THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER

INTERNAL CONTROL AND ACCOUNTABILITY DIRECTIVES

DIRECTIVE 2 - PROCEDURES FOR THE AUDIT OF VOUCHERS SUBMITTED UNDER COST REIMBURSABLE CONTRACTUAL AGREEMENTS

INTRODUCTION

This Directive provides procedures agency audit staffs must use for auditing payment vouchers issued against cost reimbursable contracts. Agencies must insure that voucher audits are conducted in accordance with the Directive's requirements prior to approving requests for payment under such contracts.

The Directive summarizes the cost accounting principles applicable to cost reimbursable contracts, provides techniques for assessing the allowability of direct and indirect costs presented for payment, and offers specific audit steps and procedures for conducting voucher audits.

Cost reimbursable contracts generally provide for the recovery of indirect costs and profit by applying either an overhead multiplier or a fixed fee markup to direct costs. The audit of indirect costs, particularly when an interim multiplier is used, is an area that requires particular attention. Consequently, the Directive places significant emphasis on this subject.

This Directive is issued pursuant to Section 93(h) of the New York City Charter, which empowers the Office of the Comptroller to prescribe methods for preparing and auditing vouchers before payment and to conduct reviews to ensure compliance. The Directive's provisions must be reflected in requests for proposals, bid documentation, and contracts. Specific language that should be included in all agency contracts with cost reimbursable provisions is provided in §6.0.

1.0 GENERAL INFORMATION

1.1 Directive Organization

1.0 General Information
2.0 Audit Function Overview
3.0 Cost Accounting Principles - General
4.0 Audit Steps and Procedures
5.0 Unallowable Indirect Costs
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1.2 Effective Date

This Directive is effective immediately and supersedes the previous release dated April 13, 1982.

1.3 Assistance

Requests for additional copies and questions concerning this Directive should be addressed to Joseph Trapani, Chief, Bureau of Management and Accounting Systems, Municipal Building, 1 Centre Street, Room 1005, New York, NY 10007, (212) 669-8201.

2.0 AUDIT FUNCTION OVERVIEW

The voucher auditing function, as discussed in this Directive, refers to the review, verification and authorization of all direct and indirect costs due and payable under contracts with cost reimbursement provisions. Although cost reimbursable contracts are most frequently used by the City of New York for construction, engineering consultant, and architectural design services, they are occasionally used in other situations.

The voucher audit is an agency's final detailed review of payment requests. Such audits are performed after all required authorization signatures have been obtained, and prior to the agency's submission of the vouchers to the Financial Information Services Agency (FISA) for payment.

Agencies must insure that voucher audits are conducted by properly trained staff. In addition, to ensure the integrity of the audit function, the auditors must be independent of the purchasing, receiving, and voucher preparation functions, and cannot be part of the agency's payment authorization process.

2.1 Audit Planning and Organization

To insure that voucher audits are conducted as efficiently and effectively as possible, they must be adequately planned and organized. Advance audit preparation and planning steps include:

(1) The identification of the audit's basic objectives and most likely potential problem areas.

(2) A review of the cost accounting principles applicable to cost reimbursable contracts.

(3) The identification and review of City Charter and Administrative Code provisions and Comptroller's Directives applicable to the audit.

(4) A review of the reports and/or workpapers from prior or related audits and the identification of the work of other auditors that may be relied upon.

(5) A review of the contract's terms and conditions. Contract review is discussed in §4.2.

2.2 General Audit Objectives

Voucher audit programs must be designed to achieve the following general objectives:

(1) To verify that the requisition for payment is appropriate in all respects;

(2) To insure that the amount of the payment requested is appropriate for the work or services provided;

(3) To determine that the contractor has complied with the terms and conditions of the contract that are applicable to the payment requested;

(4) To verify that the payment requisition has been properly authorized by the appropriate agency personnel; and

(5) To insure that the payment complies with the provisions of this Directive and all other appropriate rules and regulations.

Developing audit programs in accordance with the procedures provided in Section 4.0 will help insure that these general audit objectives are achieved.

2.3 Contractual Provisions for Indirect Costs

Indirect costs and profits are generally reimbursed in accordance with agreed upon cost formulas that employ either an overhead multiplier (customarily used with consulting type contracts) or a fixed fee percentage (customarily used with construction contracts). Agencies must use different indirect cost audit procedures depending on the method used to recover indirect costs as set forth in the contract agreement. Sections 4.6 and 4.7 contain detailed audit procedures for indirect costs, and section 4.8 contains detailed audit procedures for profits.

Contracts with interim overhead multipliers stipulate an agreed upon percentage that is applied to direct labor to approximate reimbursable indirect costs and profit. The multiplier is used to recover a proportionate amount of indirect costs and profit on each interim payment voucher. An audit of the interim multiplier should be performed no later than when 60 percent of the contract funds have been expended. Upon completion of the contract the actual indirect costs incurred must be audited to establish the actual overhead multiplier. Any difference between the amounts paid to the contractor based on the application of the interim multiplier and the actual overhead multiplier determined by audit are adjusted in the final payment process.

Contracts with fixed fee indirect cost provisions use a contractually specified fixed rate that is applied to direct costs to determine the amount of indirect costs and profit that will be paid. In such contracts the underlying overhead costs are not audited unless otherwise required by contract.

2.4 Computing the Overhead Multiplier

The overhead multiplier is a factor that, when applied to direct labor billings, calculates the total direct labor, indirect costs and profit payable to the contractor.

The overhead multiplier is computed as follows:

(1) The sum of the contractor's allowable overhead costs and general and administrative expenses is divided by the overall direct labor costs (labor costs incurred specifically for the project or contract) for the same period. The quotient is the *Overhead Rate*.

(2) The *Overhead Rate* is added to the integer one (1), representing the direct labor costs billed for the contract, to yield the *Overhead Factor*.

(3) To allow for profit, the *Overhead Factor* is multiplied by one (1) plus the agreed profit percentage. (i.e., where the profit is 10 percent, the *Overhead Factor* is multiplied by 1.1.) The product is the overhead multiplier.

3.0 COST ACCOUNTING PRINCIPLES - GENERAL

This section discusses cost accounting standards and their application in cost reimbursable contract voucher audits.

3.1 Direct Costs Defined

Direct costs are those costs that are specifically incurred for, and can be expressly identified with, a particular contract or function. Examples of direct costs include labor, materials and supplies, certain clerical and secretarial salaries, telephone, and travel, where the service or consumption is directly connected to an individual, job, or contract.

3.2 Indirect Costs Defined

Indirect costs, also called overhead or overhead burden, are any other costs that cannot be readily classified as direct costs. For consistency, this directive uses the term "indirect costs" when referring to these costs. Indirect costs usually cannot be directly related to a specific contract or project, because they are incurred for common or joint objectives which, nevertheless, are necessary for the satisfactory performance of a contract. Examples of indirect costs include home office expenses such as rent, electricity, depreciation or insurance where the service or consumption is not directly connected to an individual, job or contract.

3.3 Allowable Costs

All of the costs a contractor submits for payment may not be allowable for reimbursement. Certain categories of costs, and excess costs must be disallowed because they do not meet the criteria for allowability described in this section, or otherwise fail to comply with this Directive.

Only the following may be included in allowable costs:

(1) Direct costs incident to the performance of a contract,
(2) Allocable indirect costs,
(3) Any costs specifically allowed by the contract agreement, and
(4) The contractor's profit.

To be considered an allowable cost, an expenditure, whether direct or indirect, must meet the following criteria:

(1) It must provide a tangible benefit to the City or the project;
(2) It must be reasonable;
(3) If an indirect cost, it must be allocable to the contract under the standards, limitations, or exclusions provided in the contract and/or this Directive;
(4) It must be treated consistently under generally accepted accounting principles; and

(5) It must otherwise comply with the provisions set forth in this Directive.

Other rules or contract provisions that are more restrictive than this Directive's criteria, or not otherwise addressed by this Directive may apply.

The four substantive allowability tests are discussed in greater detail in the following sections.

3.3.1 Tangible Benefit Test

To be allowable, an expenditure must furnish the City of New York with a tangible benefit. Examples of indirect costs that do not meet the tangible benefit test include (i) technical labor costs for personnel without or between assignments, and (ii) parent company or local office costs for activities that provide no tangible value to the City or the specific project. An example of direct costs that do not meet the tangible benefit test includes idle or standby personnel and equipment unless otherwise provided for in the contract.

3.3.2 Reasonableness Test

To be allowable, a cost must be reasonable. A cost is considered reasonable if, in its nature or amount, it does not exceed that which would be incurred by an ordinarily prudent person in the conduct of a competitive business.

The following must be considered in determining a given cost's reasonableness:

(1) Is the cost generally recognized as ordinary and necessary for the conduct of the contractor's business?

(2) Is the cost necessary to comply with the requirements or restraints in the contract's terms and specifications?

(3) Are there significant deviations from the contractor's established practices which might unjustifiably increase the cost?

3.3.3 Allocability of Indirect Costs

Certain indirect costs may be considered allowable expenditures if they can be properly allocated to the contract under audit. The cost allocation method must follow generally accepted cost accounting principles as appropriate for the contract. Tests for proper allocation include:

(1) The cost is beneficial to both the contract and other business activities of the contractor and can be distributed between the contract under audit and the contractor's other business activities in a reasonable ratio.

(2) The cost is necessary to the overall operation of the contractor's business and can be distributed to the contract by a generally accepted formula or method.

(3) The cost is incurred specifically for the contract, in which case the auditor must determine whether it should be classified as a direct or indirect cost.

3.3.4 Consistency of Accounting Treatment Test

To be allowable, an expenditure must be treated consistently under generally accepted accounting principles from period to period. Changes in accounting principles can result in significant fluctuations in the amounts contractors claim for direct costs, overhead, profits, losses and other financial statement elements, and consequently could impact the amount to be reimbursed under the contract. An intentional manipulation of, or erroneous change in, accounting treatment could result in excessive reimbursement to the contractor.

Typical examples of changes in accounting principles that could impact cost reimbursement include the change from a straight line depreciation method to an accelerated method, and changes in the method of valuing and accounting for inventories.

A change in accounting principles may not result in a disallowance if the newly adopted principle is a generally accepted accounting principle, the method of accounting for the effect of the change is in conformity with generally accepted accounting principles and the contractor's justification for the change is reasonable. Excess costs resulting from accounting changes that do not meet these conditions must be disallowed.

4.0 AUDIT STEPS AND PROCEDURES

This section describes specific audit steps and procedures that agencies must incorporate, as appropriate, in developing audit programs for cost reimbursable contract vouchers. The auditor's basic responsibility is to determine whether the contractor has complied with the provisions of the contract, this Directive, and other appropriate rules and regulations. Because audit procedures will vary depending on the specifics of the contract and the payment under audit, agency audit staffs must use their professional judgment, consistent with the provisions of this Directive, to determine the nature and extent of the audit procedures necessary.

4.1 Preliminary Audit Steps

(1) Review prior audit reports, audit workpapers, and permanent files and note previously reported deficiencies and areas of weakness. Determine if the contractor has been audited by another governmental agency. If so, obtain a copy of the audit reports prepared by such agency.

(2) Review progress and/or final cost statements.

a) Check for mathematical accuracy, as appropriate.
b) Trace final costs to the contractor's general and/or job cost ledger.

(3) Review contractor's independently audited financial statements and supporting schedules.

4.2 Contract Review

The proper audit of payment requests requires that the auditor develop a working knowledge of the contract and its payment provisions to gain an understanding of the contract's general terms, any unusual terms, and to learn of any potential audit issues. Audit procedures must be adjusted depending on the nature of the contract and its specific terms and conditions. The auditor should prepare a checklist of all contract provisions requiring verification or further follow-up. Some key contract provisions, of particular importance to the auditor, include:

4.2.1 Not to Exceed Clauses

Many cost reimbursable contracts include an amount that is specified as the maximum to be paid. If a contract is written with such a "not to exceed" clause, audit procedures must include verification that the agency has established a satisfactory payment control system that insures that all payments made under the contract are properly recorded and that subsequent payments, in the aggregate, do not surpass the contract's not to exceed amount.

4.2.2 Allowable/Unallowable Costs Clause

Many cost reimbursable contracts specifically identify all or certain costs that are allowable and/or unallowable. The auditor must ensure that only those costs stipulated as allowable in the contract are reimbursed.

4.2.3 Overhead Multiplier Clause

Cost reimbursable consultant contracts usually contain provisions for the use of an interim overhead cost multiplier to charge indirect costs on interim payments. The multiplier is typically applied to direct technical salary costs to cover employee fringe benefits, a pro-rata share of general and administrative expenses, and the consultant's profit. Overhead multipliers require a final audit at the completion of the contract.

4.3 Interim Payments

Interim or progress payments may be authorized periodically during the term of a contract. When auditing interim payments it must be verified that sufficient progress has been made by the contractor to warrant the payment requested and the cumulative payments to date. If the interim payment requests reimbursement for indirect costs and profit, similar audit steps must be taken to insure that indirect cost and profit payments are commensurate with the extent of work performed to date.

4.4 Comptroller's Directive 7

In addition to complying with the provisions of this Directive, audits of all cost reimbursable construction, and engineering and architectural service contracts must also be conducted in accordance with the provisions of Comptroller's Internal Control and Accountability Directive 7, *Audit of Payment Vouchers Issued Under Contracts for Construction, Equipment and Related Consulting Services*.

4.5 Audit of Direct Cost Elements

The audit of direct costs requires the measurement and verification of wages and salaries, equipment charges, materials and supplies, travel expenses and other costs that were incurred specifically for the contract or that otherwise meet the definition of direct costs.

4.5.1 Direct Wages and Salaries

Audit procedures for direct wages and salaries include:

(1) Reviewing the adequacy of internal controls over payroll activities, e.g., the adequacy of separation of duties for personnel, timekeeping, payroll computation, payroll preparation and payroll distribution.

(2) Verifying that the wages and salaries charged to the contract are for employees who are actually working on the contract by conducting a physical check of personnel being charged to the job.

(3) Determining that time tickets, distribution records, payrolls, checks, personnel actions, and other related documents are signed and/or approved by duly authorized contractor personnel.

(4) Examining personnel records to verify authority for employment and rates used.

(5) Ascertaining that the number of hours constituting a day's work, overtime, wage and salary rates and classifications are approved by the agency

employee responsible for coordination of the contract, and are in accordance with contract terms.

(6) Checking hours and rates billed to the basic time records, distribution records and payrolls, in addition to checking the labor distribution summary for total hours worked during the payroll period.

(7) Verifying that the labor costs claimed are properly classified as direct labor.

(8) Verifying all computations, extensions and footings. This includes comparing the total dollar amount of payroll with the total dollar amount of the labor distribution summary and tracing posting of direct labor (for both contract and other work) to the general ledger and/or subsidiary ledger accounts.

(9) Selectively examining cancelled checks to verify that payments have been made by the contractor and to ensure that direct salary costs include only those hours for which the employee was actually paid and exclude any unpaid hours which may have been charged to the job.

(10) Identifying unclaimed wage and salary checks and verifying they were properly handled.

4.5.2 Direct Materials and Supplies

Audit procedures for direct materials and supplies include the review of material and supply requisitions to determine that:

(1) The contractor's procurement procedures have proper internal controls. Audit steps include checking contract terms for specific Contracting Officer's approval requirements and verifying the justification for the payment request;

(2) Competitive bidding was used if required by the contract or the contractor's purchasing procedures and that the purchases were actually made from the lowest bidder;

(3) The price, quantity, and description of items procured are accurate and mathematically correct and all source documentation supporting the purchase (from purchase requisition to receipt and payment for purchases) is verified;

(4) Materials delivered directly to the worksite do not include overhead type materials.

(5) Account codings are correct, that accurate postings are made to cost distribution records, and that cost distribution records are properly controlled by general ledger accounts;

(6) An internal system has been set up to control credits to contract costs.

4.5.3 Materials Withdrawn From Contractor's Stores

Audit procedures for materials drawn from contractor's stores include:

(1) Comparing representative contractor invoices that include items charged to stores, with the store's records to determine the accuracy of quantity and price postings.

(2) Examining a number of job material requisitions to determine that:

   (a) Requisitions have been posted to the store's records;

   (b) Requisitions are authorized and receipt of materials is confirmed against shipping documents and acknowledged in writing by responsible personnel;

   (c) Pricing is consistently applied using first-in/first-out, average costing or other generally accepted inventory costing method.

   (d) Quantities are not in excess of requirements;

   (e) Items are correctly listed and summary totals are correct;

   (f) The accounting distribution is proper;

   (g) The total distribution is approved by a responsible executive;

   (h) The computations are accurate;

   (i) Items similar to those charged directly from purchase invoices are not a duplication of costs;

   (j) Materials charged from stores directly to a contract do not include overhead type materials.

4.5.4 Travel Expenses

Travel expenses charged directly to the contract must be audited to insure

compliance with contract terms and to establish that they are reasonable.
The audit of travel expense includes:

a) Determining that the purpose of the travel is acceptable under the contract's terms and the expenses charged are reasonable.

b) Reviewing the original travel expense submissions and supporting documentation to verify employee's name, purpose of trip, travel start and end points, dates of departure and arrival, mode and class (if applicable) of transportation, compliance with contract terms for expenses or per diem rates, executive authorization, employee's receipt if paid in cash, or check number if paid by check.

c) Verifying that the travel expense accountings are accurately computed.

d) Verification that payments have been made by the contractor by selective examination of cancelled checks and/or receipts.

e) Tracing the charges to the general ledger and/or job cost ledgers.

f) Verifying conformance with Comptroller's Internal Control and Accountability Directive #6, *Travel, Meals, Lodging and Miscellaneous Agency Expenses*.

4.6 Audit of Indirect Costs - General

Agency auditors must take the following minimal audit steps for any payment voucher requesting the reimbursement of indirect costs, regardless of whether the cost is based on an interim multiplier or a fixed rate.

(1) Verification that the rate used, whether multiplier or fixed, is consistent with the rate specified in the contract.

(2) Verification that the rate is applied to the correct direct cost base.

(3) Verification that the computation is accurate.

4.7 Audit of Indirect Costs - Consultant Type Contracts

The audit procedures in this section apply primarily to audits of consultant type contracts with interim overhead multipliers. Procedures for specific indirect cost elements are provided in §5.0 *Unallowable Indirect Costs.*

The audit of indirect costs requires verification of the appropriateness of the indirect costs, that the costs were actually incurred, that they were subsequently accumulated in logical and homogeneous pools, and that they were allocated accurately.

The auditor must verify that specific cost elements are not charged twice; as a direct expense and again as an overhead expense component. Where the contractor's policy is to charge items ordinarily treated as overhead directly to contracts, the auditor must make sufficient tests to be satisfied that the contractor has not duplicated either direct or indirect costs by double charging, once as a direct charge and again through the allocation of overhead and/or profit.

4.7.1 Indirect Cost Pools

An indirect cost pool is defined by the Cost Accounting Standards Board as, "a grouping of incurred costs identified with two or more objectives but not identified specifically with any final cost objective." Cost pools are established for the purpose of eventual cost allocation.

Indirect costs must be accumulated into logical overhead cost groupings or pools in the contractor's accounting records, such as general and administrative expense or manufacturing overhead, and must be distributed using a base that (i) is common to all the costs, and, (ii) reasonably reflects the benefits provided by the indirect costs.

Auditors must examine costs accumulated in a pool to verify the similarity of the indirect costs accumulated in that pool to insure no distortion when the costs are allocated to the contract.

4.7.2 Indirect Cost Proration Bases

Contractors use a variety of proration bases to allocate indirect costs. Auditors should be aware that contractors will often sacrifice a higher degree of accuracy because of the greater effort required. Consequently, whenever indirect costs are allocated, the auditor must be satisfied that the base used to determine the allocation rate does not produce distorted results. Any distribution method that results in an equitable distribution of costs is acceptable.

(1) Direct Labor Dollar Base

One of the most common proration methods is the direct labor dollar base. When this method is used, the auditor must:

(a) Reconcile that portion of the direct labor base allocated to the contract to the total labor costs accumulated under all contracts.

(b) Determine that no inequities exist as a result of using a direct labor dollar base. For example, the use of direct labor dollars as a base for prorating indirect costs is acceptable provided that a disproportionate amount of the contractor's more highly paid employees are not assigned to the contract under review.

(2) Other Proration Bases

If a base other than direct labor dollars is used for prorating indirect costs, the auditor must design appropriate tests to verify the accuracy, equity and propriety for the use of such base.

(3) Comparison/Discussion of Proration Bases

The relative merits of some commonly used proration bases follow:

(a) Direct Labor Hours. Some indirect costs such as indirect labor and the consumption of supplies are most closely related to the input of direct labor hours.

The direct labor hours devoted to specific projects is often used for correlating indirect costs with the project or contract. The amount of indirect costs applied to any given contract may be dependent on the amount of time devoted to an operation.

(b) Chronological Time. Many indirect costs are more closely related to the passage of time than to any other factor. Fixed costs such as depreciation, rent, taxes, and insurance, for examples, all relate to a given time period.

(c) Direct Labor Dollars. If labor rates are nearly uniform for every work task, the use of a labor-dollar base to apply overhead provides the same result as using direct-labor hours. This is the most widely used proration base.

(d) Machine Hours. Machine time is often a better measure of indirect costs than direct labor hours, since depreciation, property taxes, consumption of supplies, and indirect labor are frequently more closely related to machinery utilization than to direct labor usage.

In theory, machine time is the most accurate base for applying indirect costs, however, it is rarely used because of the added clerical cost and the difficulty of computing machine time for individual jobs.

4.8 Audit of Contractor's Profit

Audits of contractor's profit must verify that the amount paid for profit does not exceed the amount stipulated in the contract.

The allowable profit is usually expressed as a percentage of the sum of direct and indirect costs, however, it may also be established as an agreed upon fixed amount. The audit of profit requires:

(1) The verification of the cost base upon which profit is computed. Cost bases must be adjusted for any disallowances resulting from the audits of direct and indirect costs before the profit rate is applied.

(2) Verification that the rate used is consistent with the rate specified in the contract and that the computation is accurate.

(3) For interim payments, verification that the profit is proportional to the percentage of contract completion both in terms of percent of work completed and percent of dollars expended. The auditor must compute both and insure that payment for interim profit is limited to the lower amount.

4.9 Reliance on the Contractor's Financial Statements and Supplemental Cost Schedules

Auditors may choose to rely on financial statements, supplemental cost schedules and/or other work prepared by the contractor's independent auditors. Auditors must limit their reliance on the work of the contractor's auditors, however, to only that work where credibility and objectivity are:

1) Assured by the independent auditor's opinion, and
2) Supported by, and consistent with, business records kept in the normal course of the contractor's business.

Contractors may supplement their independently audited financial statements with schedules that redefine complex indirect cost categories. When agency auditors deem it necessary to rely on such supplemental schedules, these schedules must be independently audited by the contractor's auditor. The scope of the independent auditor's report should include, but not be limited to, the following:

1) Confirmation that each supplemental schedule is consistent with, and reconcilable to, the year-end account(s) from which it has been derived.
2) Confirmation that general business development expenditures have been identified and disallowed.
3) Confirmation that any bonus and/or pension allowances are supported by business records and contracts that demonstrate that a company wide plan is available to all employees on an equitable basis.

5.0 UNALLOWABLE INDIRECT COSTS

When conducting audits of indirect costs using interim overhead multipliers, auditors must carefully review indirect costs to insure that inappropriate costs have not been claimed for reimbursement. This section provides procedures for making allowability determinations for a variety of common indirect costs. Allowability determinations for other costs, not discussed in this section, must be made based on the criteria outlined in §3.3 of this directive.

5.1 Generally Unallowable Indirect Costs

The following partial listing of common indirect costs are generally not allowable. These costs may, however, be allowable under the conditions discussed in the individual sections below, or if explicitly permitted by the terms of the contract.

5.1.1 Advertising Costs

Advertising costs, including magazine, newspaper, radio and television, direct mail, trade paper, outdoor signs, dealer cards, window displays, convention expenses, exhibits, and free goods and samples are generally not allowable.

Advertising costs may be allowable when incurred solely for a specific contract performance requirement. Examples include the recruitment of personnel for a specific contract purpose, the procurement of scarce or unique parts required for performance under the contract, and the disposal of scrap or surplus material acquired under the contract.

5.1.2 Bidding Costs

Bidding costs from past accounting periods are not allowable in the current period. Bidding costs from the current accounting period are allowable to the extent reasonable.

5.1.3 Excess Compensation

Compensation for personal services must be limited to that which a reasonable person would pay in a similar circumstance. Any compensation that exceeds reasonable standards is not allowable.

5.1.4 Profit Sharing and Other Distributions

Dividend payments, bonuses, or other distributions of profit to stockholders, partners, or sole proprietors are generally not allowable. Bonuses, pensions, profit sharing, employee stock purchase and stock option plans, similar employee benefit plans and other employee incentive programs may be allowable, provided the distributions are formalized, equitable to all employees, and determined objectively.

5.1.5 Travel Expenses

Travel expenses, such as meals, lodging, transportation and gratuities are not allowable except when they are incurred primarily to obtain technical information or expertise or to obtain training that will improve production efficiency, quality or capacity. Procedures for acceptable levels of travel expenditures are set forth in Comptroller's Internal Control and Accountability Directive #6, *Travel, Meals, Lodging and Miscellaneous Agency Expenses.*

5.1.6 Bonding Costs

Employee bonding costs are not allowable unless reasonable and specifically required under the terms of the contract or incurred in accordance with sound and consistent business practices.

5.2 Unallowable Indirect Costs

The following partial listing of common indirect costs are never allowable under any circumstances. Agencies must not enter into contracts providing for reimbursement of these costs.

5.2.1 Bad Debt Expense

Bad debts resulting from actual or estimated losses due to the uncollectability of customer accounts or other claims, including any related legal or collection costs.

5.2.2 Losses From Other Contracts

Losses of any kind from the vendor's other contracts.

5.2.3 Special Compensation Plans

Costs related to establishing employee stock purchase and stock option plans or any other employee incentive program.

5.2.4 Contributions and Donations

Contributions and donations of any kind.

5.2.5 Entertainment Costs

Entertainment costs of any kind including cost for employee social events and alcoholic beverages.

5.2.6 Fines and Penalties

Fines and penalties levied as a result of violations or the failure to comply with Federal, State or local regulations.

5.2.7 Borrowing and Financing Costs

Interest on borrowing, bond discounts, financing and refinancing costs, legal and professional fees in connection with prospectus preparation, and the preparation and issuance costs for stock rights.

5.2.8 Organization Costs

Organization and reorganization costs incurred in connection with planning or establishing the organization, including the costs of mergers, acquisitions or capital sourcing. Such unallowable organizational expenditures include, but are not limited to, incorporation fees, costs of attorneys, accountants, brokers, promoters, organizers, management consultants, and investment counselors, whether or not employees of the contractor.

5.2.9 Business Development Expense

Charges for general business development expenses such as promotional activities, advertising, gifts or souvenirs, public relations, lobbying, or any expenditures intended to generate new business. This does not include bid, estimating or proposal costs. Agencies must note that the City's requirements for these expenses are more restrictive than counterpart federal guidelines which may allow business development expenses for federal cost reimbursement purposes.

5.2.10 Other Unallowable Direct Costs

The cost of officer's life insurance, legal expenses on lost liability suits, and federal, state, and local income taxes.

6.0 AUDIT PROVISION FOR CONTRACTS

The following term should be included in all agency contracts with cost reimbursable provisions.

All vouchers or invoices presented for payment to be made hereunder and the books, records and accounts upon which said vouchers or invoices are based are subject to audit by (agency name) and by the Comptroller of the City of New York *pursuant to the powers and responsibilities conferred upon said Agency and said Comptroller by any law, including but not limited to, the New York City Charter and the Administrative Code of the City of New York, as well as all orders and regulations promulgated pursuant thereto, including the Comptroller's Internal Control and Accountability Directives.*

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