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Country Contracting Handbook

Chapter 4: Cost Principles for Country Contracts

DISCLAIMER

Many of the mandatory and supplementary references to the chapters in the ADS 300 Series contain references to the Handbooks that no longer exist. If the policies remain, they are in an ADS 300 chapter. Information that has not been included in an ADS 300 chapter is guidance only. The references will be revised to refer to ADS chapters or other guidance as applicable.

Formerly Chapter 4, Handbook 11

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1.0 Introduction

1.1 Scope

a. This Chapter sets forth the U.S. Agency for International Development's (USAID) policies and procedures for applying cost principles to the evaluation of proposals and the preparation and administration of USAID-financed country contracts. The Chapter primarily outlines cost principles to be used in cost-reimbursement-type contracting, but these principles should also be employed in the amendment and termination of fixed-price contracts which require costing elements. Although this Chapter is primarily for use in connection with contracts for professional and technical services (Chapter 1), it is of sufficient scope to be appropriate for use in estimating and analyzing the cost-reimbursement portion of contracts for construction services (Chapter 2) and for equipment and materials (Chapter 3). This Chapter may also be used as a guide in cost analyses that are used for the negotiation of time-rate and fixed-price contracts.

b. These cost principles provide a framework within which items of direct and indirect cost can be incorporated in a cost-reimbursement contract or subcontract. They identify, in general, the allowable and allocable items (see Section 2.0) of cost normally associated with USAID-financed country contracts. They are especially intended for use in (1) the drafting and estimating of contracts by the USAID reviewing and approving officers, (2) negotiations between the Contracting Agency and the contractor, and (3) contract implementation by the supervisory, administrative, and auditing personnel.

1.2 Application

a. USAID recommends that the cost principles and procedures contained in this chapter be applied to USAID-funded country contracts, but the use of rules, procedures, or regulations on the costing of contracts in force in the host country are not precluded to the extent that USAID is not precluded by U.S. statute from funding the costs. However, if the use of host country rules, procedures, and regulations is contemplated, there must be a mutual agreement between the Contracting Agency, the contractor, and USAID as to their application. Where there are differences in treatment of cost items between the Contracting Agency's rules, regulations, and procedures and the principles and procedures contained in this Chapter, the differences must be discussed by the parties and an agreement set forth in the SOAG Implementation Plan prior to the award of any affected procurement. Absent such an agreement among the parties, the cost principles and procedures contained in this Chapter will prevail.

b. The Contracting Agency, contractors, and USAID personnel should recognize the importance of incorporating explicit terms with respect to the treatment of costs in all contracts. The cost principles in this Chapter may be used by specific incorporation in the contract, by incorporation by reference of this Chapter, or by incorporation by reference of only those sections relevant.

c. Failure to mention a particular item of cost in this Chapter is not intended to imply that it is either allowable or unallowable. Rather, determination in each case of allowability of a cost item should be based on the principles and standards set forth in Section 2.0 of this Chapter.

1.3 Audit of the Contract

a. Pursuant to the rules which require audits and the guidance on their conduct that are specified in the preceding Chapters*, the contract audit schedule should be planned and budgeted for in the SOAG Implementation Plan. Periodically during the contract period and/or upon contract completion, audits should be made by the Contracting Agency of Non-U.S.-based contractors, and the requirements for the audits of U.S.-based contractors** should be referred to the Contract Audit Management Branch, Office of Procurement (M/OP/PS/CAM) in USAID/W. The audits of Non-U.S.-based contractors performed by the Contracting Agency may be reviewed from time to time by USAID. In addition, USAID may audit Non-U.S.-based contractors during the contract term or during the 3-year period thereafter, as provided for in the Contractor's or Supplier's Certificate and Agreement with USAID.

b. The auditor's primary objective is 1. to examine the contractor's cost representations, in whatever form they may be presented (public voucher, incurred cost submission, termination claim, etc.) and 2. to express an opinion as to whether such claimed costs are reasonable, applicable to the contract, determined under generally accepted accounting principles and not prohibited by statute or regulation, or by previous agreement with or decision by the Contracting Agency. Particular attention should be given, during audit, to the cost items invoiced, the withholdings (if any), and the certifications by the contractor that the vouchers submitted for payment meet the requirements of the contract. Appendix 4B contains an audit program which may be used in audits of country contracts.

*Chapter	Rule	Guidance
1	2.13	3.8
2	2.12	3.11
3	2.15	3.13

** A U.S.-based contractor is an organization whose primary business records are maintained in the United States.

1.4 Currency of Payment

During the contract negotiations, the Contracting Agency and the contractor should develop a clear understanding as to which contract costs will be reimbursed in local currency and which will be reimbursed in U.S. currency. Items included in the cost estimate and the contract should be presented in such a way that the type of currency will be clearly shown.

1.5 USAID Review and Approval

The Contracting Agency should advise the contractor in advance that USAID may require, for contract review and approval purposes, data which support the contract cost estimates. The contract when submitted by the Contracting Agency to USAID for approval is to be accompanied by a statement giving the reason the Contracting Agency considers the

contract to be reasonable in price, including an explanation of the differences, if any, between the proposed and negotiated costs. (See Chapters 1, 2 and 3.)

2.0 Costs - Allowability, Allocability, and Reasonableness

The allowability of an item of cost, including its allocability and reasonableness, should be determined as set forth below.

2.1 Allowability

- a. The total allowable cost of a cost-reimbursement type contract is the sum of the allowable direct costs incurred in the performance of the contract in accordance with its terms plus the properly allocable portion of the allowable indirect costs (overhead and/or general and administrative expense), less income or credits (discounts, rebates, refunds, outside rentals, etc.). The total price of the contract is the sum of the allowable direct and indirect costs, plus fee.
- b. Direct costs are allowable to the extent they meet the criteria in paragraph c and in Section 3.0, Direct Costs. Indirect costs are allowable to the extent they meet the criteria in paragraph c and in Section 4.0, Indirect Costs.
- c. Costs, to be allowable, must meet all of the following criteria:
 1. Be reasonable (see Section 2.3);
 2. Be allocable (see Section 2.2);
 3. Be accounted for in a manner that is consistent with the contractor's usual accounting practices and, unless precluded by the terms of the contract, with the contractor's manner of charging costs to its other activities;
 4. Be incurred within the contract period, except as may be otherwise provided, in accordance with specific or general conditions of the contract;
 5. Not be excluded as an unallowable cost under Appendix 4A;
 6. Be in accordance with the terms of the contract; and
 7. Be in accordance with generally accepted accounting principles and practices appropriate to the particular circumstances.

2.2 Allocability

- a. A cost is allocable if it is assignable or chargeable to a particular cost element of the contract. Allocation of indirect costs (overhead and/or general and administrative expenses) should be based upon agreed rules and criteria consistent with the contract provisions that establish the basis for determination of indirect cost rates.
- b. To be allocable, costs must meet one of the following criteria:

1. Be incurred for work related to the contract, or
2. Benefit both the contract and other work, distributed to them in reasonable proportion to the benefits received, or
3. Be necessary to the overall operation of the business, although a direct relationship to any particular cost element cannot be shown. (This situation might arise when there is a corporate structure over a subsidiary which is providing service, or when a firm providing service is also engaged in an unrelated activity, for example, manufacturing. In such cases, there must be at least an indirect showing of benefit to the activity.)

2.3 Reasonableness

- a. The reasonableness of a cost depends upon a variety of considerations and circumstances, and determining reasonableness requires the application of sound administrative and professional judgment.
- b. In determining the reasonableness of a given cost, consideration should be given to the following criteria:
 1. The cost is of a type or amount generally recognized as ordinary and necessary for the conduct of the contractor's business and the performance of the contract.
 2. There are restraints or requirements imposed by such factors as generally accepted sound business and labor practices, arm's length bargaining, governmental laws and regulations, and contract terms and specifications.
 3. The cost incurred is one that a prudent businessman/businesswoman would incur in the circumstances, considering his/her responsibilities to the owners of the business, his/her employees, his/her customers, his/her government, and the public-at-large.
 4. The presence of significant deviations from the established policies and practices of the contractor, not provided for in the contract, which may unjustifiably increase the contract costs.

2.4 Accounts and Records - Contractor's Normal Practice

The contractor must maintain accounts and records adequate to demonstrate the allowability and allocability, including the nature, amount, and derivation, of costs charged to the contract. An accounting system is acceptable if it is both adequate and suitable for the accumulation and billing of costs under government contracts and in compliance with applicable government regulations. A contractor's accounting system must be sufficient to enable an appropriate and equitable allocation of costs to cost objectives. The system should be 1. consistently applied, 2. nondiscriminatory against the government, 3. efficient, 4. reliable, and 5. equitable. The contractor must maintain a system adequate to 1. segregate direct from indirect costs, 2. identify and accumulate direct costs by contract, and 3. present a logical and consistent method for accumulation of indirect costs to intermediate and final cost objectives.

The contractor should be instructed to prepare its cost proposal consistent with its accounting procedures and the cost principles contained or referenced in this Chapter.

2.5 Limitations and Understandings

Care must be exercised by both parties to a proposed contract to ensure that the contract reflects their agreement as to the costs which will be reimbursable. In order to minimize the chance for misunderstandings in interpretation of cost provisions, every effort should be made to negotiate agreed amounts, or limitations for specific contract costs, which may not be exceeded without approval by the Contracting Agency (i.e., maximum salary levels, limitation on obligation of funds, etc.).

2.6 Subcontract Costs

Costs incurred by a contractor as reimbursement to a subcontractor under an approved subcontract are allowable to the extent specified in the subcontract and consistent with the provisions of this Chapter, if incorporated in the prime contract.

3.0 Direct Costs

3.1 General

A direct cost is any cost which can be solely and specifically identified with a particular activity under the contract. Costs incurred for the benefit of a single contract are direct costs of that contract and are to be charged directly to it. Costs solely related to other work of the contractor are direct costs of that other work.

3.2 Minor Items of Cost

Minor items of direct cost may be considered to be indirect costs for reasons of practicality. For example, such items as petty cash expenditures, taxi fares, office machine repairs, stationery, and similar items may be included as indirect costs. However, the contract should clearly identify whether such items of minor cost are to be treated as direct or indirect costs.

3.3 Examples of Direct Costs

Examples of items which may be included as direct costs (if they meet the criteria specified in 3.1 above) are contained in Appendix 4A to this Chapter.

4.0 Indirect Costs

4.1 General

Indirect costs, also referred to as overhead and/or general and administrative expense, are for joint purposes and not for a single specific contract. They are ultimately allocated to benefiting contracts and other work of the contractor. Because of their nature these costs usually cannot be charged directly to a contract. They must first be gathered into one or more

cost pools, after which they are allocated and reallocated, as appropriate, until they are ultimately charged to specific contracts and other work of the contractor.

4.2 Bases of Distribution

Depending upon the circumstances, there may be one or more categories or "pools" of indirect expenses. In some cases, overhead is accumulated in a single pool and allocated to all work. In other cases, indirect expenses are segregated into two or more pools, such as "overhead" and "general and administrative expense," and each pool of expenses is allocated. In this latter case, different bases may be used to allocate and distribute the different pools.

The distinction usually made between departmental overhead and general and administrative expenses is that departmental overhead expenses are more closely associated with the work performed under contracts while general and administrative expenses relate to overall administration. Examples of items sometimes classified as general and administrative are executive salaries, professional expenses, legal services, etc.

The most important consideration is that indirect costs should be accumulated by logical cost groups with due attention to the reasons for incurring the costs. Another important consideration is that the base used in allocating indirect expenses must be one which results ultimately in a fair distribution to all benefiting contracts or activities of the contractor. The allocation of indirect costs is accomplished by selecting a base which most appropriately represents the principal function of the company. In the case of contracts for professional and technical services, direct labor cost (direct salaries) or total direct costs are the bases most frequently used.

4.3 Indirect Costs Charged Directly

Although contractors in their domestic work may have established acceptable methods for classifying and accumulating costs in direct cost pools, situations are sometimes encountered which result in desirable deviations from their normal practice. This may occur with respect to contracts which require work to be performed in another country. For example, a contractor normally may classify travel and related expenses as indirect expenses within its own country. On a contract involving work in another country, the contractor may deviate from its normal procedure and include travel as a direct cost of the contract. This is permissible provided that the travel costs are incurred for the contract. Similarly, expenses for per diem and transportation of personnel and household goods are usually charged to the contract, instead of to indirect costs.

In most cases when work is performed at the contract site, expenses incurred at the location may be charged directly to the contract. Consequently, costs of such items as telephone, postage, supplies, and office materials at the site could be proper direct charges. However, since costs such as these normally are charged to overhead, care must be taken to be sure that similar expenses included in the overhead pool are eliminated before allocation and distribution of indirect expenses to the contract. For example, if the contractor normally charges directly for international travel for employees and consultants working under the contract, but charges domestic travel and international travel for executives as an indirect cost, all international travel for employees and consultants (whether incurred under the contract or other activities of the contractor) must be eliminated from the overhead pool before indirect costs are allocated and distributed to the contract. However, the costs of domestic travel and international travel by executives would legitimately remain as part of the overhead pool.

In the absence of consistent cost application, an alternative method is simply to deduct the travel costs attributable to the contract from the amount of the indirect costs. If neither of the above adjustments are made, the contract could be charged both directly and indirectly for the same items of cost. Similarly, in those cases where salaries and wages (direct costs) include a surcharge for fringe benefits (normally an indirect charge), care must be exercised to be sure that such fringe benefits costs are not duplicated in the indirect (overhead) charges. These considerations should be set forth in the contract.

4.4 Overhead and/or General and Administrative Expense Rates

Under cost-reimbursement contracts, overhead and/or general and administrative expense rates are usually provisional until established as final (by audit or otherwise) at completion of the contract. If a fixed amount in lieu of overhead/general and administrative rates is negotiated at the outset, a provisional rate would not be used.

A provisional overhead rate is a tentative percentage factor mutually agreed upon by the Contracting Agency and the contractor, to be applied to an agreed upon base, for use in making interim payments, tied to a time period stated in the contract pending the determination of the actual rate.

Each provisional overhead rate and the allocation or distribution bases to which it is to be applied, in making such interim payments, must be incorporated in the contract and may be changed only by agreement between the parties.

If during the performance of a contract, a contractor should lose all or the majority of its work which normally shares in the distribution of its overhead expenses, the Contracting Agency should not have to absorb this increased allocation of overhead expenses under its contract. To prevent this situation from occurring, a ceiling or maximum rate should be considered for use in instances where there is a reasonable possibility that such a loss of other work could occur. However, a contractor may encounter bona fide increases in its overhead costs for which it should not be penalized.

A negotiated final overhead rate is a percentage factor to be applied to an agreed-upon base, which expresses the ratio, or ratios, agreed upon by the Contracting Agency and the contractor. When a provisional rate has been used, a final rate is agreed upon at the end of the contract or after closing of the contractor's fiscal year accounts, unless the parties have agreed to a different period.

Fixed amounts in lieu of overhead rates may be negotiated with any type of organization so long as the amount does not vary in relation to costs incurred by the contractor. However, this method is normally restricted to small dollar-value contracts with contractors who do not have established overhead rates.

4.5 Separate Rates for Separate Locations

Whenever the contract requires that the contractor perform a significant amount of work in two or more locations, a separate rate applicable only to the effort in each location should be considered. It is extremely important that the contractor and the Contracting Agency reach a clear understanding, which should be included in the contract, regarding the methods used in determining the rate that will apply to work performed at each location. Particular attention must

be given to assuring an equitable distribution of home office overhead and/or general and administrative expenses charged to branch or other locations.

4.6 Examples of Indirect Costs

Any of the categories of cost described in the discussion of selected indirect costs in Appendix 4A may be treated as indirect costs under a contract, unless otherwise specified in the contract.

4.7 Evaluation of Overhead Proposal

A contractor's records and procedures for allocating indirect costs may vary from formal records and detailed procedures to very informal working papers. If a pre-award audit is conducted, the contractor's records and procedures should be examined to determine if the indirect costs proposed are reasonable and properly allocated. If the contractor has been regularly audited, the proposed rate may be reviewed to determine if it is consistent with a current rate agreement. No indirect cost rate quoted by a contractor should be accepted without evaluation.

4.8 Assistance and Information Concerning Indirect Costs

- a. If a proposed contractor is based in the United States, or has done substantial cost-reimbursement contracting directly with USAID, assistance on indirect and other costs is available from the Overhead, Special Costs, and Close-Out Branch of the Office of Procurement (M/OP/PS/OCC) and from M/OP/PS/CAM, in USAID/W. When requesting such assistance the following minimal information should be supplied: name and address of proposed contractor; type of contract; estimated contracted amount; period of performance; and major cost elements, including salaries, the contractor's proposed overhead and/or general and administrative expense rates, related distribution bases, contractor's address, phone number, contact person, cognizant agency audit office (if known), and any other factors deemed significant by the Contracting Agency.
- b. When the Contracting Agency awards a contract to a contractor that also has active contracts with the U.S. Government, M/OP/PS/OCC will advise the Contracting Agency, through the cognizant USAID Mission, of all new indirect costs agreements with the contractor.
- c. M/OP/PS/CAM will arrange the audit of and report on U.S.-based contractors that are referred to it pursuant to Section 1.3 of this Chapter.
- d. The Contracting Agency may also request USAID assistance in the evaluation of proposals from and audit of Non-U.S.-based contractors. *

5.0 Unallowable Costs

5.1 General

Certain costs are of such a nature that they are not considered by the U.S. Government as allowable or allocable to direct or indirect cost categories. However, these costs may exist

as actual expenses of the contractor's organization. Such costs may well be legitimate and even desirable insofar as the contractor is concerned. However, because of their nature, these costs are not eligible for allocation as direct or indirect costs of the contract within the context of these provisions.

5.1 General

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5.2 Examples of Unallowable Costs

Costs considered as unallowable for USAID financing are shown in Appendix 4A.

6.0 Fixed Fee

6.1 General

Cost-reimbursement contracts with commercial firms usually provide for payment of a fixed fee to the contractor. Fixed fees are not paid to educational institutions; other nonprofit organizations usually are not paid fixed fees. The fixed fee, once negotiated and established, does not vary with actual costs. It may be adjusted upwards or downwards when major increases or decreases in the scope of work are negotiated as contract amendments.

6.2 Negotiation Factors

The Contracting Agency negotiates a fair and reasonable fee with the contractor to perform certain work as agreed to, considering the following criteria:

- a. Nature and complexity of the work or services to be performed;
- b. Degree of risk assumed by the contractor;
- c. Proportion of permanent staff and their positions as profit-generating personnel in the contractor's organization as compared to recruited personnel and outside consultants acquired for performance of the contract;
- d. Amount of logistic support provided by the Contracting Agency;
- e. Extent of subcontracting;
- f. Fees charged by the contractor to its other clients for similar services;
- g. Payment provisions, including any advances;

- h. Effect of competition;
- i. Amount of the contract, and
- j. Such other elements as the Contracting Agency considers pertinent.

7.0 Cost Analysis

7.1 General

Cost analysis is an essential tool to the contract negotiator in the conduct of sound and meaningful negotiations. It provides the negotiator with a means of evaluating the contractor's proposal and its relationship to the Contracting Agency's estimate. In negotiating cost-reimbursement contracts, the negotiator must be satisfied as to the adequacy and reasonableness of the contract proposal including the realism of costs proposed. Cost analysis is a primary means of accomplishing this end. The general technique of cost analysis outlined below applies to all cost-reimbursement contracts.

7.2 Contracting Agency's Estimate

The Contracting Agency prepares a cost estimate (called the "Contracting Agency's estimate") before proposals are requested. This estimate should be systematically developed, using historical and statistical data, published indexes, prior Contracting Agency experience, and any other source of information which will produce a valid and reasonable estimate, including fixed fee when appropriate. This estimate is used as a reference based in evaluation of the selected contractor's cost proposal. The assistance of USAID may be requested in the preparation of this estimate.

It is critically important that information concerning the amount and composition of the Contracting Agency's estimate be limited to those officials in the Contracting Agency and USAID with a need to know. Unauthorized disclosure may compromise the Contracting Agency's bargaining position or give an unfair competitive advantage to a potential offeror.

7.3 Contractor's Cost Proposal

The proposal submitted by the prospective contractor reflects its estimate of costs to be incurred in accomplishing the proposed contract task. It is the foundation upon which the negotiator must work in arriving at a final contract. The elements of the cost proposal must be clearly substantiated, fully documented and supported in conformance with the requirements of this Handbook.

7.4 Analysis of Contractor's Cost Proposal

The Contracting Agency should compare the contractor's cost proposal to its own estimate of costs. A review of the individual cost elements should be made to determine the degree of correlation between each of the respective cost estimates. Areas of major difference between the two estimates of cost should become the focal point of the further cost analysis and negotiation.

APPENDIX 4A, SELECTED COSTS

A1.0 INTRODUCTION

This Appendix 4A sets forth selected items of cost which are representative of those costs typically encountered in cost-reimbursement type contracting. However, not every element of cost and every situation that might arise in a particular case is covered herein. Failure to treat any item of cost is not intended to imply that it is either allowable or unallowable. With respect to all items, whether or not specifically covered, determination of allowability shall be based on the principles and standards set forth in Section 2.0 of this Chapter.

A2.0 UNALLOWABLE COST ITEMS

A2.1 General

Certain costs are of such a nature that they are not normally considered allowable to the direct or indirect (overhead) cost categories (see Section 5.0 of text). These costs may exist as actual expenses of the contractor's organization and may well be legitimate and even desirable insofar as the contractor is concerned. However, because of their nature, these costs are not eligible for allocation as direct or indirect costs to a country contract.

A2.2 Examples of Unallowable Cost Items

1. Advertising Costs

Advertising costs are generally unallowable. The only exceptions are: a) costs incurred in recruitment of personnel required by the contractor for the performance of the contract (when considered in conjunction with all other such recruitment costs); b) costs incurred in advertising authorized in the contract for items needed for the contract; or c) costs incurred in advertising the disposal of scrap or surplus materials acquired in the performance of the contract.

2. Bad Debts

Bad debts, including losses (whether actual or estimated), due to uncollectible customer's accounts and other claims, related collection costs, and related legal costs, arising from other business of the contractor.

3. Commissions and Contingency Fees

Commissions, percentages, brokerage, or contingency fees to persons or groups retained to solicit contracts unless the person or group is a bona fide commercial or selling agent maintained by the Contractor for the purpose of securing business.

4. Compensation

- a. Compensation which constitutes a distribution of profits, or

b. Bonuses and incentive compensation paid in stock outside of the contractor's normal compensation policy.

5. Contribution and Donations

6. Dividend Payments

This is a distribution of profit and is not allowed as a contract expense.

7. Entertainment Costs

Cost of amusement, diversion, social activities and incidental costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities, for the benefit of customers or clients.

8. Fines and Penalties

Cost of fines and penalties resulting from violations of, or failure of the contractor to comply with, U.S. or host country laws and regulations.

9. Interest and Other Financial Costs

Interest on borrowing (however represented), bond discounts, cost of financing and refinancing operations, legal and professional fees paid in connection with the preparation of a prospectus, costs of preparation and issuance of stock rights, and related financial charges, except for interest assessed by U.S. state or local taxing authorities other than those described in item 8 above.

10. Lobbying Costs

Costs associated with the following activities with respect to the U.S. Government (USG) and any political subdivisions thereof, are unallowable:

a. Attempts to influence the outcomes of any election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activities;

b. Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;

c. Any attempt to influence (i) the introduction of legislation, or (ii) the enactment or modification of any pending legislation through communication with any member or employee of a legislature (including efforts to influence officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

d. Any attempt to influence (i) the introduction of legislation, or (ii) the enactment or modification of any pending legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to **contribute to or participate in any mass demonstration,**

march, rally, fund raising drive, lobbying campaign or letter writing or telephone campaign;

e. Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable activities; or

f. Attempts to improperly influence, either directly or indirectly, an employee or officer of the Executive branch of the Federal Government to give consideration to or act regarding a regulatory or contract matter.

The following activities are excepted from the above restrictions on the allowability of lobbying costs:

a. Providing a technical and factual presentation of information on a topic directly related to the performance of a contract through hearing testimony, statements or letters to a legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided such information is readily obtainable and can be readily put in deliverable form; and further provided that costs under this section for transportation, lodging or meals are unallowable unless incurred for the purpose of offering testimony at a regularly scheduled legislative hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.

b. Any lobbying made unallowable by paragraph c. above of this subsection to influence state or local legislation in order to directly reduce contract cost, or to avoid material impairment of the contractor's authority to perform the contract.

c. Any activity specifically authorized by USG statute to be undertaken with funds from the contract.

11. Losses on Disposition of Plant, Equipment, or Other Capital Assets

Losses of any nature arising from the sale or exchange of plant, equipment, or other capital assets, including sale or exchange of either short- or long-term investments.

12. Losses on Other Contracts

An excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts).

13. Organization Costs

Expenditures in connection with planning or executing the organization or reorganization in the corporate structure of a business, including mergers and acquisitions, or raising capital. Such expenditures include, but are not limited to, incorporation fees and cost of

attorneys, accountants, brokers, promoters and organizers, management consultants, and counselors, whether or not employees of the contractor.

14. Retainer Fees

Retainer fees not supported by evidence that specific bona fide services were furnished.

15. Taxes

a. Income and excess profit taxes paid by the contractor to any sovereign governmental body.

b. USAID will not finance other identifiable taxes, fees, levies or impositions under the laws of the host country placed against a contractor (or any of its employees).

16. Travel Costs

First class air fare when less-than-first-class service is available and can meet the needs of the contract, as detailed in the contract.

17. Goodwill

An unidentifiable intangible asset that originates under the purchase method of accounting for a business combination when the price paid by the acquiring company exceeds the sum of the identifiable individual assets acquired less liabilities assumed, based upon their fair values. The excess is commonly referred to as goodwill. Goodwill may arise from the acquisition of a company as a whole or a portion thereof. Any costs for amortization, expensing, write-off, or write-down of goodwill are unallowable.

18. Cost of Alcoholic Beverages

19. Cost of Asset Valuations Resulting from Business Combinations

When the purchase method of accounting for a business combination is used, allowable amortization, cost of money, and depreciation shall be limited to the total of the amounts that would have been allowed had the combination not taken place.

A3.0 TREATMENT OF SELECTED DIRECT COSTS

A3.1 General

Determination of the allowability of a cost is made in accordance with Section 2.0 of Chapter 4. The following selected costs are discussed with particular guidance in connection with each item. The guidance supplied is also valid for application to similar items not specifically shown. In dealing with direct costs; on host-country contracts, all of the direct costs chargeable to the contract should be specified therein, including any applicable limitations.

A3.2 Selected Direct Costs

The following examples of direct costs are those most frequently encountered in cost-reimbursement contracts:

1. Personnel Compensation

a. Established Policy and Practice

Salaries and wages should not exceed the contractor's established policy and practice, including the contractor's established pay scale for equivalent classifications of employees, which should be certified to by the contractor. Neither should merit or promotion increases exceed those provided by the contractor's established policy and practice.

b. In-Travel Status

Salaries and wages paid while in travel status should not be reimbursable for a travel period greater than the time required for travel by the most direct and expeditious air route, in accordance with the travel and transportation requirements of the contract.

c. For Return of Discharged Employee

Salaries and wages paid to an employee serving overseas who is discharged by the contractor for misconduct should not be reimbursable for a period which extends beyond the time required to return the employee promptly to the employee's point of origin by the most expeditious air route plus accrued vacation leave.

d. Consultant Services

Compensation for consultant services should not exceed a reasonable rate. A method of measuring reasonableness might be the current compensation or the highest rate of annual compensation received by the consultant during any full year of the immediately preceding three years.

e. Overseas Recruitment Incentive

(1) (The term "employee", as used in this paragraph, means an employee who is a U.S. citizen or resident alien.) Contractor employees serving overseas under a contract who do not qualify for a U.S. tax exemption for overseas income, as provided under Section 911 of the U.S. Internal Revenue Code (26 U.S.C. 911), are eligible to receive a salary supplement (overseas recruitment incentive). The overseas recruitment incentive (ORI) shall not exceed a maximum of 10 per cent of the employee's base salary for the period of eligible services. This supplement, if offered by the Contractor, shall be paid at the end of an employee's tour of duty overseas. The Contractor shall take all reasonable and prudent steps to ensure that any employee who is paid an ORI has not claimed or received the Section 911 exemption.

(2) In the event that an employee subsequently receives a Section 911 exclusion for any part of the base salary upon which this supplement has been paid, such supplement or appropriate portion thereof shall be reimbursed by the Contractor with interest. The interest shall be calculated at the average U.S. Treasury rate in effect for the period that contractor or his employee had the funds. Neither the contractor's nor a subcontractor's inability to collect refunds from the employees shall be used as a basis to excuse subsequent refunds by the Contractor.

f. Cooperating and Third Country Nationals

Compensation, including merit or promotion increases, paid to Cooperating and Third Country Nationals may not, without the approval of the Mission Director exceed the prevailing compensation paid to personnel performing comparable work in the cooperating country, as determined by the USAID Mission.

g. Vacation Leave

(1) The contractor may grant to its employees working under the contract, vacations of reasonable duration in accordance with the contractor's established practice for its employees.

(2) Such leave can be reimbursable as a form of personal compensation if the contractor is unable to allow its employees to use their full amount of vacation, as authorized by the contractor's established policies and procedures, during their contractual period of work. This would normally only apply to contractor employees performing an assignment of one year or more, but the disposition of accrued and unused leave should be negotiated in the contract for every length of contractor employee assignment.

(3) The amount and disposition of such leave should be specified in the contract. *

h. Holiday Leave

Holiday Leave can be reimbursable as extra compensation as a form of personal compensation if contractor employees must work holidays. The number and type of holidays appropriate to the contract, and the amount of compensation that will be paid to employees working holidays should be negotiated into the contract.

i. Severance Pay*

Severance pay is a payment, in addition to regular salaries and wages, to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that in each case, it is required by (1) law, (2) employer-employee agreement, or (3) the contractor's established policy. If approved by the Contracting Agency, the costs of severance pay in other unusual circumstances are allowable.

2. Travel and Transportation

a. International Travel

(1) Costs should be reimbursable for actual travel costs and travel allowances of travelers from place of current residence (or other locations provided that the cost of such travel does not exceed the cost of travel from the employee's residence) to the post of duty in the host country and return to place of current residence (or other location provided that the cost of such travel does not exceed the cost of travel from the post of duty in the host country to the employee's residence) upon completion of services by the individual. Such travel costs and travel allowances should not be reimbursable in an amount greater than less-than-first class commercially scheduled air travel by the most expeditious route, except as otherwise provided in paragraph f. below, and unless less-than-first-class air travel or air travel space are not available.

(2) When travel is by less-than-first-class accommodations, the costs of transporting accompanied personal baggage in addition to that regularly allowed with the less-than-first-class ticket is allowable provided that the total number of pounds of baggage does not exceed that regularly allowed for first class travelers. Travel allowances for travelers should be reimbursable at specifically agreed rates in the contract, for not more than the travel time required by scheduled commercial air carrier using the most expeditious route. One stopover en route for a period of not to exceed twenty-four hours should be allowable when the traveler uses less-than-first-class accommodations for a trip of fourteen hours or more of scheduled duration. Such stopover should not be authorized with travel is by indirect route or is delayed for the convenience of the traveler. Per diem during such stopover should be reimbursed in accordance with the established practice of the contractor, but not to exceed the amounts specifically agreed to in the contract.*

b. Local Travel

Costs should be reimbursable for local travel in accordance with the rates established in the contract for the travel costs of travelers in the host country in connection with duties directly referable to the contract. In the absence of such established rates, actual travel costs of travelers in the host country, may be reimbursable in connection with duties directly referable to the contract, including travel allowances at rates in accordance with the contractor's established policy.

c. Travel for Consultation

Costs are reimbursable for the round trip of the contractor's Chief of Party in the host country or other designated contractor employee or consultant in the host country performing services required under the contract, for travel from the host country to the contractor's home office for consultation and return on occasions deemed necessary by the contractor and approved in advance, in writing, by the Contracting Agency.

Costs are also reimbursable for travel to other locations under the conditions set forth in a., b., and c. above, if they are incurred in connection with such travel for contractual purposes, specifically approved by the Contracting Agency.

d. Indirect Travel for Personal Convenience

When travel is performed by an indirect route for the personal convenience of the traveler, the allowable costs of such travel should be computed on the basis of the cost of economy class air fare via the direct usually traveled route. If the costs of indirect travel would include fares for air or ocean travel by non-authorized flag carriers, approval for indirect travel by such flag carriers must be obtained from the Contracting Agency before such travel is undertaken, since USAID may not reimburse such expenses. Otherwise, only that portion of travel accomplished by authorized flag carriers will be reimbursable within the above limitation of allowable costs.

e. Limitation on Travel by Dependents

When provided in the contract, travel costs and allowances for dependents of contractor employees may be allowed. Such costs are reimbursed for travel from place of abode to assigned station in the host country and return, only if the dependent remains in the host country for at least nine months or one-half of the required tour of duty of the contractor employee responsible for such dependent, whichever is greater.

If the dependent is eligible for educational travel, time spent away from post resulting from educational travel will be counted as time at post.

f. Delays En route

Costs may be reimbursable for reasonable delays en route, not circuitous in nature, caused by events beyond the control of the traveler or contractor.

g. Travel by Privately Owned Automobile

If a privately owned automobile is being driven to or from the host country as authorized under the contract, costs are reimbursable for travel performed by contractor employees at a rate to be specified in the contract for the employee and for each of the authorized dependents traveling in the automobile. However, the total cost of the mileage and the per diem paid to all such authorized travelers shall not exceed the total constructive cost of fare and normal per diem available to them by (1) surface common carrier, or (2) less-than-first-class air, whichever is the lesser.

h. Emergency and Irregular Travel and Transportation

Actual transportation costs and travel allowances while en route, as provided in this section, should also be reimbursed under the following conditions:

(1) The costs of going from post of duty in the host country to another location for contractor employees and/or dependent and returning to the post of duty, for:

(i) Need for medical care beyond that available within the area to which the employee is assigned, or serious effect on physical or mental health if residence is continued at assigned post of duty, subject in either case, to the limitations stated in the contract provision entitled "Physical Fitness of Employee and Dependents." This may include a medical attendant to accompany the employee or dependent at contract expense if, based on medical opinion, such an attendant is necessary. Either action should be approved by the Contracting Agency, in advance if possible, or after completion if necessary.

(ii) Death, or serious illness or injury of a member of the immediate family of the employee or the immediate family of the employee's spouse. "Serious illness or injury" is defined as one in which death is imminent or likely to occur as based on competent medical opinion; or one in which the absence of the employee or dependent would result in great personal hardship. "Immediate family" is defined as the mother or father of the employee or spouse, including stepparents or adoptive parents, the spouse of the employee, or children of the employee and/or spouse, including stepchildren or adoptive children regardless of age.

(2) When, for reasons of force majeure, it is necessary to evacuate the contractor's entire team (i.e., employees and dependents or dependent dependents only, costs should be reimbursable for actual travel and transportation expenses and travel allowance while en route, for the cost of the individuals going from post of duty in the host country to the contractor's home country or other reasonable location. The return of such employees and dependents may also be reimbursable.

(3) Costs are reimbursable for travel related to other causes in accordance with the Force Majeure clause of the contract.

i. Home Leave and Rest and Recuperation Travel

Costs for travel of contractor employees and their dependents at site should be reimbursable for home leave and/or rest and recuperation travel by the most direct route between the host country and the designated leave site. See also paragraphs a. and k. with respect to carrier and baggage limitations.

j. Transportation and/or Storage of Motor Vehicles, Personal Effects and Household Goods.

As set forth in the contract, transportation, including packing and crating costs, may be reimbursable for shipping from the point of origin to post of duty in the host country and return to point of origin of, for example:

- (1) One privately owned vehicle for each contractor employee,
- (2) Personal effects of travellers, and
- (3) Household goods of each contractor employee.

The cost of transporting motor vehicles and household goods should not exceed the cost of packing, crating and transportation by surface. In the event that the carrier does not require boxing or crating of motor vehicles for shipment to the host country, the cost of boxing or crating should not be reimbursable, unless a specific reason for reimbursement is agreed to by the Contracting Agency.

The contractor employee's cost of the storage of personal effects and household goods left in the country of origin, including packing and crating, should be reimbursable.*

*The following limitations are suggested as guidelines in establishing the combined amounts of personal effects and household goods that may be shipped or stored as reimbursable costs, without regard to family status:

Basic Household Furniture Not Supplied		Basic Household Furniture Supplied	
Net Weight	Net Weight	Net Weight	Net Weight
Kg	(Lb)	Kg	(Lb)
8,165	(18,000)	3,265	(7,200) *

The length of contractor employee tour necessary to qualify for the above transportation allowances should be delineated in the contract.

k. Unaccompanied Baggage

The contractor should be reimbursed for costs of shipment of unaccompanied baggage (in addition to the weight allowance above for household effects). The following are suggested guidelines for limitations on reimbursable shipments:

*

	Gross Weight	
	Kg	(Lb)
Employee	113	(250)
First dependent traveling	91	(200)
Second dependent traveling	68	(150)
Each additional dependent traveling	45	(100)

This unaccompanied baggage may be shipped as air freight by the most direct route between authorized points of origin and destination regardless of the modes of travel used.

Unaccompanied baggage is considered to be those personal belongings needed by the traveler immediately upon arrival at destination.

The foregoing provision concerning "unaccompanied baggage" is also applicable to home leave travel by long-term employees and to short-term employees when these are authorized by terms of this contract.

1. Storage of Household Effects

The cost of storage charges (including packing, crating and storage costs) of household goods of contractor employees should be reimbursable. A limitation for reimbursement should be negotiated into the contract.

3. Allowances

a. Host country contracts generally provide for benefits and allowances based on general practice in the host country and the established policies and procedures of the contractor. The paragraphs below list many of the benefits and allowances normally included in USAID-financed contracts. Agreement regarding the amount and applicability of each allowance to be reimbursed is negotiated and included in the contract. USAID's Standardized Regulations may be used as guidelines for establishing contract allowances, or, if appropriate, may be incorporated by reference.

b. Post Differential

Post differential is an additional compensation for service at places in foreign areas where conditions of environment differ substantially from conditions of environment in the contractor's home country and warrant additional compensation as a recruitment retention incentive.

Post differential is generally reimbursable for employees as a percentage of amounts earned during the time such employees actually spend in the host country on work under the contract. When such post differential is provided to contractor employees, it is reimbursable beginning on the date of arrival at the post of assignment and continues, including periods away from the post on official business, until the close of business on the day of departure from post of assignment en route to the employee's home. Sick leave taken at or away from the post of assignment or vacation leave taken at post of assignment should not interrupt the continuity of such post differential payments, provided such leave is not taken within the employee's home country. Post differential should not be reimbursable while the employee is away from his/her post of assignment for purposes of home leave. Short-term employees' eligibility for post differential should be established in contract negotiations.

c. Living Quarters Allowance

Living quarters allowance is an allowance granted to reimburse an employee for substantially all of the cost for residence quarters whenever host Government-owned or host Government-rented quarters are not provided to the employee at

post without charge. Temporary lodging allowance and living quarters allowance should not be reimbursable to an employee for the same period of time.

d. Temporary Lodging Allowance

Temporary lodging allowance is a quarters allowance granted to an employee for the reasonable cost of temporary quarters incurred by the employee and his/or her family for a period specified in the contract.

The contractor should be reimbursed for payment made to employees and authorized dependents for temporary lodging allowance, in lieu of living quarters allowance.

e. Post Allowance

Post allowance is a cost-of-living allowance granted to an employee stationed at a post where the cost of living, exclusive of quarters cost, is substantially higher than in his or her home location.

The contractor should be reimbursed for payments made to employees for post allowance as agreed in the contract.

f. Educational Travel

Educational travel is travel to and from a school in the employee's home country or elsewhere for secondary education (in lieu of an educational allowance) and for college education.

The contractor should be reimbursed for payments made to employees for educational travel for their dependent children provided such payment does not exceed levels negotiated into the contract.

g. Separate Maintenance Allowance

Separate maintenance allowance is an allowance to assist an employee who is compelled, by reason of dangerous, notably unhealthful, or excessively adverse living conditions at his or her post of assignment or for the convenience of the host government, to meet the additional expense of maintaining his or her dependents (as defined in the contract) elsewhere than at such post.

The contractor should be reimbursed for payments made to contractor employees for a separate maintenance allowance if provided for in the contract.

h. Payments During Evacuation

Costs are reimbursable, if agreed to in the contract, for the payment of compensation, post differential and allowances in the event of an emergency evacuation of employees or their dependents, or both, from duty stations for military or other reasons, or because of imminent danger to their lives.

If evacuation is necessary, the contractor should be reimbursed for payments made to employees and authorized dependents evacuated from their post of assignment in accordance with the terms of the contract.

i. Per Diem

Per diem is the amount of funds estimated to support the cost of lodging and meals for a contractor employee for each day in a location other than his or her post of assignment. Per diem should be adjusted if used in conjunction with temporary lodging.

There are many ways in which per diem can be reimbursed as a direct cost, ranging from a flat daily payment to reimbursement for actual expenses with the rate being an upper limit. The method of reimbursement should be set forth in the contract.

4. Other Direct Costs

a. There are many selected items of cost that are often categorized, for contractual purposes, as Other Direct Costs. These include, but are not limited to, supplies and equipment, insurance (especially that insurance required by the Defense Base Act, or other worker's compensation), medical examinations, performance bonds or guaranties, vehicle rental or purchase, miscellaneous communications expenses (telephone, cable), and official papers expenses such as visas or passports.

b. All of the above categories of costs may be reimbursable under a contract. The initial test required, once allowability, allocability and reasonableness have been established, is to determine whether any of the items described as other direct costs in the contract is an item that is normally included in the Contractor's indirect cost pools. If it is, clarification of the method mutually agreeable for charging the cost is required. The Contracting Agency must avoid paying for an item of cost directly if the item is being reimbursed indirectly.

c. Once the item of cost is established as a direct cost item, it should be reimbursed at its actual vouchered value, unless any limitation has been negotiated into the contract. Every effort should be made to assure that the quantity and quality (for supplies) or the terms and duration (for services) of the cost item is specified in the contract.

5. Participant Support Costs

Participant support costs are direct costs for items such as stipends or subsistence allowances, health insurance, travel allowances, and registration fees paid to or on behalf of participants or trainees in connection with meetings, conferences, symposia, or training activities. These costs are allowable with the prior approval of the Contracting Agency. The estimates of various rates and allowances should be specified in the contract. USAID ADS 253, Training for Development Impact, is to be incorporated into the contract by reference, and the actual amount of payment is mandated at the currently applicable rate or allowance specified therein (as of the date of the commitment for the expenditure). (See Chapter 1, 4.3.44). *

A4.0 TREATMENT OF SELECTED INDIRECT COSTS

A4.1 General

1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular element of a cost proposal. After direct costs have been determined and assigned directly to contracts or other work as appropriate, indirect costs are those remaining to be allocated to benefiting work. A cost may not be allocated to a contract as an indirect cost if that same cost has been assigned to a contract as a direct cost.
2. Because of the diverse characteristics and accounting practices of organizations, it is not possible to specify the types of cost which may be classified as indirect cost in all situations. However, typical example of indirect costs for many organizations may include depreciation or use allowances on building and equipment, the costs of operating and maintaining facilities, and general and administrative expenses, such as the salaries and expenses of executive officers, personnel administration and accounting.

A4.2 Allocation of Indirect Costs and Determination of Indirect Cost Rates

1. General
 - a. Where an organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures as described in paragraph 3 below.
 - b. Where an organization has several major functions which benefit from its indirect costs in varying degrees, allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual contracts and other activities included in that function by means of an indirect cost rate(s).
 - c. The determination of what constitutes an organization's major functions will depend on its purpose in being; the types of services it renders to the public, its clients, and its members; and the amount of effort it devotes to such activities as fund raising, public information, and membership activities.
 - d. Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in paragraphs 4 through 6 below.
 - e. The base period for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation to work performed in that

period. The base period normally coincides with the organization's fiscal year, but in any event, shall be so selected as to avoid inequities in the allocation of the costs.

2. Suggested Approach

In order to deal with indirect costs from the perspective of an USAID Mission or Host Government Contracting Agency, it is suggested that one of the following approaches be considered:

- a. If the contractor is a U.S. firm or organization, it may have established overhead/general and administrative rates with a U.S. Government agency. While this rate may not be the one proposed by the contractor for host-country contracts, it offers a base line from which to evaluate the rate proposed. The contractor's current rate for U.S. Government contracts may be obtained from M/OP/PS/OCC, USAID/W
- b. If the contractor has never proposed an indirect cost rate before, the costs involved in its current proposal are identifiable and the contract's overall value is not high, it may be preferable to have these costs treated as a direct cost category and negotiated as a fixed amount under the contract.
- c. If neither of the two above circumstances apply, it will be necessary to negotiate an indirect cost rate in accordance with paragraphs 3 through 6 below and Section A4.3. It is suggested that qualified contracting or financial personnel participate in such negotiations.

3. Simplified Allocation Method

- a. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual contracts. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities.
- b. Reimbursement of both direct and indirect costs shall exclude unallowable costs. However, unallowable costs must be included in the distribution base(s) for purposes of final indirect cost rate calculation.
- c. The distribution base may be total direct costs generally (excluding capital expenditures and other distorting items, such as major subcontracts), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs.
- d. Except where a special rate(s) is appropriate in accordance with paragraph 5 below, the indirect cost rate developed under the above principles is

applicable to all contracts with the organization. If a special rate(s) is required, appropriate modifications shall be made in order to develop the special rate(s).

4. Multiple Allocation Base Method

a. Where an organization's indirect costs benefit its major functions in varying degrees, such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefiting functions by means of a base which best measures the relative benefits.

b. The groupings shall be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping should constitute a pool of expenses that are of like character in terms of the functions they benefit and in terms of allocation base which best measures the relative benefits provided to each function. The number of separate groupings should be held within practical limits, taking into consideration the materiality of the amounts involved and the degree of precision desired.

c. Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefiting functions. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a grouping are more general in nature, the allocation should be made through the use of a selected base which produces results that are equitable to both the Contracting Agency and the organization.

In general, any cost element or cost-related factor associated with the organization's work is potentially adaptable for use as an allocation base provided (i) it can readily be expressed in terms of dollars or other quantitative measures (total direct costs, direct salaries and wages, staff hours applied, square feet used, hours of usage, number of documents processed, population served, and the like) and (ii) it is common to the benefiting functions during the base period.

d. Except where a special indirect cost rate(s) is appropriate in accordance with paragraph 6. below, the separate groupings of indirect cost allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual contracts included in that function by use of a single indirect cost rate.

e. The distribution base used in computing the indirect cost rate for each function may be total direct costs (excluding capital expenditures and other distorting items such as major subcontracts), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool.

5. Direct Allocation Method

a. Some organizations treat all costs as direct costs except general and administrative expenses. These organizations usually separate their costs into three basic categories: (i) General and administrative expenses, (ii) fund raising (for nonprofit organizations), and (iii) other functions (including **activities** performed under host country contracts). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as a direct cost to each category and to each contract or other activity using a base most appropriate to the particular cost being prorated.

b. This method is acceptable provided each joint cost is prorated using a base which accurately measures the benefits provided to each contract or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data.

c. Under this method, indirect costs consist exclusively of general and administrative expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in paragraph 1. above.

6. Special indirect cost rates

In some instances, a single indirect cost rate for all activities of an organization or for each major function of the organization may not be appropriate, since it would not take into account those direct factors which may substantially affect the indirect costs applicable to a particular segment of work. The factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements, use, or any combination thereof. When a particular segment of work is performed in an environment which appears to generate a significantly different level of indirect costs, provision should be made for a separate indirect cost pool applicable to such work. For example, overseas contracts may have one overhead rate while domestic contracts may have another. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used provided it is determined that (i) the rate differs significantly from that which would have been obtained under paragraphs 3, 4 or 5 above, and (ii) the volume of work to which the rate would apply is material.

A4.3 Negotiation and Approval of Indirect Cost Rates

1. Definitions

As used in this section, the following terms have the meanings set forth below:

a. "Provisional rate" or billing rate means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on contracts pending the establishment of a rate for the period.

b. "Final rate" means an indirect cost rate applicable to an specified period which is based on the actual, audited costs of the period. A final rate is not subject to adjustment.

c. "Indirect cost proposal" means the documentation prepared by an organization to substantiate the claim for the reimbursement of indirect costs. The proposal provides the basis for the review and negotiation leading to the establishment of an organization's indirect cost rate.

2. Negotiation and Approval of Rates

a. Provisional and final rates shall be negotiated by the Contracting Agency. For U.S.-based firms, the Contracting Agency should, as a basis for negotiation, use the information available from M/OP/PS/OCC, in USAID/W, which includes recent U.S. Government audit reports or submit a request to M/OP/PS/CAM for an audit of the proposal.

b. The results of each negotiation shall be formalized in the basic contract or by an amendment to the contract.

c. If a dispute arises in a negotiation of an indirect cost rate between the Contracting Agency and the organization, the dispute shall be resolved in accordance with the disputes procedures of the contract.

A4.4 Selected Items of Indirect Cost

Paragraphs 1 through 19 provide principles to be applied in establishing the allowability of certain items of indirect cost. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather determination as to allowability in each case should be based on the treatment of principles provided for similar or related items of cost.

1. Advertising Costs

The only advertising costs allowable are those which are solely for (i) the recruitment of personnel when considered in conjunction with all other recruitment costs, as set forth in paragraph 17; (ii) the procurement of goods and services for the contract; (iii) the disposal of surplus materials acquired in the performance of the contract, or (iv) specific requirement of the contract.

2. Bonding and Guaranty Costs

a. Bonding and guaranty costs arise when the Contracting Agency requires assurance against financial loss to itself or other by reason of the act or default of the organization. They arise also in instances where the organization requires similar assurance. Included are such bonds and guaranties as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding or guaranties required pursuant to the terms of the contract are allowable, either as direct or indirect cost.

c. Costs of bonding required by the organization in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

3. Communication Costs

Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage and the like, are allowable as direct or indirect costs.

4. Fringe Benefits

a. Fringe benefits in the form of regular compensation paid to employees during period of authorized absences from the job, such as vacation leave, sick leave, military leave, and the like, are allowable provided such costs are absorbed by all organization activities in proportion to the relative amount of time of effort actually devoted to each.

b. Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, worker's compensation insurance, pension plan costs (see paragraph 5 below), and the like, are allowable provided such benefits are granted in accordance with established written organization policies. Such benefits, whether treated as indirect costs or as direct costs, shall be distributed to particular contracts and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such contracts and other activities.

c. (1) Provisions for a reserve under a self-insurance program unemployment compensation or worker's compensation are allowable to the extent that the provisions represent reasonable estimates of the liabilities for such compensation, and the types of coverage, extent of coverage, and rates and premiums would have been allowable had insurance been purchased to cover the risks. However, provisions for self-insured liabilities which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(2) Where an organization follows a consistent policy of expending actual payments to, or on behalf of, employees or former employees for unemployment compensation or worker's compensation, such payments are allowable in the year of payment, with the prior approval of the Contracting Agency, provided they are allocated to all activities of the organization.

d. Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibility are allowable only to the extent that the insurance represents additional compensation. The costs of such insurance when the organization is named as beneficiary are allowable.

5. Pension Plan Costs

a. Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

- (1) Such policies meet the test of reasonableness;
- (2) The methods of cost allocation are not discriminatory;
- (3) The cost assigned to each fiscal year is determined in accordance with generally accepted accounting principles; and
- (4) The costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year. However, increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30 days after each quarter of the year to which such costs are assignable are unallowable.

b. Pension plan termination insurance premiums are allowable. Late payment charges on such premiums are unallowable.

c. Excise taxes on accumulated funding deficiencies are unallowable.

6. Donations

a. Services received

(1) Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost.

(2) The value of donated services utilized in the performance of a direct costs activity shall be considered in the determination of the organization's indirect cost rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs when the following circumstances exist:

- (a) The aggregate value of the services is material;
- (b) The services are supported by a significant amount of the indirect costs incurred by the organization;
- (c) The direct cost activity is not pursued primarily for the benefit of the Host Government.

(3) In those instances where there is no basis for determining the fair market value of the services rendered, the recipient and the Contracting Agency shall negotiate an appropriate allocation of indirect cost to the services.

(4) Where donated services directly benefit an activity supported by a contract, the indirect costs allocated to the services will be considered as a part of the total costs of the activity.

(5) Fair market value of donated services shall be computed as follows:

(a) Rates for volunteer services

Rates for volunteers shall be consistent with those regular rates paid for similar work in other activities of the organization. In cases where the kinds of skills involved are not found in other activities of the organization, the rates used shall be consistent with those paid for similar work in the labor market in which the organization competes for such skills.

(b) Services donated by other organizations

When an employer donates the services of an employee, these services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and indirect costs) provided the services are in the same skill for which the employee is normally paid. If the services are not in the same skill for which the employee is normally paid, fair market value shall be computed in accordance with subparagraph (a) above.

b. Goods and space

Donated goods; i.e., expendable personal property/supplies, and donated use of space may be furnished to an organization. The value of the goods and space is not reimbursable either as a direct or indirect cost.

7. Employee Moral, Health, and Welfare, Costs and Credits

The costs of house publications, health or first-aid clinics, and/or infirmaries, recreational activities, employees' counseling services, and other expenses incurred in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable. Such costs will be equitably apportioned to all activities of the organization. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably committed to employee welfare organizations. Care must be taken to assure that any benefit charged directly, or furnished in kind to the contractor such as rest and recuperation travel or home leave, is not allowed to be charged as a part of this item.

8. Insurance and Indemnification

a. Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the contract and any other insurance which the organization maintains in connection with the general conduct of its

operations. This paragraph does not apply to insurance which is costed as fringe benefits or direct costs under the contract.

(1) Costs of insurance required or approved, and maintained, pursuant to the contract are allowable.

(2) Costs of other insurance maintained by the organization in connection with the general conduct of its operations are allowable subject to the following limitations.

(a) types and extent of coverage shall be in accordance with sound business practice and the rates and premiums shall be reasonable under the circumstances.

(b) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of management fees.

(c) Costs of insurance or of any provisions for a reserve covering the risk of loss or damage to Host Government property are allowable only to the extent that the organization is liable for such loss or damage.

(d) Provisions for a reserve under a self-insurance program are allowable to the extent that types of coverage, extent of coverage, rates, and premiums would have been allowed had insurance been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(3) Actual losses which could have been covered by permissible insurance (through the purchase of insurance or a self-insurance program) are unallowable unless expressly provided for in the contract except:

(a) Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound business practice are allowable.

(b) Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of supplies, which occur in the ordinary course of operations, are allowable.

b. Indemnification includes securing the organization against liabilities to third persons and any other loss or damage, not compensated by insurance or otherwise. The Host Government is obligated to indemnify the organization only to the extent expressly provided in the contract.

9. Labor Relations Costs

Costs incurred in maintaining satisfactory relations between the organization and its employees, including costs of labor management committees, employee publications, and other related activities are allowable.

10. Meetings, Conferences

Costs of meetings and conferences held to conduct the general administration of the organization are allowable.

11. Memberships, Subscriptions, and Professional Activity Costs

a. Costs of the organization's membership in civic, business, technical, and professional organizations are allowable.

b. Costs of the organization's subscriptions to civic, business, professional, and technical periodicals are allowable.

c. Costs of attendance at meetings and conferences, sponsored by others when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, and other items incidental to such attendance.

12. Page Charges in Professional Journals for Research Papers

Page charges for professional journal publications are allowable as a necessary part of research costs, where:

a. The research work is supported by the Host Government; and

b. The charges are levied impartially on all research papers published by the journal, whether or not by Host Government-financed authors.

13. Preaward Costs

Preaward costs are those incurred prior to the effective date of the contract where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs, both direct and indirect, are allowable only to the extent that they would have been allowable if incurred after the effective date of the contract and only with the written approval of the Contracting Agency, or if specifically authorized in the contract.

14. Professional Service Costs

a. Costs of ancillary professional and consultant services (such as lawyers, accountants, etc.) rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the organization, are allowable, subject to paragraph b, c, and d, below, when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Contracting Agency.

b. In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:

- (1) The necessity of contracting for the service, considering the organization's capability in the particular area.
- (2) The past pattern of such costs.
- (3) Whether the proportion of Host Government work to the organization's total business is such as to influence the organization in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Host Government contracts.
- (4) The qualifications of the individual or concern rendering the service and the customary fees.
- (5) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).

c. In addition to the factors in paragraph b. above, retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.

d. Cost of legal, accounting, and consulting services, and related costs incurred in connection with defense of antitrust suits, and the prosecution of claims against the U.S. Government, are unallowable. Costs of legal, accounting and consulting services, and related costs, incurred in connection with patent infringement litigation, organization and reorganization, are unallowable unless otherwise provided for in the contract.

15. Publication and Printing

a. Publication costs include the costs of printing (such as the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling.

b. If these costs are not identifiable with a particular contract, they should be allocated as indirect costs to all benefiting activities of the organization.

16. Rearrangement and Alteration Costs

Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special arrangement and alteration costs incurred specifically for the contract are allowable with the prior approval of the Contracting Agency.

17. Recruiting Costs

The following recruiting costs are allowable: cost of "help wanted" advertising, operating costs of an employment office, costs of operating an educational testing program, travel expenses including food and lodging of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees. Where the organization uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

18. Taxes

a. In general, taxes which the organization is required to pay, and which are paid or accrued in accordance with generally accepted accounting principles, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable, except for (1) taxes from which exemptions are available to the organization directly or which are available to the organization based on an exemption afforded by the Host Government and, in the latter case, when the Contracting Agency makes available the necessary exemption certificates, (2) U.S. Federal and other sovereign national income taxes.

b. USAID will not finance identifiable taxes, fees, levies, or impositions under the laws of the host country placed against a contractor (or any of its employees). However, such taxes paid by the contractor or its employees may be reimbursed by the Contracting Agency.

c. Any refund of taxes, and any payment to the organization of interest thereon, which were allowed as contract costs, will be credited either as a cost reduction or cash refund, as appropriate, to the Contracting Agency.

19. Other Indirect Costs

In addition to the selected items of indirect cost discussed above, there are many other potentially applicable items. Some of the more common are depreciation, equipment and plant, idle facilities, maintenance and repair, patents, and training of employee expenses. These and many other items are discussed in detail in the U.S. Government Office of Management and Budget Circular A-122, as published in the Federal Register, Volume 45, No. 132 dated July 8, 1980. If it is necessary to review such items of indirect cost, the guidance furnished in the above-referenced document may be helpful.

APPENDIX 4B, PROGRAM FOR AUDIT OF COUNTRY CONTRACTS FINANCED BY USAID

B1.0 INTRODUCTION

The U.S. Agency for International Development acts as a financing agent for contracts between foreign governments and private firms and organizations for services and related commodities. The host governments employ both fixed price and cost reimbursement contracts which are subject to an audit. Cost reimbursement contracts are audited for compliance with all contract provisions (including allowability, allocability, and reasonableness of costs as set forth in Chapter 4 of the USAID Country Contracting Handbook) while fixed price contracts are audited only for the nonfinancial requirements of the contract (e.g. source and origin, use of U.S. Flag Air Carriers, marking, etc.).

The host countries have found it advantageous to utilize the services of public accounting firms to augment their own audit staffs in auditing contracts. This PROGRAM FOR AUDIT OF HOST COUNTRY CONTRACTS has been prepared to provide background materials and guidance for independent public accounting firms engaged to conduct contract audits for the host country contracts which are financed by USAID.

B2.0 CONTRACT COSTS

This audit program is designed to cover work typically required in the audit of USAID-financed contracts. It is intended that generally accepted auditing standards will be applied to the extent appropriate in the view of the character of the engagement. However, it is the responsibility of the auditor to adapt these guidelines to each specific situation. In the event that major deficiencies in record keeping or other situations are encountered that would necessitate an excessive amount of effort on the part of the auditor to establish the allowability, allocability, and reasonableness of costs or compliance with other provisions, or the auditor is otherwise prevented from accomplishing the audit in a reasonable manner, the Contracting Agency requesting the audit should be promptly notified.

During the course of the audit, the auditor should, of course, discuss with the contractor any proposed disallowances of direct or indirect costs in order that the contractor may have the opportunity to submit explanations or supply audit evidence. Any questions concerning interpretation of the contract should be submitted to the Contracting Agency who will supply guidance to the auditor.

It is expected that the audit working papers and memoranda will adequately reflect the work performed. These are to be available to the Contracting Agency upon request. Guidelines for report preparation are covered in Section B.13 of this program.

B3.0 INTERNAL CONTROL AND RECORDS

An evaluation of the contractor's internal control and records is a primary consideration in every audit. The results of this evaluation will determine the extent of testing to be performed.

Comments on the contractor's internal control and records, along with recommendations for areas of improvement, if appropriate, should be included in the report to the Contracting Agency.

The contractor should maintain separate accounts to record direct costs for all work. These accounts should be supported by subsidiary accounts or analytical schedules to the extent appropriate. Individual items should in turn be supported by invoices, expense reports, payroll records, or other adequate documentation. Schedules prepared from the contractor's records should agree with or be reconciled to amounts billed to the Contracting Agency.

In order to determine the extent of testing of the contractor's records required, an analysis would ordinarily include a test of cash disbursements and accruals, a review of income accounts, and a general analysis of the contractor's annual report. If the contractor is audited by independent public accountants a copy of the report should be obtained.

This program does not intend to specify the amount of testing required to evaluate internal control. The practices of the contractor, the condition of the records and other factors should be the basis for this decision.

B4.0 PROGRAM

1. Compare the annual financial report with the contractor's general ledger. Obtain explanations for all differences.
2. On the basis of the information gained to this point, and a brief survey of the contractor's purchase and disbursements journals, select a representative group of transactions and perform a cash disbursement test. The testing should include a determination that the approval of disbursements is adequate, account classifications are accurate, and documentation is effectively cancelled to safeguard against duplicate payment of invoices. Review accruals at the end of the fiscal year. Specifically ascertain the adequacy of the basis used to distinguish between direct and indirect costs.
3. Review income accounts, paying particular attention to miscellaneous accounts to ascertain that refunds and rebates are being credited to applicable expenses rather than being taken into income.
4. Prepare a memorandum summarizing the adequacy of the contractor's internal control and records. Outline suggestions for corrective action, if applicable.
5. Obtain copies of all vouchers submitted during the period under review.
 - a. Prepare a schedule summarizing total billed, by categories, prior to the period under audit and list all current billings by category. List separately amounts billed but not reimbursed and amounts recorded but not billed and extend the totals.
 - b. Ascertain the total, or totals of individual categories have not exceeded maximum amounts set forth in the contract or in subsequent amendments.

- c. Reconcile billings with the contractor's financial statements.

B5.0 SALARIES

Salaries may be classified as direct or indirect. Be particularly alert concerning the manner in which contractor personnel apply and record their time. Direct charges should be recorded for host government contracts in the same manner that they are recorded for all other contracts. A review of the contractor's experience with regard to idle or unassigned time should be made for use in connection with the examination of overhead rates.

Typical contract provisions applicable to salaries which may be pertinent are as follows:

1. Predetermined maximum allowable amount.
2. Definition of position which may be included in the direct salary category.
3. Provision requiring prior approval by the Contracting Agency of certain categories or of all personnel working on the contract.
4. Maximum salaries for specific job classifications.
5. Restrictions as to salary increases or amounts paid in excess of previous salaries earned.
6. Restrictions on salary paid during travel time and maximum limitations on time spent for briefing and de-briefing at the contractor's home office.
7. Limitations on sick leave, holiday, and vacation pay.

If personnel are working on more than one contract or job, tests should be made to ascertain that charges are directly related to time spent on the contract and that time charges are accumulated and approved in an acceptable manner. The manner in which home office personnel charge their time should be analyzed in light of contract stipulations and for reasonableness.

B5.1 Program

1. Obtain or prepare a schedule, by employee, of salaries charged to the contract. Foot totals and compare with the summary of billings schedule.
2. On a test basis, the extent of which would be determined by a previous analysis of the contractor's internal control, perform the following steps:
 - a. Trace pay rates to the host government authorizations or applicable provisions in the contract. Ascertain that the rate applied to time charges of each employee is in accordance with the contractor's established policy and practice.

- b. Check total vacation, holiday, and sick leave charges against applicable provisions in the contract. Make certain that vacation, holiday and sick leave is recorded in a similar manner for all contracts and jobs. If leave is treated as a direct charge for host government contracts and an indirect charge for other contracts the amount should be eliminated from the overhead pool.
- c. If there has been a pay rate increase, determine that it has been properly approved and is in accord with provisions set forth in the contract.
- d. Ascertain that maximum allowable travel time and period spent for the purpose of briefing and de-briefing have not been exceeded.

In some situations, because of the limited number of employees involved or for other reasons, test procedures may not be applicable.

B6.0 ALLOWANCES

Host government contracts typically contain certain provisions for reimbursement of living expenses in one of several of the following forms: per diem, overseas differential, quarters allowance, post allowance, etc. Although the contract will stipulate which allowances are applicable to various employees under given circumstances, the auditor will probably have to look elsewhere for specific rates. Per diem rates differ in various countries depending upon the cost of living. Further, the per diem rates for travel in the United States may differ from that applicable to overseas travel. The contract may stipulate that short-term employees are to receive per diem although employees assigned for longer periods are paid overseas differential; or, an employee may receive per diem while in the United States and overseas differential while in the host country.

In any case the auditor should refer first to provisions contained in the contract or letters from the host government designating rates and secondly to U.S. Government publications containing rates by geographic location if such publications are incorporated into the contract. Since these listings are continuously updated in conjunction with economic changes in various countries, it may become necessary to obtain rates for specific locations from the host government.

B6.1 Program

1. Schedule all allowances reimbursed, by location and employee, and perform the following steps, on a test basis to the extent appropriate.
 - a. Check calculations of allowances and support by reference to number of days spent in each area.
 - b. Examine authorization for rates used either by reference to the contract and/or to the Standardized Regulations (Government Civilians, Foreign Areas), if they have been incorporated into the contract.
2. Compare totals with the summary billings schedule.

B7.0 RETIREMENT AND INSURANCE

Employee benefits may appropriately be classified as direct costs if so treated in a consistent manner by the contractor. Thus, retirement contributions for the contractor's field staff who qualify as permanent employees under the contractor's retirement plan will normally be considered as direct costs. As a general rule some stipulation as to what may or may not be included will be found in the contract. However, these costs will normally qualify as direct costs in proportion to the direct salary reimbursed under the terms of the contract.

Other employer insurance expenses which are normally reimbursable as direct costs would include worker's compensation, the employer's FICA contribution and health and accident insurance. In some cases where it is the employer's normal practice to provide life insurance, part or all of this expense may be included.

Some contracts stipulate that insurance premiums should be approved by the Contracting Agency. A disallowance should be proposed where approval has not been obtained, if the contract provides for such approval.

B8.0 TRAVEL AND TRANSPORTATION

Most contracts are specific in setting out the conditions for reimbursement of travel and related costs. The following provisions are typically covered in the contract:

1. Type and class of travel allowed.
2. Points between which travel will be reimbursed.
3. Maximum weight limitation for unaccompanied baggage.
4. Maximum weight limitation on household goods transported.
5. Whether or not transportation of private automobiles is reimbursable.
6. Restrictions on travel of dependents and additional baggage allowance for each dependent.
7. Minimum time requirement for overseas duty as a condition for the reimbursement of certain of the above expenses.
8. Use of U.S. Flag carrier as required by the contract.

In addition to the above stipulations the contract will probably contain provisions for reimbursement of transportation costs in the event of termination of an employee under varying circumstances.

B8.1 Program

1. Schedule all transportation expenses by individual reimbursed and perform the following steps, on a test basis to the extent appropriate:
 - a. Examine copies of expense reports and supporting vouchers where applicable and check for approvals.
 - b. Check footings and computations.
 - c. Determine that charges are in accordance with terms set forth in the contract.
2. Reconcile the total with the summary billings schedule.

B9.0 OTHER DIRECT COSTS

Other direct charges will include reimbursement for the cost of publications, postage, telephone, etc. There will generally be a maximum limitation on expenditures under this category. Since the contractor cannot foresee all possible expenditures which may be allowed, judgment must be exercised in determining whether or not such costs are reasonable and should be allowed. This section also applies to commodities purchased by the contractor.

B9.1 Program

1. Schedule all "other direct costs" by category and reconcile the total to the summary billings schedule.
2. Select charges, concentrating on large dollar value items for examination of supporting invoices, on a test basis to the extent appropriate.
3. Determine the propriety of all items for which the contractor has been reimbursed, taking into consideration any restrictions set out in the contract.
4. Determine that the source and origin of items conforms to these requirements of the contract.
5. Determine that all refunds, rebates and discounts, are properly treated.

B10.0 OVERHEAD

Cost contracts awarded by the host governments typically provide for interim reimbursement of indirect costs in periodic billings at a provisional rate, subject to negotiation by the host government based on the audit of contractor's overhead submission pursuant to the provisions in the contract. This section of the program covers the audit of the contractor's proposal for overhead.

The overhead rate included in host government contracts is frequently expressed as a percentage of direct salaries. Although this method predominates, other methods such as expressing overhead as a percentage of total direct costs may be used as warranted by the circumstances. The method included in the contract is ordinarily determined by the customary practices followed by the contractor and depends upon the complexity of its activities and the diversity of its operations. The contract may contain a maximum allowable overhead rate provision and final reimbursement will not be made in excess of that rate.

When contracts involve overseas activities, separate indirect cost rates are ordinarily used for home office and overseas work. This represents a cost accounting approach and method which gives consideration to the ultimate benefits to be derived from the expenditures applicable to each. The overseas rate will ordinarily exclude items such as rent, heat, light and depreciation (items comprising expenses identifiable with office occupancy), since these benefits are usually reimbursed as direct costs. Although such cost elements are not considered allocable the overseas rate, they are included in the determination of overhead applicable to home office work of the contractor.

In determining an overhead rate certain types of expenses are excluded from the overhead pool in accordance with the guidance in Appendix 4A.

Examples of expense classifications frequently excluded are donations, interest, bad debts, and advertising. A copy of the previous overhead computation is usually included in the latest audit report. It is the responsibility of the contractor to initially prepare the overhead computation in accordance with the terms of the contract.

The initial task of the auditor in examining the contractor's overhead proposal is to satisfy itself that the contractor's accounts reflects an accurate and appropriate classification of costs. Among other points to be considered is the consistent and appropriate classification of direct and indirect costs for all contracts or jobs undertaken by the contractor, including non-host government work. The review should include a determination that the overhead base is comprised of all functions of the organization's operations that generate overhead.

In the second phase of the examination of overhead costs the auditor will ascertain that the contract cost principles and any specific provisions of the contract are observed. This will include specific attention to the exclusion of unallowable elements of cost in accordance with USAID Country Contracting Handbook, Chapter 4, Appendix 4A.

If the contractor has subsidiaries, affiliates, or branch offices, the methods of allocating overhead to the various locations or entities should be reviewed in detail. If the method does not appear to be reasonable or equitable, the auditor should recommend an alternative method.

B10.1 Program

1. General
 - a. Obtain a copy of contractor's overhead proposal(s).
 - b. Prepare an overhead summary schedule.
 - c. Review prior year(s) overhead audit(s) and indicate which accounts contained questionable items.

- d. Compare current year overhead amounts by account to prior years account by amount. Make notation of significant increase or decrease.
- e. Select for audit those accounts which are indicated by c. & d. above plus other overhead accounts deemed necessary.

2. Criteria for Acceptability of Overhead Costs

The basis for acceptability of overhead expense and the basis of allocation will be reasonableness, allowability and allocability as stated under the terms of the contract and the cost principles of USAID Country Contracting Handbook, Chapter 4.

3. Audit of Overhead Expense Accounts

- a. Trace amounts per Contractor's Overhead Proposal to General Ledger (and subledger if appropriate).
- b. Perform an audit of the accounts listed under 1-e above in accordance with 2 above. Some of the main points of examination are as follows:
 - (1) Type of expense,
 - (2) Vendors bill and payment, and
 - (3) Host government approval (if applicable).

4. Basis of Allocation

- a. Verify contractor's calculation
- b. Compute acceptable overhead rate based upon audit findings.
- c. Summarize contract provisional and ceiling rates.

B11.0 FEE

When contracts have a provision for a fee in addition to reimbursement of costs it is a fixed amount, negotiated prior to the inception of the contract.

However, a limitation as to fee paid is often included to cover those instances where the contractor has not provided the agreed upon worker-months of services or otherwise performed its contractual obligations. In addition to fee limitations the contract may also specify the manner in which the fee is to be paid. For example, a certain percentage of the total fee may be held back pending completion of the contract.

B11.1 Program

1. Summarize the fees billed and reimbursed for the period under audit. Check the computation of amounts billed.
2. By reference to the contract check the computation of amounts due the contractor. Note any reduction in fee due to nonperformance by the contractor.

B12.0 COMPLIANCE WITH OTHER CONTRACT REQUIREMENTS

In addition to the financial requirements contained in host country contracts there are certain provisions of nonfinancial nature which should be reviewed and the extent of compliance commented upon by the auditor. Although the auditor is not expected to make judgments in technical areas, it is expected to ascertain adherence to other nonfinancial provisions of the contract. Primarily the areas which may be covered by other provisions are: specific actions requiring host government approval, periodic reporting to the host government by the Contractor, and compliance with the nationality/source, marking, and similar requirements of the contract.

B12.1 Program

1. Read the contract, appendices, and all amendments carefully noting any nonfinancial provisions (other than technical) contained therein. Examine the contractor's records to determine the extent of compliance with such provisions contained in the contract.
2. Prepare a memorandum outlining the provisions reviewed and any noncompliance by the contractor.

B13.0 GUIDE FOR REPORT PREPARATION

The standardization of the format utilized in the preparation of audit reports provided for in this guide is designed to optimize the usefulness of audit reports to both the Contracting Agency and the Agency for International Development.

It is recognized that the host governments contract with a great variety of organizations, and thus data applicable to one organization may not apply to all other organizations. Efforts to gain the advantages of standardization in presentation are not intended to limit the substance of reports.

The format outlined should be followed to the extent that it is practicable to do so. Narrative comments should ordinarily be confined to exception reporting rather than a detailed discussion of the audit steps performed and the audit adjustments proposed. Deficiencies in the contractor's recordkeeping and internal control, deviations from the audit program, unusual problems and other comparable matters should be discussed. Results of the audit and a description of adjustments will be included in supporting schedules in a separate section of the report. The auditor should include in its report a reconciliation between the costs accepted and the total amount reimbursed the organization by the host country and/or USAID.

In the pages which follow, the sample reporting format is outlined by sections and by supporting schedules, along with such general guidance as appears appropriate in each instance.

TABLE OF CONTENTS

	<i>Page</i>
Auditing Firm's Name:	
Contract With:	
Contract No.:	
Contracting Agency, etc.:	
Auditor's Report	
Explanation, Comments, and Recommendations	
Internal Control and Records	
Other Matters	

SCHEDULES:

- I. Summary of contract costs by contract and auditor's adjustments
- II. Compilation of overhead pool and base
- III. Summary of overhead determination
- IV. Reconciliation of host country and Agency reimbursements with costs accepted by auditor
- V. Additional schedules (if necessary).

AUDITOR'S REPORT

The auditor's report should contain an identification of the contractor, an enumeration of the contracts audited, the period covered by the audit, a scope paragraph and an opinion paragraph.

A typical auditor's report where no unusual problems are encountered is illustrated below:

HEADING

We have examined the accounting records of (contractor) as they pertain to the following contracts:

Contract number	Country	Period Covered
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Our examination was made in accordance with generally accepted auditing standards to the extent appropriate in view of the character of the engagement, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the amounts billed by the contractor, after giving effect to proposed adjustments, are in all material respects in accordance with the financial provisions of the contracts enumerated above.