SELECTED AREAS OF COST

Chapter 35 – Interest and Other Financial Costs

Authoritative Sources

FAR 31.205-20 Interest and Other Financial Costs

FAR 31.205-41 Taxes

Class Deviation 2011-O0006 Utilities Privatization-Class Deviation from FAR Part 31

FAR 31.205-27 Organization Costs

FAR 31.201-6 Accounting for unallowable costs.

This chapter provides general audit guidelines for auditing interest and other financial related costs. These costs include interest on borrowings, bond discounts, costs of financing and refinancing capital, legal and professional fees paid in connection with preparing prospectuses, and costs of preparing and issuing stock rights.

This chapter addresses the following topics:

35-1 General Information **

Generally, interest expenses and other financial costs are expressly unallowable and should be excluded from billings, claims, and proposals (FAR 31.201-6(a)). For more information on expressly unallowable costs see the Audit Alert on Identifying Expressly Unallowable Costs (19-PAC-002(R)). Unallowable interest expenses can include interest on loans and lines of credit. Bond discounts and all other costs of financing and refinancing capital, (net worth plus long-term liabilities), including associated costs, are also unallowable. Examples of associated costs include, but are not limited to, legal, accounting and other professional fees, incurred in connection with preparing a prospectus, and the costs of preparing and issuing stock rights.

35-2 Related Cost Principles. **

- FAR 31.205-10 Cost of Money – makes the costs of facilities and capital assets under construction allowable so long as the costs are appropriately imputed pursuant to CAS 414 or CAS 417.
- FAR 31.205-27 Organization Costs – FAR 31.205-27(a)(3), which is related to raising capital, excludes "short-term borrowings for working capital" from unallowable reorganization costs.
- FAR 31.205-28 Other Business Expenses.
  - This cost principle makes some of the administrative costs related to raising capital allowable (e.g. transfer charges resulting in the change of ownership of the contractor's securities).
  - Interest and penalties paid on unpaid taxes where non-payment was at the direction of the contracting officer are also allowable.

35-3 General Audit Guidelines **

35-3.1 Exceptions **

There are a few exceptions in which interest and financial costs could be allowable. Interest or penalties assessed by a State or local taxing authorities for non-payment of any tax at the direction of the contracting officer is allowable (FAR 31.205-41(a)(3)). However, any other interest or other costs associated with underpayment or late payment of obligations are unreasonable as under/late paying is not a prudent business practice in accordance with FAR 31.201-3(a).

Additionally, the administrative costs of short-term borrowings for working capital are allowable under FAR 31.205-27(a).

35-3.2 Utility Privatization Deviation **

Interest may be allowable, under certain circumstances pursuant to the provisions of Class Deviation 2011-O0006, Utility Privatization – Class Deviation from FAR 31, issued by Defense Procurement and Acquisition Policy dated March 31, 2011, on a contract awarded in conjunction with the conveyance of a utility systems under 10 U.S.C. §2688. The audit team should review the Class Deviation for the conditions to allowability when the contractor proposes interest costs that, subject to other conditions identified, are reasonable and related to the capital expenditures to acquire, renovate, upgrade, and expand the subject utility systems.

35-3.3 Purchase Card Merchant Fees **

Transaction fees relating to the acceptance of purchase cards for payment for goods and services are generally allowable as normal business expenses.

Many contractors allow purchasers, including the Government, to pay for purchases through the use of a purchase card (such as the Government Commercial Purchase card). When a contractor accepts a purchase card for payment of goods and services, the contractor is charged for transaction costs, generally referred to as “merchant fees”. Merchant fees include fees paid by the contractor to the contractor’s bank, the credit card company (e.g., VISA, MasterCard), and the card-issuing bank for processing payment through the credit card network. Auditors should not assume these fees represent unallowable interest costs merely because the fee is usually expressed as a percentage of the amount of the transaction. The transaction fees associated with the use of the purchase card represent a charge for administrative processing and do not represent interest on borrowings.

35-3.4 Unallowable Bank Fees **

Some banks offer financial agreements which grant lines of credit at less than the prime interest rate. The bank may classify this difference as a bank fee which the contractor may be claiming as an allowable cost under Government contracts. However, the difference between the agreement’s rate and the prime rate should be considered unallowable under FAR 31.205-20, which specifically disallows interest on borrowings, however represented. Accordingly, bank fees claimed by contractors should be carefully reviewed to determine whether they are, in fact, interest costs.

Definitions

Commitment Fee – Fees charged for entering into an agreement that obligates the entity to make or acquire a loan or to satisfy an obligation of the other party under a specified condition. Commitment fees include fees for letters of credit and obligations to purchase a loan or group of loans and pass-through certificates. (Return)

Letter of Credit – There are several forms of this letter, but generally a letter of credit, or "credit letter" is a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make a payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase. (Return)

Line of Credit – A line of credit or revolving debt arrangement is an agreement that provides the borrower with the option to make multiple borrowings up to a specified maximum amount, to repay portions of previous borrowings, and to then re-borrow under the same contract. Line of credit and revolving debt arrangements may include both amount drawn by the debtor (a debt instrument) and a commitment by the creditor to make additional amounts available to the debtor under redefined terms (a loan commitment). (Return)