When reviewing depreciation expense, special considerations apply to organizations under common control, fully depreciated assets, asset disposals, capital leases, rentals, and other special CAS provisions contained in the FAR. Consistency is a key element.

Most of the engineering consultants under contract to state DOTs are not subject to full CAS coverage; therefore, the following would generally apply:

A. Depreciation Expense Presented Is Same for Both Financial and Income Tax Purposes

Costs are reasonable if the engineering consultant follows policies and procedures that are: (a) consistent with those followed in the same cost center for business other than government, and (b) reflected in the engineering consultant's books of accounts and financial statements.

B. Depreciation Expense Presented for Financial Purposes Differs from Income Tax Purposes

Reimbursement of fixed-asset costs shall be based on the asset costs recovered over the estimated useful life of the fixed assets using depreciation methods acceptable for financial purposes (e.g., straight line, double-declining balance, or sum-of-the-years'-digits). Allowable depreciation shall not exceed the amounts used for book and statement purposes and shall be determined in a manner consistent with the depreciation policies and procedures followed in the same cost center on non-government business (FAR 31.205-11(c)). In addition, if the amounts used for book and financial statement purposes are not reasonable or equitable, costs should be questioned.

***Note**: As discussed previously, expenses computed based on special tax deduction methodologies (e.g., I.R.C. Section 179 or "bonus depreciation") are not allowable.*

For those engineering consultants that are required to follow CAS, the consultant must comply with the provisions of CAS 409, Depreciation of Tangible Capital Assets, and CAS 404, Capitalization of Tangible Assets. CAS 404 and CAS 409 are incorporated into FAR Part 31. (See Section 8.11 for a discussion of the treatment of gains and losses on sale of assets per FAR 31.205-16.)

8.8—EMPLOYEE MORALE, HEALTH, AND WELFARE

[Reference: FAR 31.205-13]

Entertainment expenses, which are unallowable, often are incorrectly categorized as Employee Morale expenses. Employee-morale type expenses often are covered by the entertainment cost principle, FAR 31.205-14.

***Note**: FAC 90-31, effective October 1, 1995, clarified that entertainment costs are unallowable under any cost principle, without exception. Consequently, the entertainment cost principle at FAR 31.205-14 overrides all other cost principles.*

To be allowable, expenses and income generated by employee welfare and morale activities must comply with FAR 31.205-13. This includes employee welfare and morale expenses incurred on activities to improve working conditions, employer employee relations, employee morale, and employee performance.

Types of activities that fall under this subsection are limited. Examples of *allowable* activities include in-house publications, health clinics, wellness/fitness, and employee counseling services. Also allowable are food services and dormitory services (i.e., cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations, and other similar types of services) at or near the consultant's facilities, subject to the requirements of FAR 31.205-13.

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Generally, gifts are expressly unallowable; however, the cost principle specifically excludes two categories of awards from the unallowable gift definition:

- Awards covered by the compensation cost principle FAR 31.205-6; and
- Awards made pursuant to an established plan or policy for recognition of employee achievements.

Additionally, recreation expenses are expressly unallowable unless they meet all of the following criteria:

- The claimed cost is for employee participation in a sports team or employee organization.
- The team or organization is company sponsored.
- The team or organization's activity is designed to improve company loyalty, team work, or physical fitness.

Taken together, the cost principles at FAR 31.205-13, Employee Morale, and FAR 31.205-14, Entertainment, expressly disallow certain costs that some engineering consultants may have considered allowable prior to the effective date of the current rule, October 1, 1995. Examples of *unallowable* costs include, but are not limited to:

- Entertainment provided as part of public relations, employee relations, or company celebrations;
- Gifts to the public;
- Gifts to employees which are not for performance or achievement or are not made according to an established plan or policy;
- Travel tickets or tickets to shows or sporting events; and
- Recreational trips, shows, picnics, or parties.

8.9—ENTERTAINMENT

[Reference: FAR 31.205-14]

Costs of amusement, diversions, social activities, and any directly-associated costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable. Costs of membership in social, dining, country clubs, or other organizations having the same purposes are also unallowable, regardless of whether the cost is reported as taxable income to the employees. Examples of unallowable company sponsored employee social events include, but are not limited to, outings to professional and college sporting events, company picnics, theme and holiday parties, and expo fairs.

8.10—FINES AND PENALTIES

[Reference: FAR 31.205-15]

Costs of fines and penalties resulting from violations of, or noncompliance with, Federal, state, local, or foreign laws and regulations are unallowable except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer.

8.11—GAINS AND LOSSES ON DEPRECIABLE PROPERTY

[Reference: FAR 31.205-16]

Gains and losses from the sale, retirement, or other disposition (but see FAR 31.205-19) of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation or amortization applicable to those assets was included (but see last paragraph below). However, no gain or loss shall be recognized as a result of the transfer of assets in a business combination (see FAR 31.205-52).

Gains and losses on disposition of tangible capital assets, including those acquired under capital leases (see FAR 31.205-11(h)), shall be considered as adjustments of depreciation costs previously recognized. The gain or loss for each asset disposed of is the difference between the net amount realized (including insurance proceeds from involuntary conversions) and its undepreciated balance. The gain recognized

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shall be limited to the difference between the acquisition cost (or for assets acquired under a capital lease, the value at which the leased asset is capitalized) of the asset and its undepreciated balance.

Gains and losses on the disposition of depreciable property shall not be recognized as a separate charge or credit when either of the following conditions exists:

- Gains and losses are processed through the depreciation reserve account and reflected in the depreciation allowable under FAR 31.205-11; or
- The property is exchanged as part of the purchase price of a similar item, and the gain or loss is taken into consideration in the depreciation cost basis of the new item.

8.12—IDLE FACILITIES AND IDLE CAPACITY COSTS

[Reference: FAR 31.205-17]

The term *idle facilities* refers to completely unused facilities that exceed the engineering consultant's current needs. Costs of idle facilities must be excluded from overhead unless:

- The costs are necessary to meet fluctuations in workload, or
- The facilities, when acquired, were necessary but have become idle because of changes in requirements, production economies, reorganization, or other unforeseeable causes. Costs of idle facilities are allowable for a reasonable period, which generally may not exceed one year.

Costs of idle capacity are costs of doing business and are a factor in the normal fluctuations of usage or overhead rates from period to period. Such costs are allowable provided the capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire plant, or among a group of assets having substantially the same function, may be idle facilities.

8.13—BID AND PROPOSAL COSTS

[Reference: FAR 31.205-18]

Frequently, the composition of bid and proposal (B&P) costs is a key issue. Although marketing[24] and B&P activities can be similar in nature and frequently are performed by the same employees, there is an important distinction between the activities. That is, basic B&P costs are costs incurred in preparing, submitting, and supporting bids and proposals (whether or not solicited) on potential government or non-government contracts. By contrast, marketing costs are more general in nature. Therefore, engineering consultants must establish procedures for segregating B&P costs from selling and marketing costs.

B&P costs are allowable and should be treated as indirect costs, unless a specific contract requires submission of a proposal for subsequent work and authorizes the costs to be charged directly to that contract.

8.14—PRECONTRACT COSTS

[References: FAR 31.205-32 & FAR 31.109(h)]

FAR 31.205-32 provides that (emphasis added):

> *Precontract costs* means costs incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule. These costs are allowable to the extent that they would have been allowable if incurred after the date of the contract.

Precontract costs are associated with specific contracts and therefore must not be included in the indirect cost pool. Precontract costs that meet the requirements of FAR 31.205-32 may be billable as direct

[24] This guide uses the word "marketing" to identify unallowable types of selling, advertising, corporate image enhancement, and market planning costs.

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project charges; however, an advance agreement may be required (see FAR 31.109(h)). Precontract labor must remain allocated as a direct cost regardless of whether it is billable to a client.

***Note**: Contracting agencies and engineering consultants should be aware that any project costs incurred prior to Federal authorization of that project, or phase of work within the project, are not eligible for reimbursement from Federal funds.*

8.15—INSURANCE

[Reference: FAR 31.205-19]

A. Insurance on Lives of Key Personnel

Costs of insurance on the lives of key personnel, such as officers, partners, or proprietors are allowable only to the extent that: (1) the insurance represents additional compensation, and (2) the amount paid is reasonable. However, if the company or its owners are beneficiaries, the costs are unallowable.

B. Professional Liability Insurance

Professional liability insurance (also referred to as *errors and omissions insurance*) protects against damages to clients or third parties resulting from professional errors or judgments. The cost of professional liability insurance is allowable, subject to tests of allocability and reasonableness.

Alternately, the costs incurred by an engineering consultant to correct its own defects, settle claims in lieu of correcting its own defects, or similar acts are unallowable costs as either a direct or an indirect charge, however represented. Simply changing the label to "warranty" or "settlement" does not render the costs allowable.

C. Losses and Insurance Deductibles

Per FAR 31.205-19(d)(3), actual losses are unallowable unless expressly provided for in the contract, except:

> (i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable; and
>
> (ii) Minor losses, such as spoilage, breakage, and disappearance of small hand tools that occur in the ordinary course of business and that are not covered by insurance, are allowable.

D. Self Insurance

Engineering consultants may elect to provide coverage for certain risks from their own resources under a program of self-insurance. The engineering consultant's decision to self-insure should be based on a determination that the coverage can be provided by self-insurance at a cost not greater than the cost of obtaining equivalent coverage from an insurance company or state fund. If purchased insurance is available, the charge for any self-insurance coverage plus insurance administrative expenses shall not exceed the cost of comparable purchased insurance plus associated insurance administrative expenses.

Many engineering consultants rely on self-insurance to cover ordinary risks and losses but maintain various forms of purchased insurance to cover major risks and catastrophic losses. The self-insurance charge plus insurance administration expenses may be equal to, but must not exceed, the sum of comparable purchased insurance plus the associated insurance administration expenses. The engineering consultant's actual loss experience shall be evaluated regularly, and self-insurance charges for subsequent periods shall reflect such experience in a similar manner to purchased insurance.

As discussed in FAR 31.205-19(c)(2), the requirements of FAR 28.308 must be met. This requires self-insurance programs to be submitted for pre-approval when 50 percent or more of the self-insurance costs to be incurred at a segment will be allocated to negotiated government contracts, and the self-insurance costs at the segment are expected to be $200,000 or more annually.

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8.16—INTEREST COSTS

[Reference: FAR 31.205-20]

Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities), legal and professional fees paid in connection with preparing prospectuses, and costs of preparing and issuing stock rights are unallowable (but see FAR 31.205-28). However, interest assessed by state or local taxing authorities under the conditions specified in FAR 31.205-41(a)(3) is allowable.

8.17—LOBBYING COSTS

[Reference: FAR 31.205-22]

Lobbying and political activity costs are generally unallowable. Some examples of these types of costs are:

- Activities that attempt to influence Federal, state, or local legislation or the outcomes of Federal, state, or local elections;
- Contributions to political parties or organizations;
- Legislative liaison activities; and
- Activities that attempt influence employees of the executive branch of government.

Certain activities may be allowable, if detailed records are maintained. They may include activities such as providing technical and factual presentation of information through testimony, statements, or letters in response to a document request on topics directly related to contracts, or lobbying activities that may directly reduce contract cost.

8.18—LOSSES ON OTHER CONTRACTS

[Reference: FAR 31.205-23]

Any excess of costs over income under any other contract (including the engineering consultant's contributed portion under cost-sharing contracts) is unallowable. This includes costs applicable to direct project labor and/or expenses not fully reimbursed due to contractual limitations.

8.19—ORGANIZATION AND REORGANIZATION COSTS

[References: FAR 31.205-6, FAR 31.205-27]

All costs incurred in connection with planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions or raising capital, are unallowable. However, an exception to this appears in FAR 31.205-27(b); the cost of activities primarily intended to provide compensation (acquiring stock for executive bonuses, employee savings plans, and employee stock ownership plans), are not considered organizational costs, but instead are governed by FAR 31.205-6.

8.20—PATENT COSTS

[Reference: FAR 31.205-30]

Patent costs not required by the government contract are unallowable. Certain costs may be allowable if they are incurred as a requirement of a government contract. They include costs such as preparing disclosures, filing documentation, searching records, and counseling related to general patent matters.

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8.21—RETAINER AGREEMENTS

[Reference: FAR 31.205-33]

Costs for specialized work performed by outside consultants and other professionals are allowable if the work is for an allowable purpose and is supported by detailed evidence of the nature and scope of the work performed. When engineering consultants engage such professionals on a retainer-fee basis, FAR 31.205-33(e) requires that allowable retainer fees be supported by evidence that:

- The services provided by the professional are necessary and customary,
- The fee is reasonable in comparison with maintaining an in-house capability, and
- The level of past services justifies the amount of the retainer fees.

The following supporting evidential matter requirements also apply to retainer agreements, except retainer agreements are not required to (and generally do not) have specific statements of work. FAR 31.205-33(f) contains three specific documentation requirements that must be met for any professional and consultant service costs, including those on retainer-fee basis, to be allowable. These requirements are:

- Details of all agreements (e.g., work requirements, rate of compensation, and nature and amount of other expenses if any) and details of actual services performed.
- Invoices or billings submitted by consultants, including sufficient detail as to the time expended and nature of the actual services provided.
- Consultant work products and related documents, such as trip reports indicating persons visited and subjects discussed, minutes of meetings, and collateral memoranda and reports.

8.22—RELOCATION COSTS

[Reference: FAR 31.205-35]

Certain costs of relocating permanent employees are allowable if numerous requirements are met. For more details, see FAR 31.205-35(a). Limitations for considering costs allowable include the following criteria, as set forth in FAR 31.205-35(b):

> (1) The move must be for the benefit of the employer.
>
> (2) Reimbursement must be in accordance with an established policy or practice that is consistently followed by the employer and is designed to motivate employees to relocate promptly and economically.
>
> (3) The costs must not be otherwise unallowable under [FAR] Subpart 31.2.
>
> (4) Amounts to be reimbursed shall not exceed the employee's actual expenses, except as provided for in paragraphs (b)(5) and (b)(6) of this subsection.
>
> (5) For miscellaneous costs of the type discussed in paragraph (a)(5) of this subsection, a lump-sum amount, not to exceed $5,000, may be allowed in lieu of actual costs.
>
> (6)
>
> > (i) Reimbursement on a lump-sum basis may be allowed for any of the following relocation costs when adequately supported by data on the individual elements (e.g., transportation, lodging, and meals) comprising the build-up of the lump-sum amount to be paid based on the circumstances of the particular employee's relocation:
> >
> > > (A) Costs of finding a new home, as discussed in paragraph (a)(2) of this subsection.
> > >
> > > (B) Costs of travel to the new location, as discussed in paragraph (a)(1) of this subsection (but not costs for the transportation of household goods).

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(C) Costs of temporary lodging, as discussed in paragraph (a)(2) of this subsection.

(ii) When reimbursement on a lump-sum basis is used, any adjustments to reflect actual costs are unallowable.

The following types of relocation costs are *unallowable*:

(1) Loss on the sale of a home.

(2) Costs incident to acquiring a home in the new location as follows:

(i) Real estate brokers' fees and commissions.

(ii) Costs of litigation.

(iii) Real and personal property insurance against damage or loss of property.

(iv) Mortgage life insurance.

(v) Owner's title policy insurance when such insurance was not previously carried by the employee on the old residence. (However, the cost of a mortgage title policy is allowable.)

(vi) Property taxes and operating or maintenance costs.

(3) Continuing mortgage principal payments on a residence being sold.

(4) Costs incident to furnishing equity or non-equity loans to employees or making arrangements with lenders for employees to obtain lower-than-market rate mortgage loans.

Some examples of the conditions which would cause the costs to be unallowable include the following:

- The claimed costs include mortgage-related costs, and the employees were not homeowners prior to the move.
- The move is for a period less than 12 months.
- The move does not benefit the employer.
- The employer does not have a consistent relocation policy for all employees.
- The claimed costs include a loss on the sale of a home.
- The claimed costs represent continuing mortgage principal payments on a sold residence.

8.23—RENT/LEASE

[Reference: FAR 31.205-36]

An operating lease is the most common type of agreement used to lease realty or personal property. Under an operating lease, the engineering consultant pays rent to a third party at prevailing market rates. Operating lease payments generally are allowable in full, provided that the leased assets are allocable to, and used in, the engineering consultant's primary business activities. By contrast, special consideration is required for arrangements that are either structured as capital leases (a.k.a. "financing leases") or involve common control.

A. Capital Leases

In some cases, leased property is considered a purchased asset and must be accounted for as a capital lease. Accounting for capital leases requires the property acquired through the lease to be capitalized and amortized/depreciated over the property's useful life. The criteria for classifying leases are discussed in paragraph 7 of FASB Statement No. 13. If a lease meets one or more of the following four criteria, the lease shall be classified as a capital lease; otherwise, it shall be classified as an operating lease:

1. The lease transfers ownership of the property to the lessee by the end of the lease term.
2. The lease contains a bargain purchase option.
3. The lease is equal to 75 percent or more of the estimated economic life of the leased property.
4. The present value at the beginning of the lease term of the minimum lease payment (with certain exclusions) equals or exceeds 90 percent of the fair value of the leased property to the lessor at the inception of the lease over any related investment tax credit retained by the lessor and expected to be realized by him.

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B. Common Control and Cost of Ownership

Common control is another important issue when considering the allowability of rental costs. In accordance with FAR 31.205-36(b)(3), charges in the nature of rent for property between any divisions, subsidiaries, or organizations under common control are allowable to the extent that the charges do not exceed the normal costs of ownership (e.g., depreciation, taxes, insurance, facilities capital cost of money, and maintenance), provided that no part of such costs shall duplicate any other allowed cost. Rental cost of *personal property* (property other than real estate) leased from any division, subsidiary, or affiliate of the contractor under common control, that has an established practice of leasing the same or similar property to unaffiliated lessees, shall be allowed in accordance with FAR 31.205-36(b)(1).

FAR Part 31 does not specifically define *common control*; however, per ASC 850-10-20, *control* is defined as: "The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise." ASC 850-10-20 also identifies and lists related parties. The question of whether two entities are under common control, or related parties, is a question of fact. The key question is whether one party has the ability to exercise control over the operating and financial policies of the related party.

An individual does not need to have over 50 percent ownership to have control. Regardless of the ownership percentage, costs exceeding the constructive cost of ownership are unallowable in total and should not be prorated based thereon.

The auditor must evaluate the control relationship and review the transactions that actually occurred to determine whether common control exists. A party may have actual control even if such control is not evidenced by the agreement. Therefore, it is important to review the events and transactions that actually occurred in making a determination of whether control exists. Two of the most important areas to review are: (1) the actual decision-making process, and (2) the reasonableness of the lease terms.

***Note**: If any portion of business assets, including square footage of a building, is used for a purpose other than the engineering consultant's business operations, then the associated costs must be excluded from the cost-of-ownership computation. This includes personal use of assets and/or the sublet of office space to another business entity. Costs that can be specifically identified with the sublet space should be disallowed entirely, and a commensurate amount of shared costs (e.g., depreciation and property taxes) should be disallowed based on the relative square footage of the sublet space.*

(For further details, see Section 11.2.G.1, Example 11-8.)

C. Sale and Leaseback Transactions

Sale and leaseback rental costs are allowable only up to the amount the engineering consultant would be allowed if the consultant retained title, computed based upon the net book value of the asset on the date the consultant becomes a lessee of the property, adjusted for any gain or loss recognized in accordance with FAR 31.205-16(b). The gain or loss is the difference between the net amount realized (i.e., sales price less costs to complete and sell goods) and the net book value (the undepreciated balance) of the asset on the date of the sale and leaseback transaction. The annual lease cost limitation should reflect the amortization of the adjusted net book value and other costs of ownership, which may include facilities capital cost of money, taxes, insurance, and/or similar types of costs. However, gains and losses recognized for government contract costing purposes are further limited as follows:

- ***Gain Transactions***. FAR 31.205-16 limits the recognition of any gain associated with the disposition of capital assets to the amount of depreciation costs previously recognized. The government participates in the cost and credit for the use of the capital asset by the contractor; however, per FAR 31.205-16(d), the government participation in the gain (i.e., credit) does not extend to any appreciation in asset value in excess of the asset's acquisition cost.
- ***Loss Transactions***. Sale and leaseback transactions usually are consummated as a means of raising capital; therefore, recognizing losses based on the net amount realized, instead of the fair market value of the asset, may place the government at risk for reimbursing the costs of raising capital, as well as losses that may be artificially inflated. FAR 31.205-16(b)(2) provides protection to the government by limiting the allowable amount of a loss to the amount by which

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the net book value exceeds the fair market value of the asset. The allowable loss is zero if the fair market value exceeds the net book value of the asset.

8.24—SELLING COSTS

[Reference: FAR 31.205-38]

Generally. *Selling* is a generic term that includes efforts to market a company's goods and services. Selling costs usually are considered *necessary* for the overall operation of a business, but not all types of selling costs are allowable charges against government contracts. Costs in the following categories should be reviewed for allowability:

- Advertising (FAR 31.205-1).
- Corporate image enhancement and public relations costs (FAR 31.205-1).
- Bid and Proposal costs (FAR 31.205-18).
- Entertainment costs (FAR 31.205-14).
- Direct selling costs (FAR 31.205-38; see further discussion below*).
- Long-range market planning costs (FAR 31.205-12).

Determining Allowability. Selling costs are allowable if they:

- Are reasonable and allocable in accordance with FAR 31.201-3 and FAR 31.201-4, respectively;
- Meet the criteria established in FAR 31.205-1(d) through (f), FAR 31.205-12, FAR 31.205-18, and FAR 31.205-38 (as applicable); and
- Are not specifically disallowed by other FAR cost principles (e.g., the FAR 31.205-14 Entertainment cost principle).

***(*) Note**: One example of allowable selling costs is* direct selling*, which involves person-to-person contact to induce a particular customer to purchase the engineering consultant's services.*

Selling and marketing costs cannot be adequately identified merely by reference to account titles, as such a cursory analysis is not sufficient to assess the allocability and allowability of costs within an account. The actual composition of the account or the activities it represents must be known and analyzed.

Allocability. Selling and marketing costs may be subject to challenge by state DOTs if the costs can be considered unnecessary or unallocable to government contracts. In determining the reasonableness of selling costs, state DOTs may consider the nature and amount of the expenses in light of expenses a prudent individual would incur in a competitive business, the proportionate amounts expended/allocated between government and commercial business, the trend and comparability of current costs with historical costs, comparisons to industry benchmarks for selling costs, and the nature and extent of the selling and marketing efforts in relation to the contract value.

General Advertising. Costs of promotional material, brochures, handouts, magazines, or other media designed to call favorable attention to the company and its activities are unallowable. FAR 31.205-38 prohibits claiming these costs as selling expenses since FAR 31.205-1 specifically identifies these costs as unallowable advertising or public relations costs.

8.25—TAXES

[References: FAR 31.201-4, 31.205-20, 31.205-27, & 31.205-41]

Federal income taxes and excess profits taxes are unallowable, as are taxes in connection with financing, refinancing, refunding operations, or reorganizations. State and local taxes are allowable (e.g., property, franchise, income, and use taxes). However, if taxes are paid late or in error, any penalties or interest assessed by the government (Federal, state, or local) are unallowable.

Engineering consultants that elect Subchapter S Corporation tax status are not taxed at the corporate level; accordingly, no payments or accruals for income taxes should be recorded in the consultant's

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financial records. S Corporation income passes through to the shareholders and is taxed on their personal income tax returns.

***Note**: Auditors should ensure that engineering consultants that have elected Subchapter S tax status[25] claim only the state or local taxes that are required to be paid by, or are otherwise accrued by, the engineering consultant at the corporate level. The state and local income taxes resulting from the individual shareholders' pass-through income are not allocable to government contracts and must not be included in the engineering consultant's indirect cost rate.*

8.26—TRAVEL EXPENSES

[References: FAR 31.205-46, DCAA CAM Section 7-1003]

A. Generally

Depending on their nature and purpose, travel expenses may be allowable as either indirect or direct charges. Travel costs incurred in the normal course of overall administration of the business are allowable and should be treated as indirect costs. By contrast, travel costs incurred in connection with a specific contract/project must be allocated/charged to the contract regardless of whether the costs are reimbursable in accordance with contract terms. Engineering consultants must prepare billing invoices in accordance with the FAR Part 31 cost principles, subject to any additional contractual limitations that may exist.

***Note**: Engineering consultants may have cost accounting practices that are developed in accordance with the Cost Accounting Standards, which may override the general contract costing practices outlined above.*

Costs for transportation may be based on mileage rates, actual costs incurred, or on a combination thereof. Costs of lodging, meals, and incidental expenses may be based on per diem, actual expenses, or a combination thereof, provided that the method used results in a reasonable charge. In accordance with FAR 31.205-46(a)(2), lodging, travel meals,(*) and incidental costs must be disallowed to the extent that, on a daily basis, they exceed the FTR per diem rates (or JTR rates for Alaska or Hawaii and outlying areas of the United States).

*(*) Note: Regarding **Non-Travel Business Meals**. FAR Part 31 specifically references Federal per diem rates only in connection with travel. Meals not associated with travel are allowable if they are properly supported, have a valid business purpose, and are reasonable in amount. Non-travel business meals are governed by FAR 31.205-43(c), which provides that incidental meal costs incurred during business meetings are allowable if the principal purpose of the meeting is the dissemination of trade, business, technical, or professional information.*

B. Substantiation of Travel Costs

As provided in FAR 31.205-46(a)(7), travel costs are allowable only if the following information is documented:

- Date and place of the expenses;
- Purpose of the trip; and
- Name of person on trip and that person's title or relationship to the contractor.

C. Aircraft Costs

Costs of travel in aircraft owned, leased, or chartered by the engineering consultant are required to be fully documented and justified. The engineering consultant must maintain and make available flight manifest/logs for all flights and at a minimum, the flight manifest/log must specify:

- Date, time, and points of departure;

[25] The same applies for any other tax status in which taxes on the pass-through income of the corporation must be paid by the individual shareholders (e.g., limited liability companies).

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