Interpretive Guidance Document

Uncompensated Overtime

Architectural & Engineering Firm
Indirect Costs WSDOT

Internal Audit Office
September 23, 2011
Interpretive Guidance Document – Uncompensated Overtime

This Interpretive Guidance Document will address Uncompensated Overtime, which is an issue that affects many Architectural and Engineering (A/E) Consultants. We continue to work with the A/E firms to help them account for costs correctly and make appropriate adjustments in accordance with Part 31 of the Federal Acquisition Regulations (FAR). To ensure compliance, we discuss uncompensated overtime with CPA firms that perform audits of Consultants’ indirect cost schedules.

Rules for Uncompensated Overtime

Uncompensated overtime is defined in FAR 52.237-10 as “hours worked without additional compensation in excess of an average of 40 hours per week by direct charge employees who are exempt from the Fair Labor Standards Act”. Compensated personal absences such as holidays, vacations, and sick leave must be included in the normal work week for purposes of computing uncompensated overtime hours.”

Firms contracting with WSDOT under Architecture & Engineering agreements must have procedures covering the consistent recording and accounting for hours worked, whether paid or unpaid, to ensure the proper distribution of labor costs. This is necessary because labor rates and labor indirect costs can be affected by total hours worked not just paid hours worked.

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1 Reference AASHTO Audit Guide, Chapter 1, page 9.

Calculating Uncompensated Overtime

The AASHTO Uniform Audit & Accounting Guide for Transportation Consultants (2012 Edition) gives an example of the Salary Variance Method for calculating uncompensated overtime. This method is to be used for determining labor costs associated with agreements between the consulting firm and WSDOT. This example is based on the standard 2,080 hours per year. See Chapter 5.4, F, 2, Pages 32 & 33. The Effective Rate Method does not apply to WSDOT A/E Cost Reimbursable Agreements

The Standard Wages Rates based on 2,080 hours per year should be used to compute hourly rates for agreements with WSDOT. If your firm accounts for labor using the Effective Rate Method; the labor accounts will need to be converted using the standard 2,080 hours and an adjustment will need to be made to your indirect cost schedule (described below). These adjustments will ensure that each labor account as well as the uncompensated overtime is recorded at the standard hourly rate. Some labor systems have the capability to run a report to show this labor conversion. If your system does not have this capability, the worksheets at the following link can be used for this purpose
Example A- Effective Rate Worksheet

We will be happy to answer your questions about these worksheets.

Adjustments for Uncompensated Overtime

The direct-labor portion of the uncompensated overtime should be added to the direct labor base. Likewise, the offset for your uncompensated overtime should be shown as a credit to indirect costs in the General & Administrative Section on your indirect cost schedule, using the account title “Payroll Variance/Uncompensated Overtime”. The attached worksheet, Procedures for Handling Uncompensated Overtime and Posting of Payroll, shows how uncompensated overtime should be accounted for on your indirect cost schedule. The worksheet at the following link shows a firm that tracks all hours worked.
Example B – Firm Tracks All Hours Worked
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If Your Firm Does Not Record Employee Hours Worked Over 2,080 per Year

If your firm is not currently recording hours worked over 2,080 per year for each employee, the worksheets mentioned above can be used to compute the estimated value of your uncompensated overtime (Example C – Estimate). We do allow a one year estimate, but we expect firms to implement procedures in subsequent fiscal years to account for all hours worked, and to record uncompensated overtime appropriately.

If your firm has recorded all hours over 2,080 for all employees, but has not included the dollar value of those hours in the indirect costs – this worksheet may also be used as a tool for that purpose.

Key Points

- All hours worked must be recorded on timesheets for all employees (both direct & indirect hours).
- Compute hourly rates for employees based on the standard 2,080 hours per year.
- Make the appropriate adjustment for uncompensated overtime for exempt employees for hours worked, but not paid.
- Your uncompensated overtime calculation will omit those employees who have worked less than 2,080 hours per year.
- If your firm is using the Effective Rate Method, the Direct & Indirect labor must be converted to the Standard Rate for agreements for services contracted with WSDOT under/for A&E services.

We have been notifying consulting firms by email & phone of the above requirements, and we also have related information in our FAQ document at http://www.wsdot.wa.gov/Audit/FAQs.htm
PROCEDURES FOR HANDLING UNCOMPENSATED OVERTIME AND POSTING OF PAYROLL

Exempt, salaried employees are required to work the minimum number of hours each semi-monthly pay period. All hours worked must be posted on timesheets whether billable or not. Exempt employees do not receive overtime pay for extra hours worked.

All hours contained on timesheets are posted to the project cost management system at the employee’s raw hourly salary cost (annual salary divided by 2,080 annual hours). At the end of each month a payroll journal entry is computed by taking ALL direct labor hours posted on timesheets and multiplying that by raw hourly salary – that is the direct labor posting for the general ledger. Then the indirect labor hours posted on timesheets (administration, proposals, business development, vacation, sick leave and holiday) are multiplied by raw hourly salary – that is the indirect labor posting for the general ledger.

Full posting of these gross hours and dollars to direct and indirect labor always results in a negative variance between the cost of direct hours plus indirect hours vs. the gross payroll being debited from the checking account (because employees work extra hours); therefore, that entire difference is posted to the Payroll Variance/Uncompensated Overtime account (a separate general ledger category under indirect labor).

For indirect cost rate calculation purposes, Direct Labor is not adjusted down and remains unaffected by the negative figure contained in the Payroll Variance/Uncompensated Overtime account.

The following is an example of the calculation of the payroll variance/uncompensated overtime for the general ledger payroll journal entry:

<table>
<thead>
<tr>
<th>Employee A’s Timesheets for May</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Projects</td>
<td>Timesheet Hours</td>
<td>Raw Hourly Cost</td>
<td>Monthly Salary</td>
</tr>
<tr>
<td>Project ABC</td>
<td>84 hours</td>
<td>$2,019.36</td>
<td></td>
</tr>
<tr>
<td>Project XYZ</td>
<td>76 hours</td>
<td>1,827.04</td>
<td></td>
</tr>
<tr>
<td>Indirect Labor – Administration</td>
<td>12 hours</td>
<td>288.48</td>
<td></td>
</tr>
<tr>
<td>Indirect Labor – Holiday</td>
<td>8 hours</td>
<td>192.32</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>180 hours</td>
<td>$4,327.20</td>
<td>$4,166.67</td>
</tr>
</tbody>
</table>

Note: Employee A’s raw salary is $50,000/year; $4,166.67/month; $24.04/hour.

<table>
<thead>
<tr>
<th>Payroll Journal Entry for General Ledger</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Checking Account Withdrawal</td>
<td>($4,166.67)</td>
</tr>
<tr>
<td>Direct Labor</td>
<td>3,846.40</td>
</tr>
<tr>
<td>Indirect Labor – Administration</td>
<td>288.48</td>
</tr>
<tr>
<td>Indirect Labor – Holiday</td>
<td>192.32</td>
</tr>
<tr>
<td>Payroll Variance/Uncompensated Overtime</td>
<td>(160.53)</td>
</tr>
</tbody>
</table>
## Interpretive Guidance Document – Uncompensated Overtime

### Example A

<table>
<thead>
<tr>
<th>Exempt Employee</th>
<th>Salary</th>
<th>Hrly Rate (based on 2080)</th>
<th>Total Hrs Worked (per t/sheets)</th>
<th>Direct Hours</th>
<th>Direct Dollars</th>
<th>% Direct Hours</th>
<th>Indirect Hours</th>
<th>Vacn Hours</th>
<th>Vacn Dollars</th>
<th>Sick Hours</th>
<th>Sick Dollars</th>
<th>Holiday Hours</th>
<th>Holiday Dollars</th>
<th>Hours Worked Above 2080</th>
<th>Uncomp OT</th>
</tr>
</thead>
<tbody>
<tr>
<td>John Doe</td>
<td>$110,000</td>
<td>$52.88</td>
<td>2,482</td>
<td>2,059</td>
<td>108,879.92</td>
<td>83.00%</td>
<td>199</td>
<td>136</td>
<td>7,191.68</td>
<td>20</td>
<td>1,057.60</td>
<td>68</td>
<td>3,595.84</td>
<td>402</td>
<td>$21,257.76</td>
</tr>
<tr>
<td>Jane Brown</td>
<td>$105,500</td>
<td>$50.72</td>
<td>2,287</td>
<td>1,457</td>
<td>73,899.04</td>
<td>64.00%</td>
<td>580</td>
<td>174</td>
<td>8,825.28</td>
<td>16</td>
<td>811.52</td>
<td>60</td>
<td>3,043.20</td>
<td>207</td>
<td>$10,499.04</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td>4,769</td>
<td>3,516</td>
<td>182,778.96</td>
<td>779</td>
<td>310</td>
<td>16,016.96</td>
<td>36</td>
<td>1,869.12</td>
<td>128</td>
<td>6,639.04</td>
<td>609</td>
<td><strong>$31,756.80</strong></td>
<td></td>
</tr>
</tbody>
</table>

**ICR Adjustments:**

- Direct Labor: $24,363
- Indirect Labor: $7,393

Payroll Variance/Uncompensated Overtime: ($31,756)

In this example, the firm was recording all hours worked on timesheets. However, this firm had recorded their labor at the "effective rate", not based on the standard 2,080 hours per year. Effective rates are computed weekly, based on actual time charges. If the consultant records labor at effective hourly rates, then an adjustment must be made at year end to convert to the standard hourly rate. The total number of direct hours (for instance) is multiplied by the difference between standard and effective hourly rates. This worksheet allows the labor to be recomputed, and adjustments made to each labor category to correct.

The Internal Audit Office populated two lines of the worksheet for demonstration purposes, and the firm completed the rest. One line for each employee was computed, and the resulting totals allowed us to correct the labor accounts.

Once the firm adds the remaining employees to this worksheet, we have labor totals based on the standard 2080 hours. The difference between the labor totals at the effective rate, and the labor totals shown on the worksheet based on 2080 is our adjustment. Uncompensated overtime adjustments apply to direct and indirect only. The PTO categories are used only to arrive at total hours worked.

The main purpose of the Uncompensated overtime worksheet is to correct direct & indirect labor as needed, we typically don't make an adjustment for paid time off.
## Interpretive Guidance Document – Uncompensated Overtime
### Example B

<table>
<thead>
<tr>
<th>Exempt Employee</th>
<th>Salary (based on 2080)</th>
<th>Hrly Rate (per t/sheets)</th>
<th>Total Hrs Worked</th>
<th>Direct Hours</th>
<th>% Direct</th>
<th>Indirect Hours</th>
<th>Vacn Hours</th>
<th>Sick Hours</th>
<th>Holiday Hours</th>
<th>Hours Worked Above 2080</th>
<th>Uncomp OT</th>
<th>% Direct</th>
</tr>
</thead>
<tbody>
<tr>
<td>John Doe</td>
<td>$110,000</td>
<td>$52.88</td>
<td>2,162</td>
<td>1,535</td>
<td>71.00%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>82</td>
<td>$4,336.16</td>
<td>$3,078.67</td>
</tr>
<tr>
<td>Jane Brown</td>
<td>$105,500</td>
<td>$50.72</td>
<td>2,135</td>
<td>1,879</td>
<td>88.00%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>55</td>
<td>$2,789.60</td>
<td>$2,454.85</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td>4,297</td>
<td>3,414</td>
<td></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>137</td>
<td>$7,125.76</td>
<td>$5,533.52</td>
</tr>
</tbody>
</table>

**Overhead Adjustments:**

- **Direct Labor:** $5,534 Included in direct labor base
- **Indirect Labor:** $1,592 Included in indirect labor

**Payroll Variance/Uncompensated Overtime:** ($7,126) Make adjustment to Indirect - Variance

This firm did track all hours on timesheets for exempt employees, but had not made an adjustment for the variance amount. They had recorded direct & indirect hours appropriately, but without the variance account - the payroll was over-stated. Our worksheet was used to correct and balance the payroll, by adding the variance.

This was the optimal situation, all hours worked were tracked individually by the firm on employee timesheets. See the Procedures for Handling Uncompensated Overtime.
Interpretive Guidance Document – Uncompensated Overtime

Example C

<table>
<thead>
<tr>
<th>Exempt Employee</th>
<th>Salary (based on 2080)</th>
<th>Hrly Rate (per t/sheets)</th>
<th>Total Hrs Worked</th>
<th>Direct Hrs</th>
<th>% Direct</th>
<th>Indirect Hrs</th>
<th>Vac Hours</th>
<th>Sick Hours</th>
<th>Holiday Hours</th>
<th>Hrs Worked Above 2080</th>
<th>Est. Uncomp. OT</th>
<th>% Direct</th>
</tr>
</thead>
<tbody>
<tr>
<td>John Doe</td>
<td>$110,000</td>
<td>$52.88</td>
<td>2,080</td>
<td>1,500</td>
<td>72.00%</td>
<td>347</td>
<td>150</td>
<td>15</td>
<td>68</td>
<td>80</td>
<td>$4,230.40</td>
<td>$3,045.89</td>
</tr>
<tr>
<td>Jane Brown</td>
<td>$105,500</td>
<td>$50.72</td>
<td>2,080</td>
<td>1,457</td>
<td>70.00%</td>
<td>580</td>
<td>174</td>
<td>16</td>
<td>60</td>
<td>80</td>
<td>$4,057.60</td>
<td>$2,840.32</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td>4,160</td>
<td>2,957</td>
<td></td>
<td>927</td>
<td>324</td>
<td>31</td>
<td>128</td>
<td>160</td>
<td><strong>$8,288.00</strong></td>
<td><strong>$5,886.21</strong></td>
</tr>
</tbody>
</table>

Overhead Adjustments:

- Direct Labor: $5,886 Adjustment A
- Indirect Labor: $2,402 Adjustment B

Payroll Variance/Uncompensated Overtime: ($8,288) Adjustment C

This example is the one that we see the most, where a firm does not record hours over 2080 for executives/principals/owners.

If a firm does not record all hour worked (uncompensated overtime), then this worksheet is a tool that may be completed to arrive at the adjustment for the overhead.

In the example above, the firm did not track hours over 40 in a week, or over 2,080 in the year. We were able to agree on an estimate for the adjustment.

This method requires the firm to estimate or determine the amount of hours in excess of 2,080 that were worked.

Uncompensated overtime requires a two part adjustment.

- The adjustment to Direct Labor corrects the direct labor base for hours worked by the employee but not paid to the employee, hours billed to the client & paid to the consultant, and non-billable hours which also must be accounted for in the direct labor base. (Adjustment A)
- The debit to indirect (Adjustment B) corrects the indirect labor for hours worked by the employee, but not paid to the employee.

If the direct/indirect labor adjustments (Adjustments A & B) are the only one made, the payroll would be over-stated because those hours were not paid.

Adjustment C is a credit adjustment to balance the payroll.

Estimate/Percentage of direct labor was used in this instance. In the optimal situation, the hours would be tracked individually.

See the Procedures for Handling Uncompensated Overtime.

Please note - This method to estimate uncompensated overtime is a one year process. In the subsequent years, it is our expectation that firm’s will implement a procedure to track all hours worked by all employees.

WSDOT Internal Audit Office

September 23, 2011