

Practical Insights: What You Need to Know

Cost charging in government contracts **can result in common, but avoidable, pitfalls**



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As the surety industry has long known, federal government contracting is a lucrative, but compliance-driven business. And when it comes to performing under cost-reimbursement type contracts, perhaps no area of federal government contracting is more regulated than the costs that can be charged to the U.S. government. Set forth below is a short summary of the types of costs a contractor may be able to recover from the government and the pitfalls that can arise when contractors fail to accurately charge the government, as well as a few suggested best practices contractors should consider to avoid those common pitfalls.

As an initial matter, in order for a contractor to recover costs from the government, the costs must be “reasonable, allowable, and allocable” to the contract to which the costs are being charged. Entire volumes of commentary have been dedicated to this seemingly simple principle, but each of these requirements can be summed up rather succinctly:

- A **“reasonable” cost** is a cost that, in nature and amount, does not exceed that which a prudent person would

incur in the conduct of a competitive business. For example, a business class airline ticket may be reasonable under certain circumstances, but unreasonable under other circumstances because a prudent business person would not have incurred such a cost. Of particular note, recent precedent holds that reasonableness may be viewed through the eye of the government and not the contractor. At any rate, the reasonableness element has and always will be a subjective element.

- **An “allowable” cost** is a cost that is reasonable, allocable, in accordance with the terms of the contract, and is not otherwise limited by regulation. For example, regulations provide that certain costs are expressly unallowable, such as the costs of alcohol, fines and penalties, bad debts, and losses on other contracts; and individual contracts may also expressly disallow certain costs. Regulations also provide that certain costs are generally allowable, such as bonding costs, depreciation, material costs, training costs, and rental costs.
- **A cost is “allocable”** when it can be “allocated” to a particular government contract. A cost is allocable to a contract when it is a direct cost that is incurred specifically for the contract or an indirect cost that can be shown to benefit the contract. When indirect costs benefit multiple contracts, the contractor must have a means of fairly attributing those costs to each contract.

In addition to these requirements, contractors may be subject to additional regulations addressing the recovery of costs, depending on the value of the contracts at issue. Therefore, at a very basic level, costs charged to the government must meet these above-stated requirements, and contractors must keep these requirements in mind when seeking reimbursement of their costs from the government.

CONTRACTORS CAN ENCOUNTER SIGNIFICANT LIABILITY WHEN THEIR EMPLOYEES EITHER INADVERTENTLY OR INTENTIONALLY ENGAGE IN “MISCHARGING.”

Although charging the government may seem simple based on the discussion above, contractors can encounter significant liability when their employees either inadvertently or intentionally engage in “mischarging.” Mischarging typically results from employees charging time to the wrong contract or cost code, or from employees overstating the hours they worked under a given contract. Such practices not only jeopardize a contractor’s ability to recover costs from the government, but also may result in criminal or civil liability. Among the more serious sanctions, a contractor found to have mischarged the government may face suspension and debarment, or criminal and civil sanctions under the False Claims Acts. Therefore, contractors should ensure that they have effective policies, procedures, and controls in place to avoid mischarging and the consequences that flow from such practices.

Accordingly, to avoid the pitfalls associated with mischarging costs under government contracts, contractors should consider the following suggested best practices:

- **Ethics training.** Contractors should require personnel to take ethics courses, including training on timekeeping and labor charging.
- **Contractor culture.** A compliance and ethics program is only as strong as its leaders’ confidence in and support of an ethical culture. Accordingly, contractors should sustain a corporate “tone at the top” that emphasizes the importance of ethics and honesty, particularly in connection with cost charging.
- **Timekeeping system.** A timekeeping system, in which employees can record time in connection with various tasks performed under contract, is a key element to charging

the government in a proper manner. Regardless of whether a contractor uses a manual or automated method for keeping time, the timekeeping system should enable employees to enter their time accurately. Any corrections to timekeeping records should be documented, authorized, and approved.

- **Monitoring and enforcement.** Contractors should have a mechanism for monitoring compliance with the company’s time-charging policies. Regular audits of timekeepers’ entries are key to monitoring compliance, as are regular reviews of the timekeeping system to ensure that it adequately captures and allocates time entries.
- **Report suspected mischarging.** In the event of mischarging, report such instances immediately to the company’s counsel or ethics official. Cost charging is a highly regulated and compliance-driven part of government contracting. Seemingly endless regulations address what can and cannot be charged to the government and how contractors should go about charging and accounting for those costs. This article addresses but a small part of that regulatory maze, yet provides practical steps all contractors should consider when seeking reimbursement of costs from the government. ●

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