

SELECTED AREAS OF COST

Chapter 50 – Organization Costs

Authoritative Sources

[FAR 31.205-27](#) Organization costs

[FAR 31.205-6\(l\)](#) Compensation incidental to business acquisitions.

[FAR 31.205-41](#) Taxes

[FAR 31.205-47\(b\)](#) Costs related to legal and other proceedings

[FAR 31.205-33](#) Professional and consultant service costs

[DFARS 231.205-6\(f\)](#) Compensation for personal services

[FAR 31.205-12](#) Economic planning costs

[FAR 31.205-38](#) Selling Costs

This chapter provides general audit guidelines for auditing organization related costs. Such expenditures include, but are not limited to, incorporation fees and costs of attorneys, accountants, brokers, promoters, organizers, consultants, and investment counselors, whether or not they are employees of the contractor.

This chapter addresses the following topics:

50-1 General Information

50-2 General Audit Guidelines

50-3 Other Relevant Cost Principles

50-4 Economic Planning versus Organization Costs

50-1 General Information

Unallowable organization costs are costs incurred related to the organization or reorganization of the corporate structure of a business, including mergers and acquisitions (FAR 31.205-27).

Additionally, organizational cost includes cost related to partnerships. Accounting and legal fees incurred solely for the benefit of the principals are unallowable as follows:

- preparing a partnership agreement,
- reviewing partnership contracts,

- obtaining permits,
- setting up partnership books, and
- filing partnership and individual tax returns.

50-2 General Audit Guidelines

Expenditures made in connection with planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, are expressly unallowable under FAR 31.205-27(a). In establishing the coverage at FAR 31.205-27, the FAR Council relied on the following definition of an organization and reorganization and the costs thereof:

- 1) A major change in the financial structure of a corporation or a group of associated corporations resulting in alterations in the rights and interest of security holders; a recapitalization, merger, or consolidation.
- 2) Any costs incurred in establishing a corporation or other form of organization; as, incorporation, legal and accounting fees, promotional costs incident to the sale of securities, security-qualification expense.

Other costs the auditor should consider evaluating for allowability under FAR 31.205-27 include costs expended to redesign company marks, signs, logos, etc. due to a corporate merger or reorganization.

Normal recurring expenditures associated with internal reorganizations of contractor segments and divisions are generally allowable costs to the extent they are reasonable and allocable. Such expenditures may be incurred for business planning and forecasting, developing policies and procedures, preparing a CAS disclosure statement, establishing an accounting system, etc.

50-3 Other Relevant Cost Principles

During an organization or reorganization of contractor's structure, related activities occur. Some of those costs may be unallowable under cost principles other than FAR 31.205-27. The audit team should consider other types of related costs that the contractor may incur. The list below includes some, but not all, of these type of costs and applicable regulations (i.e. FAR Cost Principle, DFARS).

- **FAR 31.205-6 Compensation for Personal Services** - FAR 31.205-27 was not intended to limit or inhibit the methods or amounts paid as compensation. Therefore, FAR 31.205-6 should be consulted for such costs as Employee Stock Ownership Plans, Executive Compensation, and Employee Savings Plans that may be paid in conjunction with a merger or acquisition. See FAR 31.206-6(f)(1) Bonus and Incentive Compensation, and FAR 31.205-6(l) Compensation Incidental to Business Acquisitions.
- **FAR 31.205-12 Economic Planning Costs** - Makes long range economic planning concerning future overall development of the contractor's business allowable.
- **FAR 31.205-28 Other Business Expenses** - Makes certain regularly recurring costs allowable, like the costs resulting from the transfer of ownership of securities issued by the contractor, the cost of shareholder and director meetings, and publishing reports to shareholders.
- **FAR 31.205-38 Selling Costs** - Defines "Market Planning" as market research and analysis and general management planning concerned with development of the contractor's business. Indicates that long-range planning is subject to the allowability provisions of FAR 31.205-12, but other market planning costs are allowable.
- **FAR 31.205-47(f)(2) Legal Costs** - Makes unallowable legal costs resulting from organizations, reorganizations, mergers, and acquisitions, or resisting mergers and acquisitions.
- **FAR 31.205-49 Goodwill** - Makes unallowable the amortizing, expensing, write-off or write-down of goodwill. Goodwill is the difference between the excess price paid and the sum of the value of the acquired assets less liabilities in a business combination.
- **FAR 42.1204 Applicability of Novation Agreements** - Novation Agreement requires agreement by contractors that the Government is not obligated to pay or reimburse any costs, taxes, or other expenses, or any relate increases, directly or indirectly arising out of or resulting from the transfer or Agreement.
- **DFARS 231.205-70 External Restructuring Costs** - This provision limits the allowability of certain costs resulting from restructuring activities that result from the merger, acquisition, or sale/purchase of assets and the resulting combination of the operations of two companies not previously under common control. A restructuring activity is a non-routine, non-recurring or extraordinary activity to combine operations to eliminate redundancy, improve operations, and reduce costs. This clause permits contractors to charge restructuring costs to the Government if the contractor can demonstrate that the projected savings for DOD resulting from the restructuring will exceed a 2 to 1 factor.

50-4 Economic Planning versus Organization Costs

Economic planning costs are allowable under Government contracts, in accordance with FAR 31.205-12. However, allowable economic planning costs do not include organization or reorganization costs. Costs incurred for market research and analysis and general management planning concerned with development of the contractor's business are also allowable under FAR 31.205-38 Selling Costs. Often times, the distinction between allowable economic planning costs and unallowable planning for the organization or reorganization is not very clear.

Cost incurred for actually planning the organization or reorganization of a business, such as by a specific merger or acquisition, are unallowable in accordance with FAR 31.205-27. However, generalized long-range management planning costs were allowable in accordance with FAR 31.205-12 Economic Planning Costs. The costs of surveying various business opportunities, making demographic and economic studies, and evaluating potential markets or firms for mergers or acquisitions would be allowable. On the contrary, once a target for mergers or acquisition has been identified, the costs of planning or executing organizational changes would be unallowable.