

Chapter 27 Fines, Penalties & Mischarging Costs

Authoritative Sources

[FAR 31.201-3](#) Determining Reasonableness

[FAR 31.201-4](#) Determining Allocability

[FAR 31.204](#) Application of Principles and Procedures

[FAR 31.205-15](#) Fines, Penalties, and Mischarging Costs

General Audit Guidelines

This chapter provides general audit guidelines for reviewing fines, penalties, and mischarging costs. In general, fines and penalties are forms of punishment or are levied in order to serve a deterrent function. Penalties do not include restitution, reimbursement, or compensatory damages (FAR 31.205-47(a)). Mischarging costs are costs incurred due to the contractor's inappropriate behavior or unreasonable acts.

This chapter addresses the following topics:

- 27-1** General Matters Concerning Fines, Penalties, and Mischarging Costs
- 27-2** Allowability of Fines and Penalties
- 27-3** Allowability of Mischarging

27-1 General Matters Concerning Fines, Penalties, and Mischarging Costs

Fines, Penalties, and Mischarging Costs can be associated with many activities of the contractor and are often combined with several types of cost. In addition, fines and penalties can be associated with and included in several elements of cost including employment related, legal, environmental, taxes, and banking. The variable nature of fines and penalties requires the auditor to use critical thinking skills when applying the criteria in the cost principle. The auditor should also consider whether the costs are allowable based on the "similar or related costs" concept in FAR 31.204(d) with reference to FAR 31.205-15. FAR 31.204(d) provides that the determination of allowability shall be based on the guidance contained in the subsection that most specifically deals with the cost at issue. For example, civil court monetary judgments or civil jury awards, expressly identified as punitive damages, can be similar to the penalties resulting from contractor violations of Federal, State, local, or foreign laws and regulations, which are expressly unallowable under FAR 31.205-15. Lastly, the auditor should consider reasonableness under FAR 31.201-3, Determining Reasonableness, and allocability under FAR 31.201-4, Determining Allocability, and applicable Cost Accounting Standards.

A key concept for the auditor to consider is the intent behind FAR 31.205-15, which is to prevent contractors from recovering fines, penalties, and costs associated with mischarging due to the contractor's inappropriate behavior or unreasonable acts.

27-2 Allowability of Fines and Penalties

The cost principle at FAR 31.205-15(a) makes costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, Federal, State, local, or foreign laws and regulations unallowable, except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer. While punitive damages that are awarded in civil cases appear to be similar to the penalties identified in this cost principle, they do not constitute a penalty unless the punitive damages:

- (1) are unrelated to the amount of actual harm suffered and are related more to the penalized party's conduct;
- (2) are the proceeds from infractions that are collected by the state rather than paid to the individual harmed; **and**
- (3) result from a lawsuit that is based on a statute or regulation that was meant to address harm to the public rather than provide a remedy to the plaintiff.

Punitive damages will normally not meet all of these criteria and therefore are not typically unallowable under this cost principle. See discussion of the *Ingalls Shipbuilding v. Dalton*, 119 F.3d 972 (Fed. Cir. 1997) case below.

27-3 Allowability of Mischarging

The cost principle at FAR 31.205-15(b) states that costs incurred in connection with, or related to, the mischarging of costs on Government contracts are unallowable when the costs are caused by, or result from, alteration or destruction of records, or other false or improper charging or recording of costs. Such costs include those incurred to measure or otherwise determine the magnitude of the improper charging, and costs incurred to remedy or correct the mischarging, such as costs to rescreen and reconstruct records.