GOVERNMENT CONTRACT
COSTS, PRICING & ACCOUNTING REPORT®

SEPTEMBER 2013 | VOLUME 8 | ISSUE 5

## ¶ 38 Penalties For Unallowable Costs

*By Karen L. Manos*[1]

As many defense contractors have found, Defense Contract Audit Agency auditors have over the past few years become increasingly aggressive in recommending penalties for costs questioned as unallowable. At the same time, Defense Contract Management Agency administrative contracting officers have started more frequently assessing, and become less willing to waive, penalties. The new policy appears to be that whenever an ACO determines that a cost is expressly unallowable, penalties must be assessed regardless of whether a waiver is appropriate. However, not all unallowable costs are expressly unallowable, not all expressly unallowable costs are subject to penalties, and even when the disallowed cost is subject to penalties, a waiver may be required. This article examines when penalties are appropriate and when they must be waived.

The rules for assessing and waiving penalties are prescribed by Federal Acquisition Regulation § 42.709 and FAR clause 52.242-3, Penalties for Unallowable Costs. The penalty provisions apply to all contracts worth over $700,000, except fixed-price contracts without cost incentives and firm-fixed-price contracts for the purchase of commercial items. The same "covered contracts" are subject to FAR clause 52.242-4, Certification of Final Indirect Costs, which requires a certification by the contractor that no unallowable costs have been included in any final indirect cost rate proposal or final statement of costs incurred or estimated to be incurred under a fixed-price incentive contract.

Penalties may be assessed if certain types of unallowable indirect costs are included in a final indirect cost rate proposal or final statement of costs incurred and estimated to be incurred under a fixed-price incentive contract.[2] In particular, if the indirect cost is expressly unallowable under a cost principle in the FAR or an executive agency supplement, the penalty is equal to the amount of the disallowed costs allocated to covered contracts for which the indirect cost proposal was submitted.[3] The penalty is double that amount if the indirect cost was determined to be unallowable for that contractor before the proposal was submitted.[4] It is not necessary for the costs to have been paid for the penalty to be assessed,[5] but if the costs have been paid, then in addition to the penalty, the contractor is liable for interest on the paid portion of the disallowance.[6] The Government bears the burden of proving that penalties are appropriate.[7]

### Not All Unallowable Costs Are Expressly Unallowable

Expressly unallowable costs are a relatively small subset of unallowable costs. An "unallowable cost" is defined as "any cost that, under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost reimbursements, or settlements under a Government contract to which it is allocable."[8]

[1] *Karen L. Manos is a partner in Gibson, Dunn & Crutcher, LLP, and the author of Government Contract Costs & Pricing (2d ed. 2009).*

Regardless of whether a contract is otherwise subject to the Cost Accounting Standards, the FAR requires that "the practices for accounting for and presentation of unallowable costs must be those described in 48 CFR 9904.405, Accounting for Unallowable Costs."[9] CAS 405 distinguishes between five different types of unallowable costs: (1) expressly unallowable costs, (2) costs mutually agreed to be unallowable, (3) unallowable directly associated costs, (4) costs designated by the contracting officer as unallowable, and (5) costs that are not contractually authorized.[10]

An "expressly unallowable cost" is defined as "a particular item or type of cost which, under the express provision of an applicable law, regulation, or contract, is specifically named and stated to be unallowable."[11] The CAS Board stated that it "used the word 'expressly' in the broad dictionary sense—that which is in direct or unmistakable terms."[12] Mutually agreed to be unallowable costs are, as the name implies, costs that both parties agree are unallowable.[13] Importantly, a contractor's agreement to exclude a particular cost from a billing, claim or proposal should not be confused with an agreement that the cost is *unallowable*.

CAS 405 defines "directly associated cost" as "any cost which is generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred."[14] Although FAR 31.001 contains the same definition, the application in FAR 31.201-6 is broader for salary expenses of employees who participate in activities that generate unallowable costs. Because salaried employees receive the same salary regardless of whether they participate in activities that generate unallowable activities, no portion of their salary meets the criteria of having been "generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred." Nevertheless, FAR 31.201-6(e)(2) provides:

> 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 subparagraph (e)(1) above (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 the such activities are a part of the employee's regular duties.[15]

The FAR applies the same materiality criteria to other directly associated costs, stating in FAR 31.201-6(e)(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 were allowance of any of the directly associated costs involved would be considered to be contrary to public policy.[16]

Both CAS 405 and FAR 31.201-6 require the contractor to identify and exclude from any billing, claim or proposal applicable to a Government contract, costs that are expressly unallowable or mutually agreed to be unallowable, including costs that are mutually agreed to be unallowable directly associated costs.[17]

CAS 405 defines costs designated as unallowable as those "which specifically become designated as unallowable as a result of a written decision furnished by a contracting officer pursuant to contract disputes procedures."[18] For penalty purposes, the FAR uses a slightly broader definition of "designate" that includes not only an unappealed CO's final decision, but also a (1) DCAA Form 1, Notice of Contract Costs Suspended and/or Disapproved, that the contractor elected not to appeal and was not withdrawn by the cognizant Government agency; (2) prior board of contract appeals or court decision involving the contractor which upheld the cost disallowance; or (3) determination or agreement of unallowability under FAR 31.201-6.[19] Costs designated as unallowable need only be identified, and need not be excluded from billings, claims and proposals, so long as the parties dispute the allowability of the costs.[20] The preamble to CAS 405 states in this regard:

> The Board notes that the identification of costs covered by an adverse contracting officer decision will not

> prevent a contractor from continuing to claim such costs, where disagreement as to allowability continues. It serves merely to identify the costs for special consideration, thereby helping to assure adequate reevaluations, and to promote resolution of the issues involved in the disagreement.[21]

Once a cost has been designated as unallowable, the identification requirement applies to all other costs incurred for the same purpose under like circumstances.[22]

On the other hand, costs that are not contractually authorized must be accounted for in a manner permitting "ready separation" from contractually authorized costs, but they are not required to be either identified or excluded from billings, claims and proposals.[23]

### Not All Expressly Unallowable Costs Are Subject to Penalties

In addition to the fact that expressly unallowable costs are a relatively small subset of unallowable costs, not all expressly unallowable costs are subject to penalties.

To begin, only indirect costs, and not direct costs, are subject to penalties.[24] Second, only costs allocated to covered contracts are subject to penalties.[25] Third, only costs that are expressly unallowable under a FAR cost principle or agency supplement—as opposed to costs that are expressly unallowable under an applicable law, regulation other than the FAR cost principles or agency supplement, or contract provision—are subject to penalties.[26] Fourth, the Armed Services Board of Contract Appeals has held that in order to impose penalties, "the Government must show that it was unreasonable under all the circumstances for a person in the contractor's position to conclude that the costs were allowable."[27]

The ASBCA has also held that penalties may not be assessed if the ACO has discretion to accept supported costs.[28] In this case, DCAA questioned and the ACO disallowed and assessed penalties on leased aircraft costs in excess of standard coach airfare under FAR 31.205-46(e)(2) (now FAR 31.205-46(c)(2)) because there was no advance agreement approving a higher amount, no contract required travel by contractor-leased aircraft, and the contractor's flight manifest and logs lacked some of the information required by the cost principle. The ASBCA held that the disputed aircraft costs were not expressly unallowable under FAR 31.205-46(e)(2) because the ACO had discretion to accept supported costs, and, therefore, the contractor's incurred cost "claim was sufficiently colorable to preclude penalties."[29]

Despite these holdings, DCAA and DCMA have misconstrued the definition of expressly unallowable costs to include any costs that do not meet the specific requirements of a cost principle. For example, DCAA on Aug. 4, 2009, published audit guidance taking the position that the costs of providing health insurance to ineligible dependents are "expressly unallowable" and subject to penalties because such costs do not meet the "expressed requirements" of FAR 31.205-6. The audit guidance states:

> It has come to our attention that some large defense contractors are inappropriately charging the Government for health benefit costs for dependents that are no longer eligible for such benefits under the contractors' plans. Auditors should ensure that the contractor's forecasted costs and incurred cost submissions do not contain health benefit costs for ineligible dependents. The cost of health insurance premiums and claims for ineligible dependents and ineligible spousal coverage are unallowable in accordance with FAR 31.205-6(m)(1), Compensation for Personal Services, Fringe Benefits. Since purchased insurance premiums or self insurance claims associated with ineligible dependents do not meet the expressed requirements of the referenced FAR provision (i.e., in accordance with established contractor policy), penalties should be recommended on any questioned amounts as part of incurred cost audits.[30]

FAR 31.205-6(m)(1)states in pertinent part, "[e]xcept as provided otherwise in subpart 31.2, the costs of fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor."[31] Although fringe benefit costs that do not meet these criteria are not allowable, the FAR does not make them expressly unallowable. DCAA's audit guidance ignores the second half of the definition of "expressly unallowable" costs, which requires that the particular item of cost be "specifically named and stated to be unallowable."

Notwithstanding this obvious error in DCAA's interpretation, DCMA on Sept. 24, 2010, issued an "information memorandum" stating that it reviewed DCAA's audit guidance and agreed that the costs of ineligible dependents are expressly unallowable and subject to penalties if included in a contractor's final indirect cost rate proposal.[32] Compounding the error, the information memo goes on to state, "If the ACO determines that the costs are unallowable, the ACO shall treat the costs as expressly unallowable costs."[33] This assertion fails to consider the mandatory requirement imposed by FAR 42.709-5 to waive the penalties in three circumstances, which are discussed below.

Shortly after DCMA issued its information memo, DCAA prepared a training presentation for its auditors that essentially takes the position that any cost disallowed by a specific FAR or DFARS cost principle, other than on the basis of reasonableness, is expressly unallowable.[34] For example, the presentation states:

> Evidence for First Level Penalties to Apply:
>
> - Auditor must cite a cost principle in FAR 31.205 as the basis for the questioned cost.
> - The cost must be identified in the cost principle in direct or unmistakable terms, but presence of the word "unallowable" is not a requirement.
> - One can reasonably deduce that claimed cost is expressly unallowable.[35]

Further compounding the error, DCAA on Feb. 4, 2011, issued additional audit guidance instructing its auditors that a contractor's inclusion of ineligible dependent health care costs in its indirect costs should not only be treated as the inclusion of expressly unallowable costs, but should also be treated as a CAS 405 noncompliance.[36]

Implicitly acknowledging the error in the Government's interpretation, the Director, Defense Pricing issued a memorandum, dated Feb. 17, 2012, that effectively reversed the DCAA and DCMA position that costs incurred in providing health care benefits to ineligible dependents are expressly unallowable and subject to penalties.[37] The memo states that although DOD will continue to disallow ineligible dependent health care benefit costs, it will not pursue penalties under FAR 42.709.[38]

The memo further notes that DOD intends "to amend the DFARS to make future ineligible dependent health care benefit costs expressly unallowable and thus subject to penalties."[39] As forewarned by the DDP memo, on Feb. 28, 2013, DOD published a proposed rule to amend the DFARS by adding a new ¶ 231.205-6(m)(1), explicitly stating that fringe benefit costs incurred or estimated to be incurred that are contrary to law, employer-employee agreement or an established policy of the contractor are unallowable.[40] The drafters' comments accompanying publication of the proposed rule state:

> FAR 31.205-6(m) states that the costs of fringe benefits (which include employee health care benefits) are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor. Although fringe benefit costs that do not meet these criteria are not allowable, the FAR does not make them expressly unallowable. Specifying these fringe benefit costs as expressly unallowable in the DFARS makes it clear that the penalties at FAR 42.709-1 are applicable if a contractor includes such unallowable fringe benefit costs in a final indirect cost rate proposal or in the final statement of costs incurred or estimated to be incurred under a fixed-price incentive contract.[41]

Despite having had its overly broad interpretation publicly rejected by DDP, DCAA and DCMA have persisted in treating costs that do not meet the "expressed requirements" of a cost principle as expressly unallowable costs subject to penalties. For example, DCAA and DCMA frequently take the position that professional and consultant service costs for which the contractor lacks some or all of the documentation described in FAR 31.205-33(f)(1)–(3) are expressly unallowable and subject to penalties. This position is consistent with the training presentation that DCAA prepared before the DDP memo rejecting DCAA's interpretation. The presentation includes an excerpt from a DCAA audit report that questioned the consultant costs on the basis of inadequate documentation, but did not recommend that the ACO assess penalties.

The presentation criticizes the audit report's failure to recommend penalties, stating,

> The audit report did NOT cite penalties; however, FAR 31.205-33(f) states, in direct and unmistakable terms, that fees for services rendered are allowable only under

specified conditions. Thus, if the contractor's costs do not meet those conditions, the costs are expressly unallowable under the cost principle. Accordingly, the auditor should recommend application of the FAR 42.709 penalty to costs properly questioned under FAR 31.205-33(f).[42]

One need only substitute "FAR 31.205-6(m)(1)" for "FAR 31.205-33(f)" and "dependent health care costs" for "fees for services" to recognize that this is precisely the same interpretation that was previously rejected by the DDP memo and the DFARS proposed rule on fringe benefit costs, and is directly contrary to the established ASBCA precedent discussed above.

Finally, the DCAA training presentation also takes the position that penalties apply to "directly associated costs" of expressly unallowable costs.[43] However, as CAS 405 makes clear, "directly associated costs" are different from "expressly unallowable costs."[44] Indeed, it is only "*mutually agreed to be unallowable* directly associated costs"—and not all directly associated costs of expressly unallowable costs—that must be "identified and excluded from any billing, claim, or proposal applicable to a Government contract."[45]

Even mutually agreed to be unallowable directly associated costs are not subject to penalties because they are not costs named and stated to be unallowable by a FAR cost principle or agency FAR supplement. Therefore, it is contrary to the plain language of FAR 42.709 and FAR 52.242-3 to assess penalties on "directly associated costs."

### DCMA Is Ignoring Mandatory Penalty Waivers

Equally as egregious as the overbroad interpretation of "expressly unallowable" are the blanket penalties that DCMA ACOs have been imposing without granting waivers required under FAR 42.709-5(c). FAR 42.709-5 requires the ACO to waive the penalty in three circumstances. First, the penalty must be waived if the contractor withdraws its final indirect cost rate proposal and submits a revised proposal before the Government formally initiates an audit.[46] An audit is considered formally initiated when the Government provides the contractor with written notice, or holds an entrance conference, indicating that audit work on the proposal has begun.[47]

Second, the penalty must be waived if the amount of unallowable costs subject to the penalty that would be allocated to covered contracts is $10,000 or less.[48] After two decisions holding that the $10,000 threshold applies to each individual item of cost allocated to contracts containing the penalties clause,[49] the ASBCA reversed itself on reconsideration in the second case and held that the FAR 42.709-5(b) threshold applies to the *aggregate* amount of allocable, expressly unallowable costs.[50]

Third, under FAR 42.709-5(c), the ACO is required to waive the penalties if the contractor demonstrates to the ACO's satisfaction that (1) it has established policies, personnel training, and an internal control and review system that provides assurance that unallowable costs subject to penalties are excluded from final indirect cost rate proposals, and (2) the unallowable costs subject to the penalty were inadvertently incorporated into the proposal.[51]

As examples of the types of internal controls that are sufficient to satisfy the first criterion of FAR 42.709-5(c), FAR 42.709-5(c)(1) lists "the types of controls required for satisfactory participation in the Department of Defense sponsored self-governance programs, specific accounting controls over indirect costs, compliance tests which demonstrate that the controls are effective, and Government audits which have not disclosed recurring instances of expressly unallowable costs."[52]

Regarding the second criterion—that the unallowable costs were inadvertently incorporated into the proposal, FAR 42.709-5(c)(2) adds the following explanatory phrase to the language of the underlying statute, "i.e., their inclusion resulted from an unintentional error notwithstanding the exercise of due care."[53]

In this author's experience, however, DCMA ACOs have recently begun applying the second criterion of FAR 42.709-5(c) as a strict liability measure, i.e., if an expressly unallowable cost subject to penalty is included in the contractor's proposal, the contractor must have failed to exercise due care and, therefore, a waiver is not appropriate. This strict liability interpretation virtually ensures no waiver ever will or can be

granted under FAR 42.709-5(c). Because the DCMA interpretation renders the FAR 42.709-5(c) waiver provision superfluous, it is for that reason alone untenable.[54]

The appropriate test is inadvertence. That is, a waiver must be granted for the inadvertent inclusion—and penalties may only be assessed for the purposeful inclusion—of costs made expressly unallowable by a FAR cost principle or agency FAR supplement. "Inadvertent" means "[m]arked by unintentional lack of care."[55] It is a synonym of "careless."[56]

As noted above, the FAR implementation of the statutory waiver provision includes an explanatory note to help define what is meant by inadvertent. FAR 42.709-5(c)(2) states, "The unallowable costs subject to the penalty were inadvertently incorporated into the proposal; *i.e.*, their inclusion resulted from an unintentional error, notwithstanding the exercise of due care." "Due care" is synonymous with "reasonable care."[57] It means the level of care that is "due" or "reasonable" under the circumstances. For example, Black's Law Dictionary provides the following definition for "reasonable care":

> As a test of liability for negligence, the degree of care that a prudent and competent person engaged in the same line of business or endeavor would exercise under similar circumstances.—Also termed *due care*; *ordinary care*; *adequate care*; *proper care*. See reasonable person.[58]

Consistent with this definition, cases have held that the "exercise of due care" means following the "customary practice" for the transaction at issue.[59] In the context of FAR 42.709-5(c)(2), so long as a contractor took reasonable steps to ensure that its final indirect cost rate proposal did not include unallowable costs, and did not intentionally include them, the costs should be considered to have been inadvertently incorporated in the proposal, notwithstanding the exercise of due care.

The legislative history of the penalties provision supports this interpretation because it demonstrates that Congress expressly added a mandatory waiver provision to ensure that penalties would not be imposed for inadvertent mistakes.[60] FAR 42.709-5 implements section 818 of the National Defense Authorization Act for Fiscal Year 1993.[61] The waiver provision was added to the defense authorization bill during the conference committee hearings to reconcile the House version of the bill, which contained no waiver provision, and the Senate version, which contained two minor unrelated waiver provisions.

The Senate Report stated that penalties serve as an important deterrent to fraudulent and negligent submissions, but noted concern that the statute, as then worded, "requires penalties to be assessed even when there are reasonable differences of opinion on the issue of allowability or when unallowable costs were included inadvertently in a submission."[62] The Senate therefore "recommend[ed] a provision which would revise current law."[63] The House Report described the Senate version of the bill, noted that the House bill contained no similar provision, and provided the following description of the conference committee action:

> The House recedes with an amendment that would authorize the Secretary of Defense to issue regulations providing for the waiver of a penalty if the contractor demonstrates, to the contracting officer's satisfaction, that it has established appropriate policies, personnel training, an internal control and review system that provide assurances that unallowable costs are not included in the contractor's proposal, and that the unallowable costs were included by mistake. The conferees note that the purpose of the penalty provisions in 10 U.S.C. 2324 is to ensure that contractors, rather than the government, bear the burden of assuring that contractor submissions for reimbursement of costs on government contracts do not include unallowable costs.[64]

The legislative history demonstrates that although Congress intended for contractors, rather than the Government, to bear the burden of scrubbing their indirect cost rate proposals to exclude unallowable costs, it did not want to punish contractors for mistakenly including such costs. Thus, DCMA's strict liability interpretation of the waiver provision is contrary to the plain language of the underlying statute, implementing regulation and legislative history.

## Conclusion

In summary, DCAA and DCMA have been apply-

ing an overbroad interpretation of expressly unallowable costs subject to waivers, and improperly refusing to grant waivers when required by FAR 42.709-5(c).

**ENDNOTES:**

[2]FAR 42.709-1(a)(1); 52.243-2(b).

[3]FAR 42.709-1(a)(1).

[4]FAR 42.709-1(a)(2).

[5]FAR 42.709-1(c).

[6]FAR 42.709-1(a)(1)(ii).

[7]*Appeal of Fiber Materials, Inc.*, A.S.B.C.A. No. 53616, 07-1 B.C.A. (CCH) ¶ 33563, 2007 WL 1252481 (Armed Serv. B.C.A. 2007), citing *In re General Dynamics Corp.*, A.S.B.C.A. No. 49372, 02-2 B.C.A. (CCH) ¶ 31888, 2002 WL 1307491 (Armed Serv. B.C.A. 2002), rev'd in part, 365 F.3d 1380 (Fed. Cir. 2004).

[8]FAR 2.101; accord 48 C.F.R. 9904.405-30(a)(4).

[9]FAR 31.201-6(c)(1).

[10]See 48 C.F.R. 9904.405-40.

[11]48 C.F.R. 9904.405-30(a)(2); accord FAR 31.001.

[12]CAS 405, Preamble A, Item 3, 38 Fed. Reg. 24195 (Sept. 6, 1973), reprinted in CCH Cost Accounting Standards Guide ¶ 3992 at 5040.

[13]48 C.F.R. 9904.405-40(a).

[14]48 C.F.R. 9904.405-40(a)(1); accord FAR 31.001.

[15]FAR 31.201-6(e)(2); see also Richard Johnson, "CAS 405 And Directly Associated Labor Costs: An Historic Clash Between DoD and the CAS Board," 31 Pub. Cont. L.J. 479 (2002).

[16]FAR 31.201-6(e)(3).

[17]48 C.F.R. 9904.405-40(a); FAR 31.201-6(a).

[18]48 C.F.R. 9904.405-40(b).

[19]FAR 42.709-1(a)(2).

[20]48 C.F.R. 9904.405-40(c); FAR 31.201-6(b).

[21]CAS 405, Preamble A, Item 5, 38 Fed. Reg. 24195 (Sept. 6, 1973), reprinted in CCH Cost Accounting Standards Guide ¶ 3992 at 5041.

[22]48 C.F.R. 9904.405-40(b); FAR 31.201-6(b).

[23]48 C.F.R. 9904.405-40(d).

[24]FAR 42.709-1(a)(1).

[25]Id.

[26]Id.

[27]*In re General Dynamics Corp., A.S.B.C.A. No. 49372*, 02-2 B.C.A. (CCH) ¶ 31888 at 157,570, 2002 WL 1307491 (Armed Serv. B.C.A. 2002), rev'd in part, 365 F.3d 1380 (Fed. Cir. 2004); accord *Appeal of Fiber Materials, Inc.*, A.S.B.C.A. No. 53616, 07-1 B.C.A. (CCH) ¶ 33563, 2007 WL 1252481 (Armed Serv. B.C.A. 2007).

[28]*Appeal of Fiber Materials, Inc.*, A.S.B.C.A. No. 53616, 07-1 B.C.A. (CCH) ¶ 33563, 2007 WL 1252481 (Armed Serv. B.C.A. 2007).

[29]Id.

[30]DCAA Memorandum for Regional Directors, "Audit Guidance on Review of Dependent Health Benefit Costs" (09-PSP-016(R)) (Aug. 4, 2009); 4 CP&A Rep. ¶ 44.

[31]FAR 31.205-6(m)(1).

[32]DCMA Information Memorandum No. 10-527, "Ineligible Dependent Health Benefit Costs" (Sept. 24, 2010); 5 CP&A Rep. ¶ 60(i).

[33]Id.

[34]See DCAA Memorandum for Regional Directors, "Transmittal of FAO Staff Conference Presentation—Penalties on Unallowable Costs" (10-PAC-031(R)) (Oct. 26, 2010).

[35]Id.

[36]DCAA Memorandum for Regional Directors, "Audit Guidance on Cost Impact Resulting from CAS 405 Noncompliance Related to Dependent Health Benefit Costs" (11-PAC-002(R)) (Feb. 14, 2011).

[37]DDP Memorandum for Director, DCAA and Director, DCMA, "Unallowable Costs for Ineligible Dependent Health Care Benefits" (Feb. 17, 2012); see also DCAA Memorandum for Regional Directors, "Update on Audit Guidance Regarding Unallowable Costs for Ineligible Dependent Health Care Benefit Costs" (13-PAC-004(R)) (March 28, 2013).

[38]Id.

[39]Id.

[40]See 78 Fed. Reg. 13606 (Feb. 28, 2013); 8 CP&A Rep. ¶ 18(f).

[41]78 Fed. Reg. at 13607.

[42]DCAA Memorandum for Regional Directors, "Transmittal of FAO Staff Conference Presentation—Penalties on Unallowable Costs" (10-PAC-031(R)) (Oct. 26, 2010).

[43]Id.

[44]Compare 48 C.F.R. 9904.405-30(a)(1) (defining directly associated cost) with 48 C.F.R. 9904.405-30(a)(2) (defining expressly unallowable cost).

[45]48 C.F.R. 9904.405–FAR 31.201-6(a) (emphasis

 

added).

[46]FAR 42.709-5(a).

[47]Id.

[48]FAR 42.709-5(b).

[49]See *Appeal of Fiber Materials, Inc.*, A.S.B.C.A. No. 53616, 07-1 B.C.A. (CCH) ¶ 33563, 2007 WL 1252481 (Armed Serv. B.C.A. 2007); accord *Appeal of Thomas Associates, Inc.*, A.S.B.C.A. No. 57126, 11-1 B.C.A. (CCH) ¶ 34764, 2011 WL 2135548 (Armed Serv. B.C.A. 2011).

[50]See *Appeal of Thomas Associates, Inc.*, A.S.B.C.A. No. 57126, 11-2 B.C.A. (CCH) ¶ 34858, 2011 WL 5142513 (Armed Serv. B.C.A. 2011).

[51]FAR 42.709-5.

[52]FAR 42.709-5(c)(1).

[53]FAR 42.709-5(c)(2).

[54]See, e.g., *U.S. v. Hassanzadeh*, 271 F.3d 574, 582, 58 Fed. R. Evid. Serv. 149 (4th Cir. 2001)("We construe a statute or regulation 'so that, when possible, no part... is superfluous.' ").

[55]The American Heritage Dictionary of the English Language 884 (4th ed. 2000).

[56]Id.

[57]See Black's Law Dictionary 574 (9th ed. 2011) (defining "due care" as "See *reasonable care* under care.").

[58]Id. at 240.

[59]See, e.g., *Czarobski v. Lata*, 227 Ill. 2d 364, 317 Ill. Dec. 656, 882 N.E.2d 536 (2008) (party seeking rescission of contract based on a unilateral or mutual mistake must demonstrate that "the mistake occurred notwithstanding the exercise of due care" by that party, and "due care" requires following "customary" practices).

[60]See Ralph Nash and John Cibinic, "Penalties for Unallowable Costs: A Kinder and Gentler Statute for DoD Contractors and Things to Come for Civilian Agency Contractors," 7 Nash & Cibinic Rep. ¶ 8.

[61]See National Defense Authorization Act for Fiscal Year 1993, Pub. L. No. 102-484, 818, 106 Stat. 2315, 2457 (1992), codified in 10 USCA § 2324(c) and 41 USCA § 4303(c).

[62]S. Rep. 102-352, at 237 (1992).

[63]Id.

[64]H.R. Rep. No. 102-966, at 728 (1992) (Conf. Rep.), reprinted in 1992 U.S.C.C.A.N. 1769, 1819.