbying or Charitable Activities – Costs for memberships in these organizations are unallowable per FAR 31.205-8 and FAR 31.205-22.
5. Ensure that contributions related to dues and subscription accounts are excluded from claimed costs. Professional organizations often include a suggested voluntary contribution as part of the membership dues. The amount in excess of the value established is an expressly unallowable contribution under FAR 31.205-8.
6. Determination of allowability requires knowledge concerning the purpose and nature of activity at the meeting or conference. Review expenses to determine whether the contractor maintain adequate records supplying such information on properly prepared travel vouchers or expense records supported by copies of paid invoices, receipts, charge slips.

7. Review costs to determine whether costs are for guest expenses for meals or other incidentals applicable to Federal employees. These costs should normally be questioned as unnecessary, and hence unreasonable costs, except under limited circumstances, since they are prohibited from accepting gratuities by Executive Order 11222 of 1965, Title 5 CFR 2635, and various departmental implementing directives.
8. Determine whether expenses associated with a particular meeting or conference represent allowable business expense under FAR 31.205-43(c) or unallowable social activity under FAR 31.205-14, *Entertainment Costs*, and should be made on a case-by-case basis, based on all pertinent facts. FAR 31.205-43(c)(3) disallows costs associated with the spouse of an attendee because the spouse's attendance is not essential to achieve the purpose of the meeting.
9. For individuals on official travel, assure the meal expense is not included in both the claimed travel costs and subsistence costs included as part of organizing the meeting.
10. For individuals not on official travel, assure that any meal expense is an integral part of the meeting as described in FAR 31.205-43(c), necessary for the continuation of official business during the meal period, and not a social function.

D. Public Relations and Advertising Costs

1. Review costs for compliance with standards in FAR:
 - a. FAR 31.205-1(a) defines public relations as all functions and activities dedicated to: (i) maintaining, protecting, and enhancing the image of a concern or its products; or (ii) maintaining or promoting reciprocal understanding and favorable relations with the public at large, or any segment of the public. The term public relations include activities associated with areas such as advertising and customer relations.
 - b. FAR 31.205-1(b) defines advertising as the use of media to promote the sale of products or services and to accomplish the activities referred to in FAR 31.205-1(d).
 - c. FAR 31.205-1(d), (e), and (f) address the allowability of public relations and advertising costs. All advertising costs other than those specified in FAR 31.205-1(d) are unallowable.
 - d. FAR 31.205-34 limits allowable advertising costs for recruitment.
 - e. FAR 31.205-1(e)(3) makes costs for participation in community service activities such as blood bank drives, charity drives, savings bond drives, and disaster assistance allowable provided that the activity does not materially affect their other regular duties and responsibilities.
 - f. FAR 31.204(c) prevents contractors from successfully claiming unallowable public relations costs under more favorable and broader cost principle coverage such as unallowable costs of ceremonies per FAR 31.205-1(f)(4) claimed as employee morale and welfare under FAR 31.205-13.

2. Determine whether costs are allowable public relations costs such as cost incurred for (i) responding to inquiries on company policies and activities; (ii) communicating with the public, press, stockholders, creditors, and customers; and (iii) conducting general liaison with news media and government public relations officers.
3. Costs of plant tours and open houses are allowable; however, ensure that promotional material, motion pictures, videotapes, brochures, handouts, magazines, and other media that are designed to call favorable attention to the contractor and its activities are not claimed.
4. Ensure that costs not specifically identified as public relations cost such as materials and services found in the following cost categories are reviewed as public relations costs per FAR 31.205-1:
 - Advertising Costs
 - Compensation for Personal Services
 - Contributions and Donations
 - Employee Morale, Health, Welfare and Food Service and Dormitory Costs and Credits
 - Entertainment Costs
 - Labor Relations Costs
 - Other Business Expenses
 - Professional and Consultant Service Costs-Legal, Accounting, Engineering and Other
 - Selling Costs
 - Trade, Business, Technical and Professional Activity Costs
5. When reviewing the different categories of costs, the auditors should consider major factors related to the costs such as the nature of the service rendered, the function performed, the propriety of the base of allocation, and the basic consideration of reasonableness.
6. Determine whether costs fall into one of the categories of public relations costs claimed by a contractor for the preparation and printing of such items as plant newspapers and magazines, recruitment pamphlets, technical brochures, and contractor and product capability promotional items. Audits of claimed publications costs should be based on an appropriate examination of the contractor's policies and procedures. There are five broad categories into which most publications may be grouped:
 - Employee Welfare and Industrial Relations – The most common publications of this type are regularly issued newspapers or magazines.
 - Professional and Technical Articles – These publications are disseminated to a professional or technical type audience and generally take the form of dissertations on technical subjects that are related to the contractor's products or activities.
 - Selling, Marketing, and Advertising – In those instances where the material provides little or no technical assistance to the recipient and is distributed to all customers and potential customers, the cost should be treated as advertising (FAR 31.205-1) or selling costs (FAR 31.205-38).

- Contractor and Product Capability – Promotional items differ from normal selling, marketing, and advertising publications in that they stress the superior capabilities of the contractor's facilities and/or personnel in research and/or development of new products.
- Public Relations – This category includes pictures, decals, and promotional material that emphasize the contractor's accomplishments in producing equipment or providing services.

7. Determine whether total public relations expenditures are reasonable, especially when there have been significant increases relative to prior years.

E. Payroll and Related Costs

1. Determine whether executive compensation costs are claimed in accordance with ranges established by contract terms or FAR 31.205-6 and Office of Federal Procurement Policy (OFPP).
2. Review employee receiving pay over maximum salary range of the employee's grade range.
3. Review time sheets, payroll, personnel, and/or other records to determine if an employee was a real employee who worked on the contract effort.
4. Determine if overtime and associated premium hours have been approved, if required by the contract terms.
5. Determine if payroll costs were computed as reported on the timesheet and the pay rates identified in the personnel records.

F. Employee Welfare and Morale Expense

1. Determine if recreation program and exercise/wellness facility are available to all employees.
2. Determine if the Employee Recognition/Service Awards cost complies with the contract and the contractor's established policies and procedures.
3. Determine whether expenses and income generated by employee welfare and morale activities comply with FAR 31.205-13. If employee morale expenses fall into the category of entertainment then they are unallowable per FAR 31.205-14.
4. Determine whether the cost of operating the cafeteria results in a break even scenario. A loss may be allowable, provided the contractor can demonstrate that unusual circumstances exist such that even with efficient management, operating the service on a breakeven basis would require charging inordinately high prices, or prices higher than those charged by commercial establishments.

G. Professional and Consultant Service Costs

1. Obtain vendor listing and 1099-Misc. forms and review for possible consultants not included on the listing.

2. Analyze consultants' agreements, work products, and related records for sensitive consultants such as i) lobbyists; ii) sales/marketing; iii) management services (excluding CPA firms); iv) legal; v) technical/engineering; and vi) accounting, CPA firms, actuary, and insurance.
3. Determine whether the activity engaged in by the consultant is strictly unallowable in accordance with the contract and applicable FAR and DEAR provisions.
4. If the review of agreements and work products fails to establish a logical link to activity that benefits either the business as a whole or government contracts or programs in particular, then the cost and related consultant expenses should be questioned.
5. If the nature of the consulting service appears to be allowable and allocable, work products should be reviewed for the reasonableness of the total costs charged.
6. Trace selected consultant costs through the purchasing system to determine that procedures have been followed.

H. Subcontract Costs

1. Determine that payment is being made provisionally to ensure that the amount paid can be adjusted for the results of a future audit and request or perform the audit.
2. Determine if subcontract charges were based on the subcontract's billing provisions.

I. Purchased Labor

1. Review the contractor's policy, with emphasis on the criteria used in determining whether personnel should be obtained from outside sources instead of direct hiring.
2. Analyze the purchased labor during the current or most recently completed fiscal year, whichever provides sufficient information, to:
 - Determine the number of purchased labor personnel and the duration of their engagement.
 - Compare the number of employees on the contractor's payroll (in each classification of purchased labor involved) with the number of equivalent personnel obtained from outside sources.
 - Compare the cost per staff-year with the contractor's comparable personnel.
 - Determine whether the contractor's practices are equitable with respect to the use of purchased labor compared to the contract mix.
3. Determine whether the use of purchased labor results in additional costs that are reasonable, necessary, and allocable to contracts.
4. Verify that fringe benefits and other employee related costs are not allocated to purchased labor costs. Such costs are generally paid by the entity providing personnel performing the effort.
5. Verify that indirect costs are allocated to purchased labor in a reasonable proportion to the causal or beneficial relationship of the pooled costs to cost objectives. Purchased labor must share in an allocation of indirect expenses such as supervision and occupancy costs,

where there is a causal or beneficial relationship, and the allocation method must be consistent with the contractor's disclosed accounting practices.

J. Lobbying Costs

1. Identify whether contractor has a Washington DC area office and the purpose of the office. Review costs to determine allowability.
2. Determine whether the cost was incurred to influence elections, public votes on issues, political parties, and legislation per FAR 31.205-22. Cost incurred to induce or tend to induce, either directly or indirectly, executive branch employees to give consideration or to act regarding a government contract on any basis other than the merits of the matter is unallowable.

K. Costs Related to Legal and Other Proceedings

1. Use the following guidance on the regulatory history for FAR 31.205-47 to consider applying the cost principle to specific cases:
 - The government should not pay for wrongdoing, the defense of wrongdoing, or the results or consequences of wrongdoing by contractors.
 - The government should not encourage litigation by contractors.
 - Government contractors should not be put in a better position than contractors in the commercial area.
 - The government should not discourage contractors from enforcing the government's rights and protecting the government's interests.
2. Determine whether costs are allowable legal costs per the following categories:
 - Reasonable costs associated with routine proceedings, not specifically addressed in the FAR cost principle.
 - In-house legal staff handles routine inquiries from government agencies such as DCAA.
 - Contract terms.
 - CO directed.
3. Determine whether costs are subject to ceilings defined by FAR 31.205-37(f).
4. Determine whether legal costs under review are unallowable based on the outcome of the proceedings:
 - In a criminal proceeding, a conviction.
 - In a civil or administrative proceeding (including a qui tam proceeding) involving an allegation of fraud or similar misconduct, a finding of liability.
 - In a civil or administrative proceeding not involving an allegation of fraud or similar misconduct, an assessment of a monetary penalty.

- In a proceeding held by an appropriate official of an executive agency for debarment or suspension of the contractor; rescission or voiding of a contract; or termination of a contract for default because of violation of or noncompliance with a law or regulation, a final decision unfavorable to the contractor.
 - In any proceeding shown above which led to a settlement by consent or compromise.
5. Determine whether legal costs are unallowable regardless of the outcome include:
- Defense or prosecution of claims or appeals against the Federal government (FAR 31.205-47(f)(1)).
 - Organization, reorganization, mergers, or acquisitions, or resistance to merger or acquisition (FAR 31.205-47(f)(2) and FAR 31.205-27).
 - Defense of antitrust suits (FAR 31.205-47(f)(3)).
 - Defense or prosecution of lawsuits or appeals between contractors arising from such agreements as teaming arrangement, dual sourcing, co-production, or similar programs (FAR 31.205-47(f)(5)).
 - Defense against stockholder suits that are related to contractor wrongdoing such as intentional harm to other persons, and instances where there has been a reckless disregard for the harmful consequences of an action.
 - Patent infringement proceedings if not required by the contract (FAR 31.205-30, FAR 31.205-47(f)(6)).
 - Defense against contractor misconduct addressed in another proceeding whose outcome determined the costs to be unallowable.
 - Bid protest costs and costs of defending against protests are expressly unallowable under FAR 31.205-47(f)(8) for contracts awarded on or after October 7, 1996 unless per written directions from the CO.
6. Review legal proceeding costs to ensure that the contractor properly segregated costs for each proceeding regardless of the outcome that is anticipated.
7. If the outcome of a proceeding described in FAR 31.205-47(b) determines costs to be allowable, review total costs for reasonableness.

L. Procurement Card Purchase

1. Select a sample from the Procurement Card universe, excluding those accounts of costs already selected for specific review.
2. Review costs for proper documentation and allowability per FAR.
3. Pay close attention to items of personal nature and scrutinize these costs.
4. Ensure that purchases are made in accordance with the policies and procedures over purchase card transactions.

M. AP Purchases

1. Select a sample from the AP universe, excluding those accounts of costs already selected for specific review.
2. Review costs for proper documentation and allowability per FAR.
3. Refer to specific areas in Sections A to K related to types of costs in the sample for additional guidance to items required for the review.

N. Transferred Cost

1. Select a sample from the account(s) for cost transfers in and out (inter/intra organizational transfers).
2. Obtain an understanding of the transfer process.
3. Review costs for proper documentation and allowability per FAR.
4. Ensure that transferred costs are allowable and do not duplicate the types of costs that are covered by any contractual management allowance or fee arrangements.
5. Incorporate results of Home Office reviews from other audit.