

Unallowable Cost Quick Reference

Every FAR 31.205 cost category that government contractors must identify, segregate, and exclude from contract billings. Organized by risk level with practical examples and a monthly self-audit checklist.

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THE COST OF GETTING THIS WRONG

Billing unallowable costs to government contracts, even accidentally, triggers FAR 52.242-3 penalties: the disallowed amount plus interest plus a penalty equal to the disallowed amount. On contracts over \$650,000, the False Claims Act adds treble damages (\$11,665-\$23,331 per false claim). A \$5,000 entertainment charge billed to a cost-plus contract can become a \$25,000+ liability. Prevention costs far less than correction.

1 Always Unallowable — Zero Exceptions

These costs are unallowable under all circumstances. They must never appear in any indirect cost pool or direct charge to a government contract.

Cost Type	FAR Citation	What It Covers	Common Mistakes
Entertainment	31.205-14	Amusement, recreation, social activities, related costs	Holiday parties, team outings, client dinners with entertainment
Alcoholic Beverages	31.205-51	Any alcohol purchase regardless of context	Wine at client dinner, beer at company event
Lobbying & Political Activity	31.205-22	Political contributions, lobbying expenses, political action	Industry PAC contributions, lobbyist fees
Fines & Penalties	31.205-15	Federal, state, local fines, penalties, sanctions	Late tax penalties, parking tickets on company cards
Bad Debts	31.205-3	Uncollectible accounts, related collection costs	Writing off customer invoices to G&A pool
Donations & Contributions	31.205-8	Cash or property donations to any organization	Charity sponsorships, donations booked as marketing

Goodwill	31.205-49	Goodwill from business acquisitions	Amortizing goodwill into overhead
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2 Conditionally Unallowable — Limits Apply

These costs are allowable under certain conditions but become unallowable when those conditions are not met. These are the categories where most small contractors make mistakes.

Cost Type	FAR Citation	Allowable When	Unallowable When
Compensation	31.205-6	Reasonable, benchmarked against BLS data, documented criteria	Exceeds NDAA cap (\$695K for 2026), no benchmarking
Advertising	31.205-1	Recruitment ads, public relations, trade shows	General corporate image advertising, promotional items
Travel	31.205-46	Business purpose, FTR rates or company policy (lower of two)	First class air, exceeds FTR per diem, no receipts
Interest & Financing	31.205-20	Generally unallowable; CAS 414 FCCM is an exception	Business loans, credit card interest, late payment fees
Professional Services	31.205-33	Legal, accounting, consulting for business operations	Legal costs for fraud defense, contract disputes (partially)
Relocation	31.205-35	Employee relocation for business need, reasonable costs	Mortgage subsidy >\$25K, duplicate housing >1 year
Depreciation	31.205-11 (CAS 409)	Straight-line on owned assets used for business	Accelerated methods not approved, fully depreciated assets
Insurance	31.205-19 (CAS 416)	Standard business insurance, actual or self-insurance	Excessive coverage, insurance for risks not related to contract work
Selling Costs	31.205-38	Costs of securing new contracts	Costs of selling products to government through commercial channels
Idle Facility Costs	31.205-17	Reasonable period of idleness, actively seeking work	Prolonged idleness with no effort to re-utilize

3 Additional FAR 31.205 Categories

FAR Section	Cost Type	Status
31.205-2	Audit service costs	Allowable (except fraud/malfeasance)
31.205-4	Bonding costs	Allowable if required by contract
31.205-5	Civil defense costs	Allowable
31.205-7	Contingencies (provisions for unforeseen events)	Unallowable if self-insured reserve
31.205-9	Employee morale (recreation, health)	Allowable if reasonable
31.205-10	Cost of money (CAS 414)	Allowable per CAS 414 computation
31.205-12	Economic planning costs	Allowable
31.205-13	Employee morale and welfare	Allowable if reasonable and customary
31.205-16	Gains and losses on asset dispositions	Varies (follow CAS 409)
31.205-18	Independent R&D / B&P costs	Allowable with limits
31.205-21	Labor relations costs	Allowable
31.205-24	Losses on other contracts	Unallowable
31.205-25	Manufacturing defects	Allowable if reasonable
31.205-26	Material costs	Allowable if properly tracked
31.205-27	Organization costs	Unallowable
31.205-28	Other business expenses	Allowable if reasonable
31.205-29	Plant protection costs	Allowable
31.205-30	Patent costs	Allowable if properly allocated
31.205-31	Plant reconversion costs	Allowable
31.205-32	Precontract costs	Allowable if within scope and authorized
31.205-34	Recruitment costs	Allowable if reasonable
31.205-36	Rental costs	Allowable (CAS 409 for lease vs. buy)
31.205-37	Royalties and similar costs	Allowable if properly documented
31.205-39	Service and warranty costs	Allowable
31.205-40	Special tooling / test equipment	Allowable per contract terms
31.205-41	Taxes	Allowable (most federal, state, local)
31.205-42	Termination costs	Allowable per FAR Part 49
31.205-43	Trade/business/technical meetings	Allowable if business purpose
31.205-44	Training and education	Allowable if job-related
31.205-46	Travel costs	Allowable within FTR limits
31.205-47	Costs related to legal proceedings	Varies by circumstances

4 Executive Compensation Cap

FAR 31.205-6(p) — COMPENSATION CAP FOR CONTRACTOR EMPLOYEES

The allowable compensation cap is \$695,000 per person for fiscal years starting in 2026 (adjusted annually by the Bureau of Labor Statistics Employment Cost Index under the Bipartisan Budget Act of 2013, Section 702). This cap applies to ALL compensation: salary, bonuses, deferred comp, stock options, and other forms of remuneration. The cap is per person, not per contract. Compensation above this amount for any employee is unallowable on all government contracts. Benchmark executive compensation against BLS Occupational Employment and Wage Statistics (OEWS) data for your industry and geographic area.

Fiscal Year	Annual Cap	Source
2024	\$625,000	NDAA / BLS ECI adjustment
2025	\$660,000	NDAA / BLS ECI adjustment
2026	\$695,000	NDAA / BLS ECI adjustment (projected)

5 Monthly Self-Audit Checklist

Perform this review monthly to catch unallowable costs before they accumulate. Assign one person (bookkeeper, controller, or CPA) to complete this checklist by the 15th of the following month.

- Review all new GL entries for unallowable cost categories
Flag any transaction matching FAR 31.205 unallowable categories
- Verify no entertainment or alcohol charges in any cost pool
Check credit card statements, expense reports, and AP invoices
- Confirm travel expenses comply with FTR per diem rates
Cross-reference lodging and meals against gsa.gov rates for each city
- Check executive compensation YTD against NDAA cap
Include salary, bonuses, deferred comp, and all other remuneration
- Verify all consultant/subcontractor invoices have proper documentation
Statement of work, deliverable acceptance, rate verification
- Review advertising and marketing charges for allowability
Recruitment ads: OK. General image advertising: not OK.
- Confirm no personal expenses on company accounts
Review all company credit card statements for personal charges
- Check interest and financing charges for proper classification
Business loan interest: unallowable. CAS 414 FCCM: allowable.

- Verify donations and charitable contributions are excluded
Even if company policy allows donations, they are unallowable on contracts
- Reconcile unallowable cost accounts to GL
Ensure all flagged unallowable costs are in dedicated GL accounts
- Document your review (date, reviewer name, findings)
Keep a log of monthly reviews. DCAA may ask for evidence of ongoing monitoring.

Month/Year Reviewed: _____

Reviewed By: _____

Issues Found: _____

Corrective Actions: _____

Penalty Reference

Violation	Penalty	Threshold
FAR 52.242-3 (Unallowable costs)	Disallowed amount + interest + penalty equal to amount	Contracts > \$650,000
False Claims Act (Knowingly billing unallowable costs)	Treble damages + \$11,665-\$23,331 per false claim	Any amount (knowing or reckless)
CAS Noncompliance (Inconsistent cost treatment)	Increased costs to government triggered adjustment	CAS-covered contracts (\$7.5M+)

NEED HELP IDENTIFYING UNALLOWABLE COSTS?

Amerifusion Bookkeeping sets up your chart of accounts to automatically segregate unallowable costs at the transaction level, not at year-end. CPA-managed bookkeeping built specifically for government contractors. Schedule a free consultation at amerifusionbookkeeping.com/contact

Your GovCon Bookkeeping Toolkit:

1. DCAA Accounting System Readiness Checklist
2. Indirect Rate Setup Worksheet
- >>> 3. **Unallowable Cost Quick Reference**
4. ICS Preparation Checklist
5. GovCon Chart of Accounts Template

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