

2017 Regulatory Integrity Division (RID) Letter

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Key Word(s): Subrecipient Monitoring; Disallowable Costs; Procurement; Contracting

TO: Regulatory Integrity Division Directors
Subrecipient Monitoring Department
TWC Finance Department
Office of General Counsel

FROM: Paul Carmona, Director of Regulatory Integrity

SUBJECT: Identifying Disallowable Costs

PURPOSE

To inform Texas Workforce Commission (TWC) Subrecipient Monitoring (SRM) staff of guidance regarding identifying disallowable costs with regard to procurements and contracting. This guidance is provided to assist monitoring teams with making determinations whether specific cost principles identify expressly unallowable costs.

INFORMATION

Determining Whether a Cost Principle Identifies Expressly Unallowable Costs

In order for a cost to be expressly unallowable, SRM 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. Thus, a cost principle makes costs expressly unallowable if:

1. It states in direct terms that the costs are unallowable, or leaves little room for differences of opinion as to whether the particular cost meets the allowability criteria; and

2. It identifies the specific cost or type of costs in a way that leaves little room for interpretation.

Language of the Cost Principle Concerning Allowability

Stated in Direct Terms

In situations where the cost principle states in direct terms that the cost is unallowable or not allowable, it is easy to determine whether the cost is expressly unallowable. In those situations, there is no doubt that the costs questioned based on the cost principle are expressly unallowable.

Not Stated in Direct Terms

In many situations, SRM monitors question costs based on cost principles that do not state in direct terms that the cost is unallowable. In those situations, determining whether the cost is expressly unallowable becomes more of a challenge.

The mere fact that the cost principle does not include the word unallowable or phrase ‘not allowable’ does not mean that costs questioned based on that cost principle are not expressly unallowable.

A cost can be expressly unallowable even though the cost principle does not explicitly state that the cost is unallowable or not allowable. However, in those situations, the monitoring team will have to make a determination regarding whether the cost principle, used as the basis for questioning the costs, identifies expressly unallowable costs. In order for the cost to be expressly unallowable, it is not enough that our logical interpretation of the language is that the questioned costs are expressly unallowable. SRM must establish that it was “unreasonable under all the circumstances for a person in the contractor’s position to conclude that the costs were allowable.” Therefore, in situations where a cost principle does not specifically state that the applicable cost is unallowable or not allowable, the monitoring team will have to employ critical thinking when determining whether the cost principle identifies expressly unallowable costs. The monitoring team will need to analyze whether the

cost principle identifies a cost or type of cost clearly enough that there cannot be a reasonable difference of opinion as to whether a questioned cost meets the criteria specified.^{1 2}

Examples of cost principle not expressly stated as disallowed, but which could, by evaluation of the merits, be determined as disallowed include the following.

Reasonableness and Necessity Criteria

Cost Principle: A cost is allowable when the cost is ‘reasonable.’ There is an overarching allowability statement at 2 CFR 200.404, “A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.” This statement does not clearly identify a particular cost or type of costs and there could easily be rational differences of opinion as to whether a particular cost is reasonable. Thus, while costs that are *not* reasonable are unallowable, they are not expressly unallowable. Analysis must clearly conclude that the cost, in and of itself, is unreasonable when applying the ‘prudent person’ standard. These standards are discussed in [Chapter 8, Cost Principles](#), of TWC’s Financial Manual for Grants and Contracts (FMGG).

¹ *Emerson Electric Co.*, Armed Services Board of Contract Appeals (ASBCA) No. 30090, 87-1 BCA ¶19,478 (Nov. 19, 1986). In that case, the Board stated, “With regard to CAS 405, the CAS Board clearly intended the word ‘expressly’ in the phrase ‘expressly unallowable cost’ to be understood in the ‘broad dictionary sense,’ rather than as a term of art having some special, subtle meaning. According to the CAS Board, the unallowability of a cost item must be expressed in either ‘direct or unmistakable terms.’” The Board ruled that although the regulation did not state that foreign selling costs were unallowable, the only logical interpretation of the language was that they were expressly unallowable.

² In [General Dynamics Corp., ASBCA No. 49732, 02-2 BCA ¶ 31,888, reversed on other grounds, Rumsfeld v. General Dynamics Corp., 365 F.3d 1380 \(Fed. Cir. 2004\)](#), the Board stated that the standard for whether a cost is expressly unallowable is objective and the Government bears the burden of proof in assessing a penalty. The Board ruled that the Government should not assess a penalty where there are reasonable differences of opinion about the allowability of costs and that 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.” In situations where it is not directly stated in a cost principle, in order for a cost or type of cost to be expressly unallowable, the cost principle must identify it clearly enough that there is little room for difference of opinion as to whether a particular cost meets the criteria.

Allocable Criteria

Cost Principle: A cost is allowable when the cost is ‘allocable.’ There is an overarching allowability statement at 2 CFR 200.405(a), “A cost is allocable to a particular Federal award or other cost objective if the goods or services involved are chargeable or assignable to that Federal award or cost objective in accordance with relative benefits received.” This statement does not clearly identify a particular cost or type of costs and there could easily be rational differences of opinion as to whether a particular cost is allocable. Thus, while costs that are *not* allocable are unallowable, they are not expressly unallowable. Analysis must clearly conclude that the cost, in and of itself, is not allocable pursuant the applicable provisions of the Uniform Grant Guidance.

Contract Terms and Conditions

Cost Principle: A cost is allowable when it comports with written contract terms and conditions. In general, costs are only allowable to the extent to which the costs comply with the terms and conditions of a contract or subaward. This assumption does not clearly identify a particular cost or type of costs and there could easily be rational differences of opinion as to whether a particular cost meets the terms and conditions of a contract. Thus, while costs that do not comply with contract terms and conditions are unallowable, they are not expressly unallowable. Analysis must clearly conclude that the cost, in and of itself, was not allowable under the terms and conditions of the contract or subaward.

Assistance with Determinations:

In order to assist monitoring teams with determining whether cost principles identify potentially unallowable costs, particularly with regard to contracting and procurement issues, Attachment 1 to this letter provides various categories of procurements and contracts, issues identified in past monitoring reviews, and whether the issue, if substantiated, could result in

questioned and ultimately disallowed costs. Throughout the analysis process, two points must be stressed:

1. Each situation is unique and must be evaluated on its own merits. TWC is not able to provide a document that unequivocally states that a condition is always a finding and whether that finding will always result in a questioned cost. This letter and its attachment are *guidelines* based on typical scenarios monitors encounter as part of the monitoring process.
2. There is a clear distinction between ‘questioned costs’ and what ultimately is determined to be disallowed. Questioned costs are ‘potential’ and included in the monitoring report based on what monitors observe through review of the existing record. The audit resolution process can reach a different conclusion of costs ultimately determined as disallowed based on additional information or other mitigating factors identified by the monitored entity.

ATTACHMENT

Attachment 1: SRM Evaluation Criteria – Contracting and Procurement Findings and Potential Disallowable Costs

ACTION REQUIRED

All SRM staff should be aware of the information in this letter and its attachment as well as guidance provided in TWC’s FMGC, Chapters [8](#) and [14](#) and [Chapter II-4 – Allowable Costs – from the One-Stop Comprehensive Financial Management Technical Assistance Guide Part II](#).

INQUIRIES

Direct questions to your supervisor.

Rescissions: None	Expiration: Until Rescinded
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Attachment 1: RID Letter 10-2017 – Identifying Disallowable Costs
SRM Evaluation Criteria – Contracting and Procurement Findings and Potential Disallowable Costs

Category	Procurement Issue	Governing Regulation	Likely Questioned Cost?	Factors to Consider for Questioning Costs	Period Covered
Micro Purchase	No documentation of reasonableness	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Invoice amount
Small Purchases	No documentation for two or more sources	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Invoice amount
All procurements	No documentation in file	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Invoice/contract amount or total amount paid within a determined period.
All procurements	Local policy conflicts with State and Federal rules and regulations	Uniform Grant Guidance (2 CFR 200), FMGC	No	Costs are not questioned as long as there are no errors in the transaction testing.	
All procurements	Conflicts of Interests in procurement process	Uniform Grant Guidance (2 CFR 200), FMGC	Yes	Was the vendor/contractor chosen the only person that could provide the services?	Question amount of contract or question invoices for selected scope
Formal Procurements	Negotiated Contract differs substantially from original RFP	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Contract amount or total amount paid within a determined period
Formal Procurements	RFP restricts competition unnecessarily (i.e., restrict to one form of subrecipient provider model)	Uniform Grant Guidance (2 CFR 200), FMGC, WD Letter	Yes	Was full and open competition restricted?	Contract amount or total amount paid within a determined period

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Formal Procurements	Insufficient advertising, only posted on website and not through any other method.	Uniform Grant Guidance (2 CFR 200), FMGC	Yes	Was full and open competition restricted? In the end, were sufficient bids received?	Contract amount
Formal Procurements	Bid evaluation documentation missing or incomplete	Uniform Grant Guidance (2 CFR 200), FMGC	No	Costs are not questioned as long as the missing or incomplete bid documentation does not change the results of the evaluation	
Equipment Procurement	No 7100 sent to TWC	FMGC	Yes		Equipment amount
Contracting	No signed contract or agreement	FMGC, Uniform Grant Guidance (2 CFR 200)	Yes		Total amount paid within a determined period.
Contracting	Paying for services outside the service period.	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Question amount paid outside service period
Fiscal Integrity Review	No fiscal integrity review before contract begin date	FMGC, TAC (§802.21(a))	No		
Contracting	Excessive Use of Letters of intent	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Question amount paid before contract begin date

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Category	Procurement Issue	Governing Regulation	Likely Questioned Cost?	Factors to Consider for Questioning Costs	Period Covered
Lease Spaces	No market analysis conducted before initially signed lease or at time of renewal	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Question amount of lease for selected period
Lease Spaces	No reprocurement when contract ends and there are no lease options in contract.	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Question amount after end of contract.
Lease Spaces	Leases without clear end dates or no market analysis documented	Uniform Grant Guidance (2 CFR 200), FMGC	Yes		Question cost scope to be determined