



**Washington State
Department of Transportation**

***Guidance for Small Firms
(And/or New to WSDOT)***

(WSDOT & Local Agency Agreements)

WSDOT Internal Audit Office

July 2014

Guidance for Small Firms

(this also includes firms that are new to working with WSDOT & Local Agencies)

To get the most benefit from this guidance document, we suggest that you watch the [Basic Timekeeping Webinar](#) prior to review of this document, the link to which can be found at: <http://www.wsdot.wa.gov/Audit/guides.htm>

PREFACE

This guidance document is geared toward small A/E firms, and/or firms that are new to contracting with WSDOT and Local Agencies ¹ for A/E service to provide them with overall indirect cost rate guidance and provide them with the following:

- *Knowledge and understanding of the necessary documentation for:
 - *Supporting their direct and indirect costs,*
 - *Establishing the necessary Controls*
 - *Processes to succeed in complying with the FARS, the AASHTO Audit Guide,**
- *Assistance in complying with WSDOT's agreement terms and conditions.*

Our goal is to make the process of working with the agency smooth and successful. As a step in contracting with WSDOT or Local Agencies, coordinating with the WSDOT Audit Office is essential to help ensure firms have, or are willing to implement, the policies, practices and procedures that are necessary when working under a WSDOT agreement.

Our experience in this area has provided us with insight to some of the frequent challenges that firms may experience, especially smaller firms or those firms that are new to working with a government agency. Please see the [Audit Office Web page](#) for contact information and feel free to call with questions.

¹ The reference to Local Agencies in this document refers to Federal money that WSDOT provides for Local Agency agreements (city and county) for transportation-related projects.

CONTENTS

Chapter	Description	Page No.
Chapter 1	Timekeeping	4
Chapter 2	Support for your Raw Labor Rate	6
Chapter 3	Indirect Cost Rate	7
Chapter 4	Agreement Criteria	10
Attachment A	Sample Timesheet for a Manual Timekeeping System	
Attachment B	Sample Indirect Cost Rate Schedule	
Attachment C	AASHTO Audit Guide Chapter 5 (5.4 (F)) – Cost Accounting	28
Attachment D	AASHTO Audit Guide Chapter 6 – Labor Charging Systems and Other Considerations	44

Chapter 1 - Timekeeping

Timesheets are the source documents to support labor billed. The reliability and accuracy of a consultant's labor charging system is extremely important. Implementation of an electronic timekeeping system is NOT a necessary requirement. Manual timesheets are acceptable as long as the necessary processes & controls are in place and are followed. All firms, whether they are a prime consultant or a sub-consultant, are expected to have detailed timesheets to support all labor, regardless of the firm's size. This also applies to firms with only one person.

Each firm should have a **written timekeeping policy** or pamphlet. Timesheets should meet the timekeeping requirements as discussed in the AASHTO Audit Guide, Chapters 5 and 6. See [Attachment A](#) for sample manual timesheets, [Attachment C](#) for AASHTO Audit Guide Chapters 5, F. Internal Labor Costs, and [Attachment D](#) for AAHSTO Audit Guide Chapter 6, B. Labor Charging System Internal Controls.

Consultant's timesheets should record, and their timekeeping policy should include, the following (*this is not an all-inclusive list*):

- All hours worked by all staff, including owners/principals, should be recorded on the timesheets daily.
- Time spent on projects (including non-billable project labor)
- Time spent conducting administrative tasks
- Paid and Unpaid leave
- All hours worked, whether paid or not.
- Direct and Indirect labor must be segregated (administrative time should be recorded, as well as paid time off).
- The employee should have sole access to create his/her timesheet.
- We should be able to verify supervisory approval of the timesheets (this would not be applicable in very small one or two person firms).
- The supervisor should not be able to enter or make changes to employee timesheets without the employee's approval. Any changes to hours recorded on the timesheet must be evidenced by both employee and supervisor approval (initialed/dated in ink by employee and supervisor).
- Firms must have a written process to document any corrections to hours that were recorded on timesheets. (For 1 or 2 person firms this may not be necessary.)

Timesheets should indicate at a minimum the hours worked by project numbers, contract number or name, or other identifiers for a particular assignment. If your firm is working on a WSDOT Task Order Negotiated Hourly Rate Agreement, your timesheets must show the task information as well as the agreement identification.

Reference [WSDOT Interpretive Guidance for Labor](#)

Chapter 2 - Support for Raw Labor Rate

Hourly billing rates² for each person/classification are determined based on three components

- Employee's Actual Payroll Rate;
- Firm's Indirect Cost Rate (overhead); and
- Fixed fee.

Per the terms and conditions of the WSDOT agreement, each employee working on the agreement should be billed at a rate that is based on their actual raw labor rate. In the example below, John Doe's actual raw labor rate is \$60, and this hourly rate is supported by the firm's payroll register or equivalent payroll records. The hourly billing rate is \$135 per hour.

Example:

<i>Classification</i>	<i>Raw Labor Rate</i>	<i>Overhead (ICR) 105%</i>	<i>Fixed Fee 20%</i>	<i>Billing Rate</i>
<i>John Doe, Principal</i>	<i>\$60.00 *</i>	<i>\$63.00 *</i>	<i>\$12.00 *</i>	<i>\$135.00</i>

*In your situation, the employee's actual raw labor rate, overhead and fee may be different. The above is meant to be an example only.

The documentation that is available to **support** an individual employee's or principal's raw labor rate varies from firm to firm. Many firms have payroll registers which show each person's actual rate of pay, and whether they are hourly or salaried. For very small firms, we often see other methods of payment for the sole-proprietor, such as: checks that were taken as a draw, or amount for draws shown on Financial Statements.

For **salaried staff** the raw labor rate is determined using salary divided by the standard 2,080 hours per year. For example, Jane Fox is paid \$100,000 per year per the payroll register. Divided by the standard 2,080 hours this equates to a raw labor rate of \$48.08.

We have worked with one-person firms who do not work the full 2,080 hours per year. These one-person firms typically take draws to pay themselves. **Total draws** for the year divided by the total hours worked for the year equals the raw labor rate. (Total hours worked includes both project (direct) hours and administrative hours). If the one-person firm has not kept timesheets for the year, we will work with the individual to estimate the hours worked for the year to compute the raw labor rate. We will also provide the firm with timekeeping instructions, and our expectation is that a timekeeping process will be implemented.

² Billing rates as agreed to in the applicable prime or sub-consultant agreement

Chapter 3 - Indirect Cost Rate

Each firm who works with WSDOT or a Local Agency is required to have an **Indirect Cost Rate (ICR)** to bill administrative costs to WSDOT or Local Agency agreements. Firms that have not developed an indirect cost rate may qualify for the **Safe Harbor Pilot Program**. The Safe Harbor rate is 110% and enables the firm to begin work immediately, if the firm opts to accept that rate, and is eligible to participate in the [Safe Harbor Program](#), as they work to establish the necessary accounting system and controls on the Pathway to Compliance.

Indirect Cost Rate Schedule

The indirect cost rate schedule is the primary document used to show the calculation of the firm's non-direct costs. A firm's ICR should be shown in the standard [WSDOT format](#) and is based on your firm's account titles & dollars. The amounts on the ICR should tie to other financial documents for the period. For the sample of our indirect cost schedule please click here to see [Attachment B](#).³

The WSDOT Audit Office reviews a firm's Indirect Cost Rates. When a firm submits a qualifying proposal on an agreement, it is our expectation that the firm has a current FAR-compliant Indirect Cost Rate (ICR) and is ready to go to work, or is interested in being part of the Safe Harbor program. A FAR-compliant schedule should have all unallowable costs and the directly associated costs removed from it. The [AASHTO Audit Guide](#) has good guidance if you are not sure if an item of cost is allowable: Page 84 of AASHTO lists common unallowable costs, and Appendix C, in the Guide, shows items of cost and if they are generally allowable.

CPA-Audited Indirect Cost Rate

Your firm may have a CPA audit your indirect cost rate. The costs of this audit are allowable in your indirect cost pool and, therefore, are recoverable through your indirect cost rate. If your firm has a CPA-Audited ICR, please provide a copy of your CPA's report (including all notes) and the associated rate schedule to the WSDOT Internal Audit Office.

Cognizant Letter

A Cognizant Letter (also known as a "Cog" Letter) is a letter from a state DOT that has audited your indirect cost rate, or that has reviewed work of your CPA-audited rate. The letter issued by the state DOT says "cognizant" in the letter. If you receive such a "Cog" letter from another state DOT, please provide a copy of the letter, along with a copy of the associated indirect cost schedule to the WSDOT Internal Audit Office. Once WSDOT receives a copy of a "Cog" Letter

³ Attachment C is an example of an indirect cost schedule; the accounts on your firm's actual indirect cost schedule may differ from the ones in the example. The accounts are made up the actual accounts your firm uses in its cost accounting system.

and the associated indirect cost schedule by another state, we need do nothing further to complete our indirect cost rate review.

Labor component of the Indirect Cost Rate Schedule & Labor Reconciliation

For very small firms that do not have some of the key labor reports mentioned below, such as a Payroll Register, the process to reconcile labor costs may be different than described below.

(For one or two-person firms this process will be modified, and we would explore what documentation the firm has available). Feel free to call us at (360)705-7003 with questions.

The dollar amounts and account titles for a firm's ICR should come directly from the Income Statement or accounting general ledger accounts for the period. The total labor amount shown on the ICR must tie to a firm's payroll register for the period. It is important that each employee's labor as recorded on the timesheets and in the payroll records match. We have developed a format which can help with this process: The Labor Distribution Report (LDR) shows all hours, dollars for the year and is broken out by individual employee. Your firm may have other labor reports that may work to ensure that the payroll records match the financial statements/tax records and the indirect cost rate schedule.

The matching (reconciliation) of the four documents below is necessary and provides assurance and verification that the labor costs on the Indirect Cost Rate schedule are actual and correct.

Those four documents are:

- Indirect Cost Rate Schedule (ICR)
- Labor Distribution Report (LDR) ⁴
- Income Statement/Tax Records
- Year-end payroll register, shown by individual employee

Labor is the largest component on a firm's ICR, and we use this four part verification for assurance that the firm's labor is reconciled for the year and that the labor is based on the correct amounts. A firm's accounting system, job-costing system, and labor charging system serve as the basis for the Indirect Cost Rate Schedule (ICR). The direct labor is the base for calculating the ICR rate. When the ICR ties to Payroll Register to the Income Statement and to LDR this is good news!

If a firm's labor is not reconciled for the year, and the four documents do not match – the Audit Office will typically not be able to complete a review of your Indirect Cost Rate.

Regular reconciliation of labor costs to payroll, at the level of individual employee, is extremely important to this process it will save you time at year-end and is considered a “best practice.”

⁴ For more details about the LDR, please see our [Interpretive Guidance for Labor](#).

Reconciliation after each payroll period is ideal. Waiting until year-end to complete your labor reconciliations could be equated to waiting until year-end to reconcile your bank account to see how much money you have left. The guidance in the AASHTO Audit Guide notes that reconciliations should occur no less frequently than once every thirty days. Our office prepared an example LDR worksheet that can be used for these monthly reconciliations. We find that firms that are waiting until year end to reconcile their labor have a difficult time matching all of the totals and creates more work for all involved in the ICR Review

Some of the current labor/timekeeping issues that we see challenging to small firms when reconciling labor costs include:

- Use of furlough days.
- Staff working less than scheduled hours.
- Reduced work hours and/or reduced pay.
- Comp time taken in excess of the comp hours earned.
- Hours paid but not worked.

Chapter 4 - WSDOT Agreement Criteria

Costs that are reimbursed through WSDOT agreements are limited by the specific criteria noted in the **agreement**. The criteria in WSDOT agreements apply to all firms regardless of a firm's size, and apply to sub-consultants as well as to the prime consultant. The following is a high-level summary of portions of the agreement language.

Section V Payment Provisions of the standard WSDOT Agreement requires compliance with all applicable portions of the Federal Acquisition Regulations (FARs) in [48 CFR Part 31](#).

48 CFR 31.201-2 (d) A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported.

Section V, Payment Provisions, A. requires the consultant to have support data for verification for components of the hourly rates, this includes the raw labor rate and the indirect cost rate.

Section V, Payment Provisions, B states that direct non-salary costs must be billed at actual cost and must be supported by documentation. Travel costs must be billed in accordance with the [WSDOT Accounting Manual, M13-82, Chapter 10 Travel](#) .

Section V Payment Provisions, F. states that consultants (including sub-consultants) must have available for inspection any cost records up to three years after the final payment is made on the agreement. (For example, if you are a small firm, working as a sub-consultant on a WSDOT agreement briefly in 2013, but the prime's agreement runs until 2016 with final payment in June 2016, you would be required to have all related records available for an audit through June 2019.)

Section VI Sub-Contracting notes that all sub-consultants must be pre-approved, and are subject to the same audit criteria as the prime consultant.

Please refer to your individual WSDOT Agreement to become familiar with the various sections mentioned above. Your agreement or sub-agreement should have sections similar to these.

Closing Note

We encourage you to phone our office at (360) 705-7006, if you have questions. We can offer one-on-one training and assistance to your firm, if requested.

We have additional Interpretive Guidance documents available at the following link:

<http://www.wsdot.wa.gov/Audit/guides.htm>

TIME REPORT

Firm Name: _____

Week Ending Date: _____

Employee Name: _____

Project Name	Project No.	Task No.	√ daily entry	Weekly Total	Sat	Sun	Mon	Tue	Wed	Thu	Fri	Comments
Direct Projects:												
Subtotal Direct Projects												
Indirect Projects:												
Administration	ADMIN											
Bid & Proposal												
Bid & Proposal												
Bid & Proposal												
Direct Selling												
Public Relations												
Advertising												
Training	TRAINING											
Subtotal Indirect Projects												
Vacation	PTO											
Sick Leave	PTO											
Holiday	HOLIDAY											
Subtotal Other Hours												
Grand Total All Hours												

Employee Signature: _____	Date: _____	Approved By: _____	Date: _____
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5

Chapter 5—Cost Accounting

5.1—Allocation Bases, Generally

As discussed in Chapter 4, allocation bases are used to assign/allocate certain overhead or other indirect costs to final cost objectives (projects). There are various allocation bases commonly used in cost accounting systems for allocating indirect costs; however, for engineering contracts administered by State DOTs, *direct labor cost* is the most frequently used base. Whatever base is used for cost allocation, it should be *consistent* for all contracts. Some of the common methods are discussed below.

A. Direct Labor Cost

Direct labor cost is the allocation base most commonly used to assign indirect costs to contracts. Direct labor costs generally are computed by multiplying all direct project labor hours by labor rates, as summarized for all employees within the applicable allocation unit. Labor rates are based on actual employee wages incurred, and indirect costs are allocated to projects by multiplying the indirect cost rate by the direct labor cost incurred to complete the projects.

B. Direct Labor Hours

Indirect costs also may be allocated based on direct labor *hours*, instead of *cost*. When using this method, indirect costs are allocated to projects by multiplying the indirect cost rate by the direct labor hours incurred to complete the projects.

C. Total Labor Hours (Total Hours Worked)

This method is similar to the Direct Labor Hours allocation base, except that the base includes all hours incurred for direct and indirect activities. Use of this base assumes that costs incurred benefit both direct and indirect objectives and should be allocated to the appropriate cost objective receiving a benefit, as determined by the proportional number of hours assigned to that cost objective.

D. Total Cost Input

This base frequently is used to allocate General and Administrative (G&A) costs. The base consists of direct labor, fringe benefits, overhead costs, associated non-salary direct expenses (including other costs sometimes referred to as “internal direct expenses”) and subcontract costs.

E. Total Cost Value Added

This base is similar to the Total Cost Input base. However, the Total Cost Value Added base excludes materials (used primarily in production only) and subcontract costs, as distortion in allocations may occur due to a disproportionate amount of subcontract costs or materials in the pool.

F. Consumption/Usage

This method allocates costs to direct or indirect activities on a common unit, usually time or quantity used. For instance, an internal cost pool such as one for computer-aided drafting and design equipment (CADD) costs can be allocated specifically as a direct cost to a project or as an indirect cost based on the number of hours actually incurred.

5.2—Accounting for Unallowable Costs in Allocation Bases

[References: FAR 31.201-6, CAS 405-40(e)]

FAR 31.201-6 expressly requires engineering consultants to comply with CAS 405 to account for unallowable costs. CAS 405-40(e) provides that all unallowable costs “shall be subject to the same cost accounting principles governing cost allocability as allowable costs.”

CAS 405-40(e) further specifies that:

In circumstances where these unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they shall remain in such base or bases. Where a directly associated cost is part of a category of costs normally included in an indirect-cost pool that will be allocated over a base containing the unallowable cost with which it is associated, such a directly associated cost shall be retained in the indirect-cost pool and be allocated through the regular allocation process.

Note: Allocation bases contain allowable and unallowable costs, but indirect cost pools must be purged of unallowable costs. Additionally, regardless of whether State DOTs contractually limit the amount of direct labor that may be reimbursed on a contract, the engineering consultant’s direct labor base must remain as allocated per the consultant’s job cost system, and the direct labor base should not be adjusted for unallowable costs. A direct labor base should not be reduced for any excess compensation adjustments, but should have allocated to it the allowable overhead in accordance with FAR 31.203(d), which provides that:

“Once an appropriate base for allocating indirect costs has been accepted, the contractor shall not fragment the base by removing individual elements. All items properly includable in an indirect cost base shall bear a pro rata share of indirect costs irrespective of their acceptance as Government contract costs. For example, when a cost input base is used for the allocation of G&A costs, the contractor shall include in the base all items that would properly be part of the cost input base, whether allowable or unallowable, and these items shall bear their pro rata share of G&A costs.”

EXAMPLE 5-1.

Sample Design Firm incurred \$2.5 million in direct labor, of which \$500,000 was not billable to contracts. The total \$2.5 million must remain in the direct labor base, which will then be used to allocate the allowable indirect costs.

5.3—Cost Centers

Cost centers are established to accumulate and segregate costs associated with a single purpose. The costs are then assigned to cost objectives (projects) based on unit charges/consumption rates. For example, engineering consultants frequently compute unit charges for cost categories such as CADD, in-house printing, computers, and company vehicles. When establishing a cost center, the goal should be to estimate a unit charge that will minimize variances resulting from over- or under-applied costs.

Although some accounting systems will attempt to adjust unit charge rates throughout the year as actual costs become known, it is more common for the cost variances to be handled as an adjustment to the overhead cost pool, which is where the costs would have been allocated if they had not been directed to the cost center. However, if the over- or under-allocation is significant, then it may be necessary to adjust the contract/project charges.

Some firms do not create cost centers; instead, they estimate the cost of providing certain services by computing unit rates based on certain elements from general ledger accounts (e.g., automobile depreciation from a depreciation account). Once established, these unit charges are offset to overhead as “credit backs” or cost recoveries for allocated direct costs as they are incurred on projects. This type of costing is less precise and should not be used if the unit charges being accumulated are significant to the firm’s overall operation. If handled on a direct-cost basis, the direct cost rates must be supported and audited. The burden is on the engineering consultant to prove the direct cost rates and that direct costs

were properly removed from the indirect cost pool. The overhead audit should include disclosure notes regarding the audited direct cost rates and a listing of cost categories that the engineering consultant charges direct. See Chapter 10 for testing guidance and Chapter 11 for disclosure guidance.

Note: Firms that do create costs centers generally capture costs either by business activity (functional cost centers) or based on the firm's organizational structure, as discussed below.

A. Functional Cost Centers

This method segregates costs unique to a business activity, typically for purposes of direct costing.

B. Subsidiaries, Affiliates, Divisions, and Geographic Locations

Another method of accumulating and segregating costs is focused on the corporate structure. Some examples of cost centers used for accumulating costs are groupings of regional offices, specific subsidiaries, affiliates, divisions, or field offices.

5.4—Allocated Costs

A. Generally

Indirect costs should be accumulated by logical (homogeneous) cost groupings (pools), with due consideration of the reasons for incurring such costs, allocated to cost objectives in reasonable proportion to the beneficial and causal relationship of the pool costs to final cost objective (see FAR 31.203(c)). The auditor should make a thorough study of the indirect cost activity, including activity bases used for allocation and the cost allocated, to determine whether the activity base chosen by the engineering consultant is appropriate for cost allocation and results in a reasonable measure of the activity. The base should:

- be a reasonable measure of the activity;
- be measurable without undue expense, and, except for G&A expense;
- should fluctuate concurrently with the activity that generates the costs.

When an engineering consultant's activities are decentralized, the use of separate indirect cost rates for each geographic location will normally produce more equitable allocation of indirect costs than the use of composite or company-wide rates. Overhead rates determined for offsite/field activities should be based on eliminating from the overhead pool those types of indirect costs that do not benefit offsite activities. For example, occupancy costs may be eliminated from offsite pools because the engineering consultant uses Government facilities.

B. Fringe Benefits

Fringe benefits include costs for employee perquisites and costs associated with the employer's portion of payroll taxes and employment benefits. Such costs generally include, but are not limited to, payroll taxes, pension plan contributions, paid time off, medical insurance costs, life insurance, and certain employee welfare expenses.

C. Overhead

Overhead costs are costs that may benefit, or are associated with, two or more business activities, but are not specifically allocated to an activity for reasons of practicality. Overhead differs from general and administrative costs (see discussion below) because overhead can be associated with a business unit, based on relative benefit. Some examples of overhead costs include rent, depreciation, employee recruitment and training, and general or professional insurance policy costs.

D. General and Administrative (G&A)

G&A expenses generally comprise all costs associated with business operations that cannot be specifically identified with a smaller unit of business activities. For example, certain management or administration costs that are incurred for an entire business unit may be considered G&A, but other accounting or legal costs benefiting a segment of the business may be considered part of the overhead pool of that specific business segment.

E. Internally-Allocated Costs (Company-Owned Assets)

1. Computer/CADD Costs

Generally, this cost center includes costs such as equipment depreciation or rental; software (including license costs); employee training costs on new software; equipment maintenance; cost of special facilities or locations; and systems development labor or support costs.

2. Fleet or Company Vehicles

For the most part, these are costs associated with company vehicles such as cars, survey trucks, and vans that may be used for a direct or indirect cost objective. Costs in this center may include depreciation, lease costs, maintenance, insurance, and operation costs such as fuel.

3. Equipment

Costs accumulated to this center are similar to both computer and company vehicle pools. Company equipment can be a wide variety of items from small to large that are used in various activities. Some examples include nuclear density meters, GPS equipment, and traffic counting machines.

4. Printing/Copying/Plan Reproduction

Costs in this center are generally associated with reproduction from a single page copied to multiple prints of large specialized drawings or blue prints. In most cases, this cost center includes equipment, labor, ink or toner, and paper supplies.

No final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective.

Note: *The "Like-Cost" Issue.*

FAR 31.202(a) provides that "[n]o final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective."

*Like-cost categories should be allocated consistently in the accounting system. As an example, employee personal vehicle mileage must be allocated to similar cost objectives in the same manner as company vehicle mileage. One category of like costs may **not** be allocated directly to contracts while the related like cost category are recovered as part of the indirect cost rate.⁹*

F. Internal Labor Costs

1. Direct Labor

Labor costs are usually the most significant costs incurred by design and engineering firms in the performance of Government contracts. Incurred labor costs form the basis for estimating labor for future contracts. Therefore, it is imperative that engineering consultants establish and maintain a proper, accurate system of internal control over the labor-charging function.

Unlike other items of cost, labor is not supported by external documentation or physical evidence to provide an independent check or balance. The key link in any sound labor charging system is the individual employee. It is critical to labor charging internal control systems that management fully indoctrinate employees on their independent responsibility for accurately recording time charges. This is the single most important feature management can emphasize in recognizing its responsibility to owners, creditors, and customers to guard against fraud, waste, and significant errors in the labor charging functions.

An adequate labor accounting system, manual or electronic, will create an audit trail whenever an employee creates a timesheet entry. A system that allows an audit trail to be destroyed is inadequate because the integrity of the system can be easily compromised. Access to timesheets should be controlled and preprinted, if possible, with the employee's name, number and fiscal week. An inadequate system

⁹ Note: Other common like-cost categories include computers and telephones.

would allow employees to erase prior entries without recording the adjustment. Employees should initial all time sheet changes and adjustments should be maintained as part of the audit trail.

The engineering consultant should have procedures to ensure that labor hours are accurately recorded and that any corrections to timekeeping records are documented, including appropriate authorizations and approvals. When evaluating the engineering consultant's timekeeping procedures, the auditor should consider whether the procedures are adequate to maintain the integrity of the timekeeping system.

The engineering consultant should have policies and procedures for training employees to ensure that all employees are aware of the importance of proper time charging.

Note: See Chapter 6 for further discussion of Labor-Charging System requirements.

2. Uncompensated Overtime for Salaried Employees

Engineering consultants may not be required to pay overtime to salaried employees for hours worked in excess of 40 hours per week. Any unpaid hours worked by salaried employees in excess of the normal 40 hours per week are commonly called "uncompensated overtime."

To ensure the proper allocation/distribution of labor costs, the engineering consultant must establish procedures requiring the consistent recording and accounting for hours worked, whether paid or unpaid. This is necessary because labor rates and labor overhead costs can be affected by total hours worked, not just paid hours worked.

Per DCAA CAM Section 6-410.3.d:

If it is determined that Government contracts are being over charged by a material amount due to an inequitable allocation of costs because the contractor does not record all time worked, the contractor should be cited as being in noncompliance with FAR 31.201-4 and CAS 418. Any material excess allocation of costs to Government contracts should be questioned or disapproved as applicable. Materiality is the governing factor when determining whether noncompliances should be cited and whether a contractor should be required to implement a total-hour accounting system.

For firms with material amounts of uncompensated overtime labor, it is necessary to apply an adjustment to minimize the risk that Government projects will absorb disproportionate amounts of direct labor costs. This may be accomplished through either of the following common methods, or any other equitable method, so long as the method applied is consistently from year to year, and the methodology is reasonable and supportable:

1. **Effective Rate Method.** Using this method, effective hourly pay rates are computed weekly, based on actual time charges. This would require the client to divide each employee's total weekly salary by their respective hours worked, which would result in variable wage rates being charged to contracts. For example, if Employee Smith is paid \$1,400 per week and works 40 hours per week, then Smith's effective hourly wage rate is \$35. By contrast, if Smith actually works 55 hours in week 1 and 50 hours in week 2, then his effective wage rates are \$25.45 and \$28, respectively. Billings on Government contracts would be limited to the effective rates.

2. **Salary Variance Method.** Under this method, overhead is reduced for the appropriate portion of labor costs generated by uncompensated overtime hours. The calculation may be completed one of two ways, based on the engineering consultant’s use of standard or effective hourly rates. Standard rates are computed as the total paid labor cost compared to total paid hours (e.g., weekly pay divided by 40 hours, or annual pay divided by 2,080 hours).

(a) *Standard Wage Rates:* If the engineering consultant records labor at standard rates, then at year end the overhead cost pool must be reduced by the number of uncompensated hours multiplied by the standard wage rate. For example, if Employee Smith earns \$72,800, then his standard hourly wage rate is \$35.¹⁰ If Smith actually works 2,600 hours during the year, then there are 520 hours of uncompensated overtime.¹¹ Accordingly, the indirect cost pool must be reduced by \$18,200.¹² This example is illustrated below in Table 5-1.

Table 5-1. Salary Variance Method—Standard Rate Example

<u>Employee</u>	<u>Direct Hours</u>	<u>Indirect Hours</u>	<u>Hours Worked</u>	<u>Annual Salary</u>	<u>Standard</u>	<u>Direct Labor</u>	<u>Indirect Labor</u>	<u>Labor Variance</u>	<u>Total Labor</u>
					<u>Hourly Rate</u>				
Smith	2,000	600	2,600	\$ 72,800	\$ 35	\$ 70,000	\$ 21,000	\$ (18,200)	\$ 72,800
Ending Direct Labor:			\$ 70,000						
Ending Indirect Labor:			\$ 2,800	(\$21,000 - \$18,200)					

(b) *Effective Wage Rates:* If the engineering consultant records labor at effective hourly rates, then at year end the overhead cost pool must be reduced, and the direct labor base must be increased, by the number of direct labor hours multiplied by the difference between the standard and effective hourly rates. For example, if Employee Smith earns \$72,800 working 2,600 hours during the year, his effective rate is \$28. If 2,000 of Smith’s hours were spent on direct projects, the indirect cost pool must be reduced and direct labor base increased by \$14,000. This example is illustrated below in Table 5-2.

Table 5-2. Salary Variance Method—Effective Rate Example

<u>Employee</u>	<u>Direct Hours</u>	<u>Indirect Hours</u>	<u>Hours Worked</u>	<u>Annual Salary</u>	<u>Standard</u>	<u>Effective</u>	<u>Direct Labor</u>	<u>Indirect Labor</u>	<u>Total Labor</u>	<u>Labor Variance</u>
					<u>Hourly Rate</u>	<u>Hourly Rate</u>				
Smith	2,000	600	2,600	\$ 72,800	\$ 35	\$ 28	\$ 56,000	\$ 16,800	\$ 72,800	\$ 14,000
Ending Direct Labor:			\$ 70,000	(\$56,000 + \$14,000)						
Ending Indirect Labor:			\$ 2,800	(\$16,800 - \$14,000)						

As illustrated in Tables 5-1 and 5-2 above, the end result of using the Salary Variance Method is the same regardless of whether the engineering consultant uses the Standard Rate or Effective Rate option.

Note: Significant amounts of uncompensated overtime may have a material impact on costs invoiced directly to State DOT contracts. Accordingly, State DOTs may seek billing adjustments when appropriate.

¹⁰ \$72,800 divided by 2,080 standard hours.

¹¹ 2,600 actual hours minus 2,080 standard hours.

¹² \$35 per hour standard wage rate multiplied by 520 uncompensated overtime hours.

Some engineering consultants may have accounting systems that do not capture costs for hours worked by salaried employees in excess of 40 hours per week. Because there is a serious risk of incorrect charging of costs to Government contracts under these circumstances, the following methods of distributing these salary costs are unacceptable:

1. Distribute labor costs to only those cost objectives worked on during the first 8 hours of the day.
2. Allow employees to select the cost objectives to be charged when more than 8 hours per day are worked or the engineering consultant has an informal policy as to how employees are to select the objectives to be charged.

3. Overtime Premium

Engineering consultants must maintain records that segregate overtime premium¹³ amounts and classify them as direct or indirect costs. Additionally, consultants must establish overtime policies that are applied consistently and result in equitable cost allocations.

When employees normally work on multiple cost objectives (projects or administrative activities), it may be difficult to determine which cost objective “caused” the overtime; accordingly, many companies adopt policies requiring overtime premium to be allocated to the indirect labor cost pool. In the alternative, when overtime premium can be identified with specific cost objectives, the premium should be allocated to those cost objectives.

Note: Consultants must treat overtime premium costs consistently for all contracts, regardless of the customer (Government versus commercial) or type of contract involved.

EXAMPLE 5-2. OVERTIME PREMIUM

Sample Design Firm has eight total active projects, including three lump-sum contracts and five cost-plus fixed fee contracts. Only two of the cost-plus fixed fee contracts allow overtime premium to be billed as a direct cost. Sample Firm’s policy is to allocate project-related overtime premium directly to projects; accordingly, the overtime premium must be allocated to all eight projects consistently, regardless of whether the premium costs are billable.

4. Other Considerations Regarding Internal Labor Costs

- **Approvals and Authorizations.** The engineering consultant should have procedures to ensure that labor hours are recorded accurately and that any corrections to timekeeping records are documented, including appropriate authorizations and approvals.
- **Reconciliation of Labor System to Payroll and General Ledger.** The engineering consultant should have procedures requiring that the total labor costs reflected in labor distribution summaries (job cost) agree with the total labor charges as entered in the timekeeping, payroll systems and general ledger. This reconciliation ensures the labor charges to contracts represent actual paid or accrued costs and that such costs are appropriately recorded in the accounting records.
- **Reconciliation of General Ledger and Indirect Cost Rate Schedule to Payroll Tax Returns (IRS Form 941s).** The engineering consultant should have procedures requiring that the total labor costs recorded in the general ledger, and included on the indirect cost rate schedule, reconcile to the payroll data submitted to the Internal Revenue Service.

¹³ “Overtime premium” is the difference between an employee’s standard hourly wage rate and the special hourly wage rate paid for hours worked in excess of 40 per week. For example, an employee whose standard hourly rate is \$10 for the first 40 hours worked per week and \$15 per hour for hours worked in excess of 40 has overtime premium of \$5 for each hour worked in excess of 40. In cases where overtime is project related, the straight-time rate paid for overtime hours worked must be included in the direct labor base, while the premium amount is subject to additional considerations (see discussion above).

- **Labor Costs Directly Associated with Unallowable Activities.** The engineering consultant should have procedures requiring that direct and indirect labor costs directly associated with unallowable costs are identified and segregated.

5. Potential Areas of Risk Regarding Internal Labor

- **Overrun Contracts.** When contract costs have exceeded or are projected to exceed the maximum contract value, the excess costs must *not* be diverted to other cost objectives such as indirect labor, overhead accounts, or other contracts.
- **Significant Changes in Direct/Indirect Labor Accounts.** Trend analyses may disclose instances where charges to direct or indirect labor accounts have increased significantly. Two common ratios often used for trend analysis are the *Productivity Ratio* (direct labor/total labor) and the *Multiplier Ratio* (fee revenue/direct labor). A review should be performed to determine the nature of any significant changes from prior years.
- **Reorganization/Reclassification of Employees.** The organizational structure of the engineering consultant should be analyzed to determine if the potential exists for the inconsistent treatment of similar labor. For example, a program manager should not charge direct on cost-type contracts and indirect on fixed-price/commercial contracts.
- **Adjusting Journal Entries/Exception Reports (Labor Transfers).** Adequate rationale and supporting documentation should be available for all significant labor transfers.
- **Budgetary Control.** Engineering consultants may operate management systems that require strict adherence to budgetary controls. If the system is inflexible, then labor charges may tend to follow the identical route of the budgeted amounts. Rigid budgetary control systems can result in predetermined labor charges.
- **Mix of Contracts.** Engineering consultants must identify and allocate costs consistently in the accounting system, regardless of contract type. For firms that use combinations of lump-sum contracts and cost-reimbursement contracts, there is a significant risk that direct labor and other direct costs may not be allocated to the correct cost objective, resulting in the understatement of direct labor and overstatement of indirect labor or incorrect direct project charging.

Note: For further discussion, see Chapter 9—General Audit Considerations.

6. Sole Proprietors' and Partners' Salaries

The compensation of owners or partners must be allocated as direct labor when they are personally engaged in performing tasks on contracts. If sole proprietors or partners do not receive a salary, then their compensation must be determined by advance agreements or negotiation.

G. Contract Labor/ Purchased Labor

[Reference: CAS 418]

In some cases, engineering consultants contract for services provided by outside engineers, technicians, and similar staff rather than hiring these individuals as employees. These individuals commonly are referred to as “contract labor” or “purchased labor.” The accounting treatment varies, depending on the circumstances under which the purchased labor costs are incurred.

Two acceptable methods of accounting for this labor are:

1. Allocated as a direct cost to projects, or
2. Treated as other labor (direct or indirect as appropriate)

CAS 418 requires pooled costs to be allocated to cost objectives in reasonable proportion to the causal or beneficial relationship of the pooled costs to cost objectives. Contract labor must share in an allocation of indirect expenses where such a relationship exists and the allocation method is consistent with the engineering consultant’s disclosed accounting practices. A separate allocation base for purchased labor

may be necessary to allocate significant costs to contract labor, such as supervision and occupancy costs, or to eliminate other costs, such as fringe benefits, that do not benefit purchased labor.

5.5—Other Direct Costs-Outside Vendors/Employee Expense Reports

Other Direct Costs (ODCs) typically include items such as subcontractors, travel, and outside printing. ODCs also may include internally-allocated costs based on charge-out rates developed by the firm, such as company vehicle mileage and copying (see earlier discussion in Section 5.4.E).

Note: *To be treated as a direct cost, the item must have been required for, and used exclusively on, a specific job. The “but-for” principle should apply. “But for this job, the cost would not have been incurred.” All similar costs must also be treated as direct costs and excluded from indirect costs.*

The audit procedures for ODCs involve determining if unallowable costs were handled correctly. Per CAS 405-40 (Fundamental Requirement): “All unallowable costs shall be subject to the same cost accounting principles governing cost allocability as allowable costs. If a direct cost is unallowable, then it must remain allocated as a direct cost and may not be included in any indirect cost pool.”

5.6—Field Office Rates

[Reference: FAR 31.203(f)]

A. Generally

Engineering consultants are not always able to perform contracted services from their established home- or branch offices, as certain contracts may require establishment of offices in field locations, or the engineering consultant may be required to locate personnel in office space provided by a State DOT. Some engineering consultants may even establish a separate company for field projects. Engineering consultants may have both field (construction management) and project (design) office rates. Both rates may be required or established by contract if the consultant did not have previously established field rate accounting.

Per FAR 31.203(f): “Separate cost groupings for costs allocable to offsite locations may be necessary to permit equitable distribution of costs on the basis of the benefits accruing to the several cost objectives.” In some cases, projects involve engineering consultants working in State DOT provided office(s) for an extended period of time, and the life of the field office is determined by the duration of the project.

For projects where the engineering consultant’s employees do not work out of their own offices and do not receive office support in their day-to-day activities, the hours billed for them may not qualify for the engineering consultant’s full overhead rate. The purpose of the field rate is to pay the engineering consultant for the fringe benefits, project employee management, and home office administrative support they do provide to their field employees.

Approved costs directly identified with the project and consistently treated, as direct costs in the engineering consultant’s accounting records will be allowed as direct project costs.

Note: *Field offices may exist in several forms. Regardless of the engineering consultant’s organization, consistency in allocating costs to cost objectives is critical. This guide presents several suggested methods for computing field office rates. The use of alternative methods may be acceptable. The use of all methodologies must be supported by notes to the indirect cost rate schedule or in a separate disclosure statement.*

B. Types of Field Offices

There are many situations that may require the development of a field- or project-office rate. For example:

- **Construction Contract Administration/Construction Inspection (Field Office).** These contracts involve the management of construction projects and often involve the engineering consultant's personnel being located in an on-site project trailer provided by the contractor or the State DOT. For larger, "mega" projects, the engineering consultant's personnel may be located in the State DOT's main office or regional office.
- **Project Office.** These contracts usually involve services such as design, real estate, traffic center operations, and utilities. When working on these types of contracts, the engineering consultant's personnel typically work out of an office provide by the State DOT.
- **"On Call" Engineers.** Consultants with on-call service contracts for short-term projects and tasks may be required by contract to apply a field rate if the consultant is located in a State DOT's offices.
- **Contract Employees.** State DOTs contract with engineering consultants to provide administrative functions and the engineering consultant's personnel are located in the State DOT's offices to perform these functions.

C. Cost Accounting Considerations

Engineering consultants must be consistent in the development and application of field rates. Accordingly, if an engineering consultant has computed a field rate, this rate must be consistently applied across all business segments and disciplines.

Field rate accounting has an impact on the home office rate. If an engineering consultant has an established field rate for a particular project or State DOT, then the engineering consultant's home office rate will be higher than if the consultant had only a single company-wide rate. As such, for consistent cost accounting application, a State DOT that does not have a field office project would have a higher home rate applied to their State DOT projects.

1. Field Office Direct Labor

Direct field labor is based on actual labor hours multiplied by actual labor rates for field assigned employees. If historical data is not available when establishing a provisional field rate for the first time, then an estimate of direct hours for the contract(s) may be used to distribute direct labor to the field office overhead pool and/or a provisional rate may be negotiated.

2. Field Office Indirect Costs

There are many considerations to use when developing methodologies for field and project office rates, and these may vary between engineering consultants. However, direct labor is the common base used in the development of field rates. The following method described for allocating costs is a preferred methodology. Field- and project-office rate calculations based on different methodologies than what is provided in this guide may be acceptable. Many firms disclose their methodology in their audit footnotes or have an approved Cost Allocation Disclosure Statement that documents their field office accounting methodology.

If an alternative allocation method is used, then the consultant's allocation must have resulted from a "reasonable and determinable allocation plan, consistently applied." The engineering consultant should provide a note or other disclosure to describe the allocation methodology in sufficient detail so an auditor can examine the methodology and verify its logic and reasonableness.

Generally, State DOTs do not require extensive administrative staffing of engineering consultants' field offices. Most administrative and management functions will be performed in the home or branch office. Therefore, an equitable portion of these offices' indirect costs should be allocated to the field office. The costs that are allocated, and the basis for the allocation, depend largely on the engineering consultant's customary accounting practices. Some State DOTs require separate cost pools for accumulation of field office costs. Certain home office indirect cost should be fully allocated to the home office overhead pool,

and certain field office indirect cost should be fully allocated to the field office pool (see further discussion in Section 5.6.C.3).

Fringe Benefits. The fringe benefits applicable to the field office direct labor costs should be allocated to the field office overhead pool. If the engineering consultant's accounting records do not maintain separate accounts for field office fringe benefits, then the fringe benefits may be allocated using the Field Office Direct Labor Rate shown below in Table 5-3:

TABLE 5-3. COMPUTATION OF FIELD OFFICE DIRECT LABOR RATE

$$\frac{\text{Field Direct Labor Cost}}{\text{Total Direct Labor Cost}} = \text{Field Office Direct Labor Rate}$$

Indirect Labor—Non-Project Time. Labor costs pertaining to non-project time of professional staff working in the field office (training, staff development, staff meetings, and/or similar activities) is generally recorded specifically within the Field Office Indirect Labor accounts. If these costs are not identified or accounted for separately, then a ratio based on the Field Office Labor Rate may be used to allocate costs to the Field Offices, as shown below in Table 5-4:

TABLE 5-4. COMPUTATION OF FIELD OFFICE LABOR RATE

$$\frac{\text{Total Field Labor Cost}}{\text{Total Labor Cost}} = \text{Field Office Labor Rate}$$

Indirect Labor—Support Staff. Indirect salaries, such as accounting, legal, purchasing, personnel, management, and/or similar costs, should also be allocated to the field office overhead pool. Project managers who spend significant amounts of time managing field office staff may account for this management time as actual indirect in the field office overhead pool. This actual time must be supported and documented on the managers' time report. All other support staff time that is not specifically accounted for may be allocated between the home office overhead pool and the field office overhead pool. A ratio of Field Office Labor Percentage would be a reasonable method to allocate these costs.

3. Other Considerations Regarding Indirect Cost Allocations

Indirect Costs Fully Allocated to Home Office. Certain home office indirect costs should be fully allocated to the home office overhead cost pool. These costs include, for example, depreciation, facilities rent, real estate taxes, facility maintenance and repairs, utilities, facility insurance, and/or similar types of costs associated with home office direct labor. (Costs of support functions that support both home and field offices should be allocated accordingly.)

Indirect Costs Fully Allocated to Field Office. Likewise, certain field office indirect costs should be fully allocated to the field office overhead pool. Some examples of these costs include field equipment, on-site trailer rental, field supplies, field equipment, software specific to projects, and/or similar types of costs.

Indirect Costs Ratably Allocated to Field Office. Other general indirect costs are allocated to the field office overhead pool based on a reasonable estimate of the benefits accruing to the field office pool. One recommended method is to allocate general indirect costs on the basis of the field office labor percentage. This allocation method involves applying the field office labor percentage to the various general expense line items on the company's indirect cost rate schedule. Costs such as rent, real estate taxes, facility maintenance and repairs, utilities, facility insurance, and/or other similar costs should be allocated between the G&A portion of the home office costs and to the field offices on a basis that appropriately reflects the benefits received. For example, the space costs for accounting staff and other support services benefit all offices, including field offices; therefore, these costs should be allocated proportionately among the home and field offices.

Separate Accounting for General and Administrative (G&A) Costs. Some engineering consultants account for G&A office costs in a separate cost pool. In this situation, G&A costs may be allocated to both field and home office operations. When G&A costs are allocated on a base other than direct labor cost, then the G&A allocation rate must be separately disclosed on the indirect cost rate schedule.

Note: *If the engineering consultant computes a field office overhead rate, then this must be disclosed on the indirect cost rate schedule. The schedule should include a separate column listing the indirect field expenses, direct field labor, and resulting field rate. The schedule also should include a footnote to describe the allocation method(s) used. Tables 5-6 and 5-7 show examples of an indirect cost rate schedule with a field office rate and supporting computations (see the following pages).*

CHAPTER 5/COST ACCOUNTING

TABLE 5-5. SAMPLE INDIRECT COST RATE SCHEDULE

SAMPLE CONSULTING COMPANY, Inc.
Statement of Direct Labor, Fringe Benefits, and General Overhead
For the Year Ended December 31, 201x

Account Number & Description	General Ledger Account Balance	Direct Costs	Disallowed Costs	Proposed Company Wide	% of Direct Labor
DIRECT LABOR	\$ 1,950,501	\$ 1,950,501	\$ -	\$ 1,950,501	100.00%
INDIRECT COSTS:					
FRINGE BENEFITS					
6300 Benefits: Bonuses.....	\$ 234,060	\$ -	\$ (28,560) (a)	\$ 205,500	10.54%
6310 Benefits: 401(k).....	97,525	-	-	97,525	5.00%
6320 Benefits: PTO (vac., sick, and holiday).....	253,565	-	-	253,565	13.00%
6820 Insurance: Disability.....	58,515	-	-	58,515	3.00%
6830 Insurance: Life.....	21,846	-	(800) (b)	21,046	1.08%
6840 Insurance: Medical.....	136,535	-	-	136,535	7.00%
6850 Insurance: Workers' Comp.....	15,799	-	-	15,799	0.81%
7500 Payroll Taxes: FICA and Med.....	180,421	-	-	180,421	9.25%
7510 Payroll Taxes: FUTA and SUTA.....	78,020	-	-	78,020	4.00%
TOTAL FRINGE BENEFITS	\$ 1,076,286	\$ -	\$ (29,360)	\$ 1,046,926	53.67%
GENERAL OVERHEAD					
6700 Indirect Labor.....	\$ 741,190	\$ -	\$ (3,300) (c)	\$ 737,890	37.83%
5010 Direct: Lodging, Meals, and Travel.....	122,101	(122,101)	- (d)	-	0.00%
5020 Direct: Employee Mileage Reimbursements....	159,941	(159,941)	- (d)	-	0.00%
5030 Direct: Rentals and Supplies.....	21,651	(21,651)	- (d)	-	0.00%
5040 Direct: Subconsultants.....	44,862	(44,862)	- (d)	-	0.00%
6000 Advertising and Marketing.....	23,991	-	(6,750) (e)	17,241	0.88%
6100 Automobile Expense.....	68,268	-	(13,580) (f)	54,688	2.80%
6200 Bank Service Charges.....	9,753	-	-	9,753	0.50%
6400 Contributions and Gifts.....	14,629	-	(14,629) (g)	-	0.00%
6500 Depreciation Expense.....	117,030	-	-	117,030	6.00%
6600 Dues and Subscriptions.....	16,189	-	(350) (h)	15,839	0.81%
6800 Insurance: Automotive.....	15,409	-	-	15,409	0.79%
6810 Insurance: Business Liability.....	23,406	-	-	23,406	1.20%
6900 Interest Expense.....	36,084	-	(36,084) (i)	-	0.00%
7000 Licenses and Permits.....	21,456	-	-	21,456	1.10%
7100 Maintenance and Repairs.....	97,135	-	-	97,135	4.98%
7200 Meals & Entertainment.....	19,310	-	(1,050) (j)	18,260	0.94%
7300 Misc. Fees, Fines, Penalties.....	6,827	-	(6,827) (k)	-	0.00%
7400 Office Expense: Cleaning.....	8,192	-	-	8,192	0.42%
7410 Office Expense: Postage and Delivery.....	4,486	-	-	4,486	0.23%
7420 Office Expense: Office Supplies.....	32,183	-	-	32,183	1.65%
7430 Office Expense: Other Office Expense.....	35,889	-	-	35,889	1.84%
7600 Personal Property Tax.....	42,911	-	-	42,911	2.20%
7700 Prof Fees: Accounting and Legal.....	30,428	-	-	30,428	1.56%
7800 Rent.....	180,049	-	(2,400) (l)	177,649	9.11%
7900 Telephone.....	60,466	-	-	60,466	3.10%
8000 Utilities.....	29,472	-	-	29,472	1.51%
Credit for Internal Allocations.....	-	-	(107,278) (m)	(107,278)	-5.50%
TOTAL GENERAL OVERHEAD	\$ 1,983,306	\$ (348,555)	\$ (192,247)	\$ 1,442,505	73.96%
TOTAL INDIRECT COSTS & OVERHEAD RATE	\$ 3,059,593	\$ (348,555)	\$ (221,607)	\$ 2,489,431	127.63%

FAR References and Notes:

- (a) 31.205-6(a)(6)(ii)(B): Owners' compensation in excess of reasonable amount is disallowed (distribution of profits).
- (b) 31.205-19(e)(2)(v): Officers' life insurance is disallowed.
- (c) 31.201-6(e)(2): Marketing, lobbying, and any labor associated with unallowable activities is disallowed.
- (d) 31.202: Excluded direct project costs (both billable & non-billable costs) from indirect cost pool.
- (e) 31.205-1: Costs for general marketing materials are disallowed.
- (f) 31.205-6(m)(2) & 31.205-46(d): Personal use of a company asset (automobile) is disallowed.
- (g) 31.205-8 & 31.205-13(b): Contributions and gifts are disallowed.
- (h) 31.205-22: Lobbying costs, paid as a percentage of professional dues, are disallowed.
- (i) 31.205-20: Interest is disallowed.
- (j) 31.205-14 & 31.205-51: Costs for entertainment and alcoholic beverages are disallowed. (The entertainment cost principle supersedes all others.)
- (k) 31.201-4, 31.205-15, & 31.205-20: Disallowed late fees; Government-imposed fines and penalties; and credit card interest.
- (l) 31.205-36(b)(3): Related-party rent (not an arm's-length transaction) is limited to actual cost of ownership, net of interest and other unallowable items.
- (m) 31.202: Direct costs segregated and removed from indirect cost pool.

CHAPTER 5/COST ACCOUNTING

Table 5-6. SAMPLE INDIRECT COST RATE SCHEDULE (WITH FIELD RATE)

SAMPLE CONSULTING COMPANY, Inc.
Statement of Direct Labor, Fringe Benefits, and General Overhead (with Field Rate)
For the Year Ended December 31, 201x

Account Number & Description	General Ledger Account Balance	Direct Costs	Disallowed Costs	Proposed Company Wide	ALLOCATIONS		
					Proposed Home Office	Proposed Field Office	Percent to Field Office
DIRECT LABOR	\$ 1,950,501	\$ 1,950,501	\$ -	\$ 1,950,501	\$ 1,826,853	\$ 123,648	(n) 6.34%
INDIRECT COSTS:							
FRINGE BENEFITS							
6300 Benefits: Bonuses.....	\$ 234,060	\$ -	\$ (28,560) (a)	\$ 205,500	\$ 193,000	\$ 12,500	(n)
6310 Benefits: 401(k).....	97,525	-	-	97,525	91,255	6,270	(n)
6320 Benefits: PTO (vac., sick, and holiday).....	253,565	-	-	253,565	241,421	12,144	(n)
6820 Insurance: Disability.....	58,515	-	-	58,515	54,806	3,709	6.34%
6830 Insurance: Life.....	21,846	-	(800) (b)	21,046	19,711	1,334	6.34%
6840 Insurance: Medical.....	136,535	-	-	136,535	127,880	8,655	6.34%
6850 Insurance: Workers' Comp.....	15,799	-	-	15,799	14,798	1,002	6.34%
7500 Payroll Taxes: FICA and Med.....	180,421	-	-	180,421	168,984	11,437	6.34%
7510 Payroll Taxes: FUTA and SUTA.....	78,020	-	-	78,020	73,074	4,946	6.34%
TOTAL FRINGE BENEFITS	\$ 1,076,286	\$ -	\$ (29,360)	\$ 1,046,926	\$ 984,928	\$ 61,998	
GENERAL OVERHEAD							
6700 Indirect Labor (G&A and support allocation).....	\$ 741,190	\$ -	\$ (3,300) (c)	\$ 737,890	\$ 680,506	\$ 38,736	(o) 5.25%
6700 Indirect Labor (field labor allocation).....	-	-	-	-	-	18,648	(n)
5010 Direct: Lodging, Meals, and Travel.....	122,101	(122,101)	- (d)	-	-	-	5.25%
5020 Direct: Employee Mileage Reimbursements.....	159,941	(159,941)	- (d)	-	-	-	5.25%
5030 Direct: Rentals and Supplies.....	21,651	(21,651)	- (d)	-	-	-	5.25%
5040 Direct: Subconsultants.....	44,862	(44,862)	- (d)	-	-	-	5.25%
6000 Advertising and Marketing.....	23,991	-	(6,750) (e)	17,241	16,336	905	5.25%
6100 Automobile Expense.....	68,268	-	(13,580) (f)	54,688	51,817	2,871	5.25%
6200 Bank Service Charges.....	9,753	-	-	9,753	9,241	512	5.25%
6400 Contributions and Gifts.....	14,629	-	(14,629) (g)	-	-	-	5.25%
6500 Depreciation Expense.....	117,030	-	-	117,030	117,030	- (p)	
6600 Dues and Subscriptions.....	16,189	-	(350) (h)	15,839	15,008	831	5.25%
6800 Insurance: Automotive.....	15,409	-	-	15,409	14,600	809	5.25%
6810 Insurance: Business Liability.....	23,406	-	-	23,406	22,177	1,229	5.25%
6900 Interest Expense.....	36,084	-	(36,084) (i)	-	-	-	5.25%
7000 Licenses and Permits.....	21,456	-	-	21,456	20,329	1,126	5.25%
7100 Maintenance and Repairs.....	97,135	-	-	97,135	92,036	5,099	5.25%
7200 Meals & Entertainment.....	19,310	-	(1,050) (j)	18,260	17,301	959	5.25%
7300 Misc. Fees, Fines, Penalties.....	6,827	-	(6,827) (k)	-	-	-	5.25%
7400 Office Expense: Cleaning.....	8,192	-	-	8,192	8,192	- (p)	
7410 Office Expense: Postage and Delivery.....	4,486	-	-	4,486	4,486	- (p)	
7420 Office Expense: Office Supplies.....	32,183	-	-	32,183	32,183	- (p)	
7430 Office Expense: Other Office Expense.....	35,889	-	-	35,889	35,889	- (p)	
7600 Personal Property Tax.....	42,911	-	-	42,911	42,911	- (p)	
7700 Prof Fees: Accounting and Legal.....	30,428	-	-	30,428	28,830	1,597	5.25%
7800 Rent.....	180,049	-	(2,400) (l)	177,649	177,649	- (p)	
7900 Telephone.....	60,466	-	-	60,466	57,291	3,174	5.25%
8000 Utilities.....	29,472	-	-	29,472	29,472	- (p)	
Credit for Internal Allocations.....	-	-	(107,278) (m)	(107,278)	(107,278)	- (p)	
TOTAL GENERAL OVERHEAD	\$ 1,983,306	\$ (348,555)	\$ (192,247)	\$ 1,442,505	\$ 1,366,008	\$ 76,497	
TOTAL INDIRECT COSTS	\$ 3,059,593	\$ (348,555)	\$ (221,607)	\$ 2,489,431	\$ 2,350,936	\$ 138,495	
OVERHEAD RATES (as percentages of direct labor cost).....				127.63%	128.69%	112.01%	
				Company Wide	Home Office	Field Office	

FAR References and Notes:

- (a) 31.205-6(a)(6)(ii)(B): Owners' compensation in excess of reasonable amount is disallowed (distribution of profits).
- (b) 31.205-19(e)(2)(v): Officers' life insurance is disallowed.
- (c) 31.201-6(e)(2): Marketing, lobbying, and any labor associated with unallowable activities is disallowed.
- (d) 31.202: Excluded direct project costs (both billable & non-billable costs) from indirect cost pool.
- (e) 31.205-1: Costs for general marketing materials are disallowed.
- (f) 31.205-6(m)(2) & 31.205-46(d): Personal use of a company asset (automobile) is disallowed.
- (g) 31.205-8 & 31.205-13(b): Contributions and gifts are disallowed.
- (h) 31.205-22: Lobbying costs, paid as a percentage of professional dues, are disallowed.
- (i) 31.205-20: Interest is disallowed.
- (j) 31.205-14 & 31.205-51: Costs for entertainment and alcoholic beverages are disallowed. (The entertainment cost principle supersedes all others.)
- (k) 31.201-4, 31.205-15, & 31.205-20: Disallowed late fees; Government-imposed fines and penalties; and credit card interest.
- (l) 31.205-36(b)(3): Related-party rent (not an arm's-length transaction) is limited to actual cost of ownership, net of interest and other unallowable items.
- (m) 31.202: Direct costs segregated and removed from indirect cost pool.
- (n) Field employee labor and fringe specifically identified.
- (o) Indirect general administrative and support labor less identified field portion is allocated.
- (p) Accounts specifically identified as home office only.

CHAPTER 5/COST ACCOUNTING

TABLE 5-7. FIELD OFFICE COMPUTATIONS

Field Employee Worksheet						
Employee Name & Classification	Direct Labor	Indirect Labor (general)	Bonuses (fringe benefit)	401(k) (fringe benefit)	Paid Time Off (fringe benefit)	Field-Specific Totals
Name 1 - Project Manager	-	10,920	-	-	-	10,920
Name 2 - Senior Engineer	50,176	3,136	7,500	2,620	4,928	68,360
Name 2 - Project Engineer	41,216	2,576	3,500	1,966	4,048	53,306
Name 4 - Technician 1	32,256	2,016	1,500	1,685	3,168	40,625
	<u>123,648</u>	<u>18,648</u>	<u>12,500</u>	<u>6,270</u>	<u>12,144</u>	<u>173,210</u>

Field Office Direct Labor Calculation	
Direct Labor (Field Office)	123,648
	÷
Total Direct Labor (Home + Field)	<u>1,950,501</u>
Direct Labor Based Field %	<u>6.34%</u>

Field Office Labor Calculation		
	Company Wide	Field Office
Direct Labor	1,950,501	123,648
PTO (vacation/sick/holiday)	253,565	12,144
Indirect Labor	<u>737,890</u>	<u>18,648</u>
Totals	<u>2,941,957</u>	<u>154,440</u>
		÷
Total Company Labor		<u>2,941,957</u>
General Overhead Field %		<u>5.25%</u>

6

Chapter 6—Labor-Charging Systems and Other Considerations

The purpose of this chapter is to provide interpretive guidance only. This chapter is not intended to be authoritative or to supersede the FAR. The entire text of the FAR should be consulted when determining proper accounting treatment.

6.1—Background

Compensation for personal services is one of the largest components of cost incurred under Government contracts. It includes all remuneration paid currently or accrued, in whatever form, for services rendered by an engineering consultant's employees during contract performance.

The objective of a compensation system is to provide the level of pay and benefits necessary to attract, retain, and motivate employees to direct their efforts toward achieving the goals of the organization. To be considered adequate, an engineering consultant's compensation system must be reliable, be subject to applicable management control objectives and activities, and must result in allocable, allowable, and reasonable compensation costs to be charged to Government contracts in accordance with FAR provisions.

6.2—Labor Costs, Generally

As discussed previously in Chapter 5, labor costs typically are the most significant costs allocated to Government contracts and usually comprise the base used for allocating indirect costs. Historical labor costs frequently are used to estimate labor for follow-on or similar item Government contracts.

Unlike other cost items, labor is not supported by third party documentation such as an invoice, purchase order, or receipt. Instead, consultants' employees have complete control over the documents or devices of original entry, whether consisting of timecards, electronic media, or some other means.

Responsibility for labor reporting is diffused throughout the engineering consultant's organization. Consequently, there are significant risks associated with the accurate recording, distribution, and payment of labor costs.

6.3—Allowability and Reasonableness of Indirect Labor

[Reference: FAR 31.201-3]

Labor cost may take one of two paths—either as a direct charge to a project, or as an indirect charge to overhead. When consultants use an overhead rate to recover indirect costs, Government contracts will participate in these costs. To assess the reasonableness of the labor cost pools in accordance with FAR 31.201-3, State DOTs may apply productivity or efficiency measurements. These measurements are compared to industry standards or State DOTs' expectations to assess the reasonableness of the submitted labor costs.

Productivity and/or other efficiency measures may be used by a State DOT to assess the reasonableness of a consultant's labor distribution. If indirect labor appears to be unreasonably high, then the State DOT may make further inquiries of the consultant, may perform additional analytical procedures, and/or may conduct intensive labor testing.

Conversely, consultants must consistently monitor the recording of direct and indirect labor cost to ensure accuracy and must monitor staffing levels to ensure the maximum utilization of employees to minimize excess or idle capacity. Productivity or efficiency measurements consistently below industry standards should warrant discussions between the consultant and the State DOT(s). However, this type of ratio/measurement should not be used as the sole measure of reasonableness.

Note: Two areas of indirect labor costs, Bid and Proposal costs and Selling costs, provide consistent areas of concern to State DOTs and audit agencies. The allowability of these costs is discussed specifically below.

A. Bid and Proposal Costs (B&P)

[References: FAR 31.205-18, CAS 420.30(a)(2), CAS 420]

1. Definition

FAR 31.205-18(a) and CAS 420.30(a)(2) provide that Bid and Proposal (B&P) costs are the—

[E]xpenses incurred in preparing, submitting, and supporting bids and proposals (whether or not solicited) on potential Government or non-government contracts, provided that the effort is neither sponsored by a grant, nor required in the performance of a contract.

FAR 31.205-18(b) further provides that all contracts, regardless of whether full CAS coverage applies, are subject to the cost identification and accumulation provisions of CAS 420.

2. Identification and Accumulation of B&P

As further discussed in CAS 420, consultants must identify and accumulate B&P costs by individual projects. CAS 420 also requires that costs for B&P projects be accounted for in the same manner as contracts and include costs that would be treated as direct costs of that contract, if incurred in like circumstances, and all allocable indirect costs, with the exception of general and administrative expenses. For example, if a consultant charges clerical and technical support costs directly to final cost objectives, then it must also charge them directly to B&P projects. If, however, the consultant charges these costs to indirect cost pools, such costs incurred in support of B&P efforts also should be allocated to indirect cost pools.

3. Efforts Sponsored by Grant or Required by Contract

In accordance with the B&P definition at FAR 31.205-18(a), any efforts that are “sponsored by a grant or required in the performance of a contract” are not B&P. Accordingly, consultants must not include costs in the B&P cost pools for developmental efforts that are specifically required in the performance of a contract, or those efforts that are not explicitly stated in the contract but are necessary to perform the contract.

- Consultants must consistently require senior managers and executives to accurately track and record their time associated with B&P activities as required by CAS 420. *This issue is of particular concern, as many executives and managers do not track B&P activities separately from other overhead functions.*
- The consultant should establish clear guidance regarding the specific activities that comprise B&P activities and should ensure that all staff members are adequately trained. The consultant should regularly monitor the time coded by senior managers and executives to B&P activities to determine the accuracy of efforts expended. Labor costs associated with B&P activities should be clearly identified and must be segregated from other indirect labor activities.

B. Selling Effort and Activities

This section contains general guidance in determining the allocability, allowability, and reasonableness of selling costs under Government contracts, as discussed in FAR 31.205-38.

1. Direct Selling

[Reference: FAR 31.205-38(b)(5)]

Direct selling is characterized by person-to-person contact and includes such efforts as familiarizing a potential customer with the consultant's products or services, conditions of sale, service capabilities, and similar items. It also includes negotiation, liaison between customer and consultant personnel, technical and consulting efforts, individual demonstrations, and any other efforts having as their purpose the application or adaptation of the consultant's products or services for a particular customer's use. Generally, the costs of direct selling efforts are allowable.

2. Brokerage Fees, Commissions, and Similar Costs

[Reference: FAR 31.205-38(c)]

Notwithstanding any other provision of FAR 31.205-38, sellers' or agents' compensation, fees, commissions, percentages, retainer or brokerage fees, whether or not contingent upon the award of contracts, are allowable only when paid to bona fide employees or established commercial or selling agencies maintained by the consultant for the purpose of securing business.

3. Other Cost Principles Related to Selling Efforts

[References: FAR 31.205-1, FAR 31.205-12, FAR 31.205-14, FAR 31.205-18, FAR 31.205-27, FAR 31.205-38, CAM Section 7-1200, CAM Section 7-1500]

The nature of costs classified and allocated as selling expense should be compatible with the provisions of FAR 31.205-38. Although the generic term "selling" encompasses all effort to market a consultant's products, the acceptability of the costs of this effort is governed by several subsections of FAR 31.205. Costs that fall into the following categories should be classified accordingly. These costs should be evaluated using the appropriate subsection of FAR 31.205 as discussed below:

- **Advertising Costs (FAR 31.205-1 & -38).** Also see DCAA Contract Audit Manual Section 7-1200. In most instances, allowable advertising is limited to help-wanted advertisements.
- **Corporate Image Enhancement and Public Relations Costs (FAR 31.205-1 & -38).** Also see DCAA Contract Audit Manual Section 7-1200.
Allowable public relations costs include the following examples: costs specifically required by contract, costs of communicating with the public, costs for participating in community service activities, and costs of plant tours and open houses (excluding any entertainment costs associated with these efforts).
Unallowable public relations costs include costs for disseminating messages calling favorable attention to the firm's products or services; most costs for trade shows; and costs of sponsoring meetings, conventions, seminars, and other events when the principal purpose of the event is other than the dissemination of technical information or the stimulation of production.
- **Bid and Proposal/Independent Research and Development Costs (FAR 31.205-18).** Also see DCAA Contract Audit Manual Section 7-1500. These costs generally are allowable, subject to the limitations provided in FAR 31.205-18.
- **Entertainment Costs (FAR 31.205-14).** Entertainment costs are expressly unallowable, regardless of the purpose or intent of the entertainment. Costs made specifically unallowable under FAR 31.205-14 are not allowable under any other cost principle.
- **Long-Range Market Planning Costs (FAR 31.205-12).** Costs associated with general long-range management planning are allowable; however, organizational or reorganizational costs are unallowable (see FAR 31.205-27 for more details).

4. Recordkeeping Requirements

[References: FAR 31.201-2(d)]

Pursuant with FAR 31.201-2(d), consultants must maintain adequate records to demonstrate that claimed costs have been incurred and are allocable to the FAHP contracts. Accordingly, consultants must require all employees, including senior managers and executives, to maintain a contemporaneous record of all time devoted to selling activities. To accomplish this, the consultant must establish clear guidance regarding the specific activities that comprise selling activities and must ensure that all staff members are adequately trained.

Note: The consultant must regularly monitor the time recorded by all employees, including senior managers and executives, to determine the accuracy of efforts expended. Labor costs associated with selling activities must be easily identified and must be segregated from other indirect labor activities.

6.4—DCAA Accounting Guide

[References: FAR 31.002, DCAAP No. 7641.90]

The Defense Contract Audit Agency (DCAA) issued Pamphlet No. 7641.90 (DCAAP 7641.90), *Information for Contractors*.¹⁴ The DCAAP provides useful guidance but does not have the effect of law. The DCAAP is referenced at FAR 31.002 and provides extensive guidance regarding labor-charging systems. Specifically, sections 2-301 through 2-302.2 provide guidance regarding the—

- Accounting system,
- Labor charging system,
- Timecard preparation methods, and
- Timekeeping policy.

Note: Pertinent sections of DCAAP No. 7641.90 have been extracted and paraphrased below for emphasis and further discussion.

A. Accounting System Internal Control

When performing work in connection with Government contracts, it is essential for engineering consultants to maintain an operable accounting system under general ledger control. A properly designed system includes the following attributes:

- Proper segregation of direct costs and indirect costs.
- Identification and accumulation of direct costs by cost objective/contract.
- A logical and consistent method for allocating indirect costs to intermediate and final cost objectives.
- Accumulation of costs under general ledger control.
- A timekeeping system that identifies employees' labor by intermediate and final cost objectives.
- A labor distribution system that charges direct and indirect labor to the appropriate cost objectives.
- Interim (at least monthly) determination of costs charged to a contract through routine posting to books of account.
- Exclusion from costs charged to Government contracts of amounts that are not allowable pursuant to FAR Part 31 or other contract provisions.
- Identification of costs by appropriate units, if required by the contract.

¹⁴ Dated January 2005. The DCAAP is available via the Internet at <http://www.dcaa.mil/chap6.pdf>.

B. Labor Charging System Internal Control

1. Generally

The key link in any sound labor time charging system is the individual employee. It is critical to labor charging internal control systems that management indoctrinates employees on their independent responsibilities for accurately recording time charges. This is the single most important feature management can emphasize in recognizing its responsibility to owners, creditors, and customers to guard against fraud and waste in the labor charging function.

To be effective, the internal controls over labor charging should meet the following criteria:

- The engineering consultant should have adequate segregation of duties for labor-related activities; for example, the responsibility for timekeeping and payroll accounting should be separated.
- Supervisors who are accountable for meeting contract budgets should not have the opportunity to initiate employee time charges. (It is recognized that, for a very small company, this type of segregation may not be possible, whereas for a larger company, this type of segregation would be required in order to have good internal controls over labor costs.)
- The engineering consultant's procedures and controls must be evident, well defined, and reasonable so there is no confusion concerning the reason for the controls and no misunderstanding as to what is and what is not permissible.
- The engineering consultant must continuously maintain the controls and verify their effectiveness. Controls must be updated to correct any deficiencies, and violations must be remedied through prompt and effective action to serve as a deterrent to prospective violations.
- Individual employees must be constantly, although unobtrusively, made aware of controls that act as an effective deterrent against violations. Many businesses accomplish this by emphasizing the importance of timecard preparation in staff meetings, employee orientation, and through the posting of signs throughout the workplace to remind employees of the importance of accurate and current timecards.
- The engineering consultant should have a system of feedback to provide employees with opportunities to report to management any suspected mischarging or violations of the consultant's system of internal controls, with anonymity guaranteed.

2. Timecard Preparation

The engineering consultant should provide detailed instructions for timecard preparation in a timekeeping pamphlet and/or company procedure. Specific issues associated with automated and manual timecard systems are provided below:

(a) Automated Timekeeping System. When an automated timekeeping system is in place, procedures should provide for the accurate and current recording of labor hours by authorized employees, as well as appropriate controls to ensure corrections to labor charges are accurate and authorized. Generally, controls should be in place to ensure the following:

- Only the employee uses his or her labor charging instrument to access the labor system.
- Changes are initialed, authorized, and dated by the employee and supervisor and include a description of the reason for the change. This may be done electronically.
- A verifiable audit trail process is in place that collects all initial entries and subsequent changes.
- When an engineering consultant uses an employee badge system, badge issuance must be sufficiently controlled so that no badge number is duplicated and badges are not issued to unauthorized persons. Additionally, procedures must be in place to require employees to report lost badges promptly.

(b) Manual Timekeeping System. When a manual system is in place, procedures should provide for the accurate and complete recording of labor hours, as well as appropriate controls to ensure corrections to labor records are accurate and authorized. Generally, controls should be in place to ensure—

- Supervisory observation of employee arrival and departure to prevent improper clock-in/clock-out.
- Employee possession of timecard/timesheet.
- The employee prepares his or her timecard/timesheet in ink, as work is performed.
- Only one timecard/timesheet is prepared per employee per period; timecards/timesheets are preprinted with employee name and identification number; and timecards/timesheets are submitted to the designated timekeeping office or are collected by an authorized person.
- Pre-coded data is printed on job cards for identification purposes (e.g., codes for various leave types or indirect labor).
- Direct labor employees record their time no less often than daily. Sufficient formal subsidiary records must be maintained, if necessary, to ensure accuracy in labor recording and the proper allocation of labor costs to intermediate and final cost objectives when multiple jobs are worked in a day.
- Corrections are made in ink, initialed by the employee, properly authorized, and provide a sufficient and relevant explanation for the correction.
- The correct distribution of time by project numbers, contract number or name, or other identifiers for a particular assignment. To ensure accuracy, a listing of project numbers and their descriptions should be provided in writing to the employee.
- Recording all hours worked whether they are paid or not. This is necessary because labor costs and associated overheads are affected by *total* hours worked, not just paid hours worked. Therefore, labor rate computations and labor overhead costs should reflect all hours worked. Unpaid hours worked are termed “uncompensated overtime.”
- Employees and supervisors sign the timecards/timesheets in accordance with procedures, verifying the accuracy of the recorded effort.
- The job cost system is reconciled to the general ledger on a regular and consistent basis. This reconciliation should occur no less frequently than once every 30 days.

Note: A labor-charging checklist is attached at the end of this chapter to assist engineering consultants and accounting professionals in the assessment of the engineering consultant's labor-charging system. (See Table 6-1.)

3. Timekeeping Policy

The engineering consultant should implement a written policy that requires the following:

- Supervisors must approve and cosign all timecards.
- The supervisor is prohibited from completing an employee's timecard unless the employee is absent for a prolonged period of time on some form of authorized leave. If the employee is on travel status, the supervisor for the employee may prepare a time sheet. Upon his or her return, the employee should turn in his/her time sheet and attach it to the one prepared by the supervisor.
- The guidance should state that the nature of the work determines the proper distribution of time, not availability of funding, type of contract, or other factors. Accordingly, direct labor hours must be assigned to the cost objective/project that caused the hours to be incurred, regardless of whether the hours are billable to clients. Non-billable labor hours may not be allocated, or later reassigned, to other projects or to overhead.
- Procedures must be established to verify that the total labor hours reflected in labor distribution summaries agree with the total labor charges as entered into the timekeeping and payroll systems. This reconciliation attests that the labor charges to contracts represent actual paid or accrued costs and such costs are appropriately recorded in the accounting records. Each employee's time charge should be distributed as recorded, regardless of whether all the labor is billable to clients.

- The company policy should state that the accurate and complete preparation of timecards is a part of each employee's job. The policy also should state that careless or improper preparation of timecards may lead to disciplinary actions under company policies and/or applicable State and Federal statutes.

6.5—Compliance and Review

Auditors are encouraged to apply the requirements of DCAAP 7641.90 to their examinations of engineering consultants' labor-charging systems, as State DOTs may challenge any FAR audit or attestation engagement that does not adequately address the reliability and accuracy of a consultant's labor-charging system. In the absence of any deficiencies noted in such examinations, State DOTs generally will accept audit opinions that are developed in compliance with DCAAP criteria. This includes attestations or audits performed by independent CPAs or Government auditors, such as the DCAA.

TABLE 6-1. LABOR-CHARGING CHECKLIST

Model Characteristics of Labor-Charging Systems:		Yes	No	N/A	Note
● Is there segregation of responsibilities for labor-related activities? For example, the responsibility for timekeeping and payroll accounting should be separated.					
● Do supervisors who are accountable for meeting contract budgets have the opportunity to initiate employee time charges? (It is recognized that, for a very small company, this type of segregation may not be possible, whereas for a larger company, this type of segregation would be required in order to have good internal controls over labor costs.)					
● Are individual employees routinely made aware of controls that act as effective deterrent against violations? Many businesses accomplish this by emphasizing the importance of timecard preparation in staff meetings, employee orientation, and through posting of signs throughout the workplace that reminds employees of the importance of accurate and current timecards.					
● Were detailed instructions for timecard preparation established through a timekeeping pamphlet and/or company procedure?					
● If a manual system is in place, were instructions published to inform employees that they are personally responsible for the following?					
(1) Recording his/her time on a daily basis.					
(2) Recording time on the timecard in ink.					
(3) The correct distribution of time by project numbers, contract number or name, or other identifiers for a particular assignment. To ensure accuracy, a listing of project numbers and their descriptions should be provided in writing to the employee.					
(4) Changes to the timecard. All changes should be lined through, with the employee's initials beside the change indicating the employee personally made the change and that the change is correct.					
(5) Recording all hours worked whether they are paid or not. This is necessary because labor costs and associated overheads are affected by total hours worked, not just paid hours worked. Therefore, labor rate computations and labor overhead costs should reflect all hours worked. Unpaid hours worked are termed "uncompensated overtime."					
(6) Signing the timecard at the end of each work period.					
● Do supervisors approve and cosign all timecards?					
● Are supervisors prohibited from completing an employee's timecard unless the employee is absent for a prolonged period of time on some form of authorized leave?					
● If the employee is on travel status, the supervisor for the employee may prepare a timesheet. Upon the employee's return, does the employee turn in his/her time sheet and attach it to the one prepared by the supervisor, or does the firm in some other way document the reason why the employee did not prepare and sign the original timesheet?					
● Does the consultant's published guidance/policy state that the nature of the work determines the proper distribution of time, not availability of funding, type of contract, or other factors? (Does the consultant emphasize that the proper characterization/categorization of labor hours is not dependent upon whether such labor hours are billable to a client?)					
● Does the consultant's policy state that the accurate and complete preparation of timecards is a part of each employee's job?					
● Does the consultant's policy state that careless or improper preparation of timecards may lead to disciplinary actions under company policies as well as applicable Federal statutes?					
Evaluation of Accounting System - Critical Elements:					
● Does the consultant's accounting system provide for proper segregation of direct and indirect costs?					
● Does the accounting system provide for identification and accumulation of direct costs by cost object (contract)?					
● Does the accounting system provide for a logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives? (A contract is a final cost objective).					
● Does the accounting system articulate with a timekeeping system that identifies employees' labor by intermediate or final cost objectives?					
● Does the accounting system include interim (at least monthly) determination of costs charged to contracts through routine posting of books of account (i.e., project data is transferred from the labor distribution system to the cost accounting system)?					
● Does the accounting system include controls to exclude from costs charged to government contracts amounts that are unallowable, per the Cost Principles of FAR Part 31 and/or other applicable laws or regulations, including state audit guidance?					
● Is the accounting system currently in full operation? If not describe which portions of the system are:					
(1) operational;					
(2) set up, but not yet operational;					
(3) anticipate to be placed into operation; or					
(4) nonexistent.					
Final Assessment of Consultant's Accounting System:					
<input type="checkbox"/> Fully Acceptable.					
<input type="checkbox"/> Provisionally Acceptable - Describe requirements for status to be changed to Fully Acceptable.					
<input type="checkbox"/> Unacceptable.					