MDOT 32nd Annual CONFERENCE 1980 - 2012

Indirect Rates

What are Indirect Rates?

- Indirect rates are designed to provide a method for full cost recovery
- Indirect rates are an equitable, logical and consistent process for allocating costs not directly associated with a single contract, project or cost objective
- Indirect rates are calculated as percentages and applied to project cost/cost objectives

- Generally Calculated as:

Indirect Costs / Direct Labor = Indirect Rate

Indirect costs

FAR 31.203

- Incurred for common objectives
- Incurred to support the organization as a whole
- Identified with two or more final cost objectives
- Remainder of costs to be allocated after direct costs are identified and assigned to projects
- Examples include:
  - Depreciation or use allowance on buildings and equipment
  - Burden on labor, insurance, fringes, etc.
  - General administration and general expenses (e.g., salaries and expenses of executive officers, personnel administration, and accounting)

ALLOWABLE VS. UNALLOWABLE

Determining what costs may be charged to contracts

Basics of Allowable Costs

FAR 31.202-2

- Allowable costs are:
  - Reasonable
  - Allocable
  - In conformity with Cost Accounting Standards and Generally Accepted Accounting Principles
  - In accordance with contract terms
  - In compliance with FAR Part 31 Cost Principles

Accounting for Unallowable Costs

FAR 31.201-6

- Exclude unallowable costs from billings, claims, or proposal applicable to Government contract
- Unallowable <u>indirect</u> costs should be <u>excluded</u> from the indirect rate calculation
- Unallowable <u>direct</u> costs **<u>must be included</u>** in base when calculating and allocating indirect rates
- Even though costs may be legitimate business expenses, they must meet allowable criteria

Types of Unallowable Costs

- General FAR Part 31 Criteria
  - Costs that do not meet the reasonableness test
  - Costs that do not meet the allocability requirements
- Based on Public Policy
  - Example: Alcohol
- Prescribed Limitations
  - Example: Executive Compensation; travel in excess of federal limits
- Based on Nature of Activity
  - Example: Lobbying Activities, entertainment, charitable contributions, bad debt
- Directly associated costs to an unallowable activity
  - Example: Travel for a lobbying effort

Common Unallowable Costs

Reference	Unallowable Costs
• 31.205-1 & 31.205-38(b)(1)	Advertising
• 31.205-1(f)(2)	Trade Show Expenses
• 31.205-1(f)(2)	Trade Show Labor
• 31.205-1(f)(5)	Brochures and Other Promotional Material
• 31.205-1(d)(2)	Souvenirs/Imprinted Clothing Provided to Public
• 31.205-1(f)(7)	Membership in Civic and Community Organizations
• 31.205-3	Bad Debts
• 31.205-3	Collection Costs
• 31.205-6(m)(2)	Personal Use of Company Vehicles
• 31.205-8 & 31.205-1(e)(3)	Contributions or Donations
• 31.205-13(b)	Employee Gifts and Recreation
• 31.205-14	Membership in Social, Dining, and Country Clubs
• 31.205-14	Social Activities
• 31.205-15(a)	Fines, Penalties, and Mischarging Costs Related to Violation of Laws

Common Unallowable Costs

31.205-19(e)(2)(v)	Life Insurance on Key Employees
31.205-19	Costs to Correct Defects in Materials and Workmanship
31.205-20	Interest Expense
31.205-22	Lobbying and Political Activity Costs.
31.205-27	Organization/Reorganization Legal Fees
31.205-27	Organization/Reorganization Accounting Fees
31.205-27	Organization/Reorganization Incorporation Fees
31.205-27	Organization/Reorganization Labor
31.205-27	Capital Raising (Equity or Long-Term Debt) Legal Fees
31.205-27	Capital Raising (Equity or Long-Term Debt) Accounting Fees
31.205-27	Capital Raising (Equity or Long-Term Debt) Lender Fees
31.205-30(c)	Patent Costs
31.205-33(e)	Retainer Agreements (unless properly supported)
31.205-35	Relocation Costs (in certain circumstances)
31.205-46	Travel Costs in Excess of FTR Rates
31.205-49	Goodwill
31.205-51	Alcoholic Beverages

REASONABLENESS

FAR 31.201-3

Reasonableness

FAR 31.201-3

(a) **A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.** Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. **No presumption of reasonableness shall be attached to the incurrence of costs by a contractor**. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, **the burden of proof shall be upon the contractor to establish that such cost is reasonable.**

Reasonableness

FAR 31.201-3

(b) What is reasonable depends upon a variety of considerations and circumstances, including—

(1) Whether it is the type of cost generally recognized as **ordinary and necessary** for the conduct of the contractor's business or the contract performance;

(2) **Generally accepted sound business practices**, arm's length bargaining, and Federal and State laws and regulations;

(3) **The contractor's responsibilities** to the Government, other customers, the owners of the business, employees, and the public at large; and

(4) Any significant deviations from the contractor's established practices

Audit Preparedness

Helpful advice

Audit Preparedness:

- DOCUMENT, DOCUMENT, DOCUMENT!
- Keep all records relating to costs reported to MDOT for the contractual record retention period or the period designated by the FAR.
  - General Ledgers
  - Timesheets
  - Job cost information
  - Overhead rate information

Audit Documentation Examples

- Make sure all costs can be supported, and tied to the business (not personal).
- Mileage logs need to be kept
- Owners need to keep timesheets (“administration” or “indirect” is not a good entry)
- Meals/entertaining should include attendees/business purpose
- The federal regulations have auditors disallow just about ANYTHING that is not supported / documented / proven to be business related
  - Meaning repayment to MDOT

Helpful Advice

Make use of a qualified CPA or CPA firm

- Overhead audits increase certainty and reduce future adjustments for noncompliance (*adjustments to overhead rates*)
  - Less chance of a major adjustment several years down the road
- Reduce the amount of time that OCA is on site
  - OCA can perform reviews of the CPA/auditor's workpapers in accordance with AASHTO guidance
- Reduce likelihood that OCA will find noncompliance and make adjustments
  - If OCA's workpaper review determines that an audit was satisfactory, OCA will likely perform considerably less work

Other Benefits to CPA's

- "Bolt on" services from firms performing audits can:
  - Help select and set up accounting software
  - Assist in efforts to comply with the federal regulations and contract terms
  - Maximize your profits, find better ways to bill, perhaps find more costs to bill

- Fees for CPA services are generally 100% reimbursable through overhead, meaning you *can* recover *all* of the associated costs
  - Audits do not have to be expensive
    - If you are easy to audit, costs will likely be considerably less

- NOTE: Hire a Qualified firm
  - Make sure the CPA firm has a CURRENT peer review certificate, meaning within the last three years

NON-COMPLIANCE

Non-Compliance

- Significant noncompliance with Federal Regulations and contract terms can lead to unfavorable consequences
  - Significant adjustments
  - FHWA Office of Inspector General
  - Loss of prequalification
  - Suspension/Debarment