

**Arkansas Highway & Transportation Department**  
**Indirect Cost Rate Audit Requirements**

Revised February 22, 2002

***Necessity***

The following revision to the Indirect Cost Rate Audit Requirements of the Arkansas Highway and Transportation Department (hereinafter referred to as the Department) is a departure from the previous policy that allowed consultants and sub-consultants to submit a review of their overhead rates. The scope of a review is less than an **audit\*** and does not meet the requirements of Generally Accepted Government Auditing Standards (GAGAS), the “Yellow Book” necessary to assure compliance with 23 CFR 172.5(C), Pre-negotiation Audits. Therefore, an **audit\*** will be required for any future contracts not currently under negotiation.

***Applicability***

The requirements apply to **all engineering and design related service contracts, including sub-consultants**, entered into by the Department that are financed with Federal-aid highway funds and meet the following criteria:

- a. The contract provides for an upper limit of at least \$250,000.00 including all costs and fees.
- b. The contract upper limit is less than \$250,000.00 and:
  - i. There is insufficient knowledge of the consultant’s accounting system.
  - ii. There is previous unfavorable experience regarding the reliability of the consultant’s accounting system.
  - iii. The contract involves procurement of new equipment or supplies for which cost experience is lacking.

The requirements apply to all engineering related consultant agreements regardless of method of payment, including *cost plus fixed fee, lump sum, and specific rate of compensation*. Although agreements that provide for *lump sum or specific rates of compensation* will not include overhead data, this information is necessary for the Department’s contracting officer to evaluate the reasonableness of the cost shown in the proposal.

***Guidelines***

The Federal Highway Administration has approved the use of the Uniform Audit & Accounting Guide for Audits of Transportation Consultant’s Indirect Cost Rates prepared by the AASHTO Audit Subcommittee. The guide does not establish auditing procedures or amend any Federal or State regulations. It was created to provide any auditor conducting an audit of “for profit” consultants with “*tools to assist them in understanding terminology, policies, audit techniques, and sources for regulations and specific procedures*”.

An electronic version of this guide can be found at the FHWA home page:

**<http://www.fhwa.dot.gov/resourcecenters/southern/finance.htm>**

***Requirements***

1. An independent Certified Public Accountant (CPA) must perform the audit based on **the most recent fiscal year for which the cost data is available**, and in accordance with Generally Accepted Government Auditing Standards. A rate **audited**\* by another State, Local, or Federal Agency is acceptable if the supporting data is current, of sufficient detail and in accordance with Generally Accepted Government Auditing Standards.
2. The report shall be accompanied by a schedule showing direct labor; indirect cost by account description in the consultant's general ledger; adjustments for unallowable costs with reference to the applicable sections of **48 CFR 31, Federal Acquisition Regulations, (FAR), the Cost Principles for "For Profit Organizations"**; net allowable indirect costs; the total of these allowable costs, and the rate resulting from dividing total allowable costs by direct labor. Other data considered significant by the auditor may be included in the schedule. An example is attached to this document and can be found in the Uniform Audit & Accounting Guide for Audits of Transportation Consultant's Indirect Cost Rates.
3. The report shall meet the reporting guidelines provided in applicable sections of the Generally Accepted Government Auditing Standards, and shall include **positive assurance** that all costs included in the recommended rate are allowed by **48 CFR part 31**. In addition, the report must state that the consultant's accounting system is adequate for accurately accumulating and distributing costs to the proper cost objectives.
4. The auditor must include in his/her report that the consultant's knowledge of Federal cost eligibility and documentation requirements were satisfactory. If the consultant needs additional guidance concerning these requirements, the auditor should clearly explain what shortcomings exist so the consultant can correct the problem prior to incurring costs.

### ***Special Considerations***

If it is in the best interest of the Arkansas Highway and Transportation Department to enter into a contract with an engineering firm that does not have an overhead rate meeting the above requirements, the contracting officer may extend a temporary waiver of the requirements and accept a provisional rate if the professional integrity of the consultant is known to be adequate.

In order for a temporary waiver of the requirements to be granted, the Department's Chief Fiscal Officer must review the provisional rate and make a positive recommendation to the contracting officer. Also, the cost proposal must be accompanied by written assurance from an independent CPA that he/she has been engaged to audit the costs in accordance with the above requirements.

The anticipated audit must be based on costs incurred in the most recently completed fiscal year, with the audit scheduled to begin within a reasonable time frame. If the date of the initial cost proposal is within the last quarter of the current fiscal year, the audit may be delayed until the current fiscal year is closed and the final cost data is available. The written assurance from the CPA that he or she has been engaged to perform the audit at an appropriate time is still required.

Once an audited rate is approved, the upper limits provided for in the initial agreement will be adjusted with a supplemental agreement to implement the resulting increase or decrease in

overheads, and all amounts paid the consultant prior to receipt and acceptance of an audited rate will be retroactively adjusted for changes in the rate. However, no changes in hours, fixed fees, or other costs will be allowed as a result of applying the audited rate.

***Field and Division Office Rates***

It is often necessary for the prospective consultant to establish a field office or use employees assigned to a division office. In either case, the consultant must submit a rate for these divisions that has been subjected to the same audit requirements as the corporate rate.

The Uniform Audit & Accounting Guide for Audits of Transportation Consultant's Indirect Cost Rates addresses the treatment of field office rates in chapter 4.

*\*Audit/Audited means an audit as described in Generally Accepted Government Auditing Standards issued by the Comptroller General of the United State. A review, or any examination that is less in scope than an audit will no longer be accepted unless approved in writing by the Arkansas Highway & Transportation Department's contracting officer.*

Recommended: \_\_\_\_\_ Date \_\_\_\_\_  
Chief Fiscal Officer

Approved: \_\_\_\_\_ Date \_\_\_\_\_  
Chief Engineer

## Example:

### Schedule of Direct Labor, Fringe Benefits and General Overheads

The following sample Schedule of Indirect Costs including the FAR references and descriptions is recommended for use by state transportation department auditors and public accounting firms when performing indirect cost audits of engineering consulting firms.

Sample Engineering, Inc.  
Schedule of Direct Labor, Fringe Benefits and General Overheads  
For the Year Ended December 31, 2001

<u>Account Description</u>	<u>Account Total</u>	<u>Adjustments</u>	<u>FAR Reference</u>	<u>Allowed</u>	<u>Percent</u>
<b><u>Direct Labor</u></b>	\$1,039,290.00	\$3,245.00 (1)	31.202	\$1,042,535.00	100.00%
<b><u>Fringe Benefits</u></b>					
Unemployment Taxes	\$13,328.00			\$13,328.00	1.28%
FICA Taxes	\$120,694.00			\$120,694.00	11.58%
Bonuses	\$30,209.00	(\$6,625.00)	(2) 1.202/31.205-6(f)	\$23,584.00	2.26%
Health & Dental Insurance	\$101,246.00			\$101,246.00	9.71%
401k Expense	\$28,702.00			\$28,702.00	2.75%
<b>Total Fringe Benefits</b>	<b>\$294,179.00</b>	<b>(\$6,625.00)</b>		<b>\$287,554.00</b>	<b>27.58%</b>
<b><u>General Overhead</u></b>					
Indirect Labor	\$676,825.00	\$1,179.00	31.202/31203	\$678,004.00	65.03%
Utilities	\$52,836.00			\$52,836.00	5.07%
Vehicle Expenses	\$36,405.00			\$36,405.00	3.49%
Legal & Accounting	\$20,101.00	(\$7,762.00)	31205-27(a)	\$12,339.00	1.18%
Office Supplies	\$41,624.00			\$41,624.00	3.99%
Repairs & Maintenance	\$9,511.00			\$9,511.00	0.91%
Equipment Lease	(\$3,002.00)			(\$3,002.00)	-0.29%
Dues & Subscriptions	\$10,256.00	(\$398.00)	31.205-14	\$9,858.00	0.95%
Travel	\$2,910.00			\$2,910.00	0.28%
Shipping & Postage	\$13,269.00			\$13,269.00	1.27%
Payroll Charges	\$1,838.00			\$1,838.00	0.18%
Rent	\$136,939.00	(\$18,000.00)	Rel. Party Trans.	\$118,939.00	11.41%
Licenses & Permits	\$5,280.00			\$5,280.00	0.51%
Depreciation	\$60,114.00	(\$3,802.00)	31.202/31205-49	\$56,312.00	5.40%
Outside Services	\$361,553.00	(\$300,019.00)	31.202	\$61,534.00	5.90%
Insurance	\$83,651.00			\$83,651.00	8.02%
Education	\$6,346.00			\$6,346.00	0.61%
Business Meetings	\$6,396.00			\$6,396.00	0.61%
Environmental & Survey Sup.	\$22,419.00			\$22,419.00	2.15%
Vehicle Lease	\$55,068.00			\$55,068.00	5.28%
Assessments	\$5,750.00			\$5,750.00	0.55%
Printing Expense	\$8,593.00			\$8,593.00	0.82%
Taxes	\$32,439.00			\$32,439.00	3.11%
<b>Total General Overhead</b>	<b>\$1,647,121.00</b>	<b>(\$328,802.00)</b>		<b>\$1,318,319.00</b>	<b>126.45%</b>
<b>Total Indirect Costs</b>	<b>\$1,941,300.00</b>	<b>(\$335,427.00)</b>		<b>\$1,605,873.00</b>	<b>154.04%</b>
<b>Facilities Capital Cost of Money</b>	<b>\$13,376.00</b>			<b>\$13,376.00</b>	<b>1.28%</b>

*Note: In the event that the consultant uses multiple rates, such as separate field office rates, they must be disclosed in the Schedule of Direct Labor, Fringe Benefits and General Overheads. Also, complete explanations of audit adjustments and their associated FAR references must be attached to the Schedule.*

## Criteria Description for FAR References and Other Audit Adjustments

- (1) Labor costs identified specifically with a contract are direct costs of the contract.
- (2) 31.202 - Bonuses specifically related to project are direct.  
31.205-6(f) – Bonuses are allowed if paid according to an existing plan or consistent policy
- (3) 31.202 – Labor costs identified specifically with a contract are direct costs of the contract.  
31.203 – Indirect labor costs are those related two or more cost objectives.
- (4) 31.205-27(a) – Legal costs associated with organization of the firm are unallowable.
- (5) 31.205-14 – Dues associated with social, dining or country clubs are unallowable
- (6) Related Party Transaction - See explanation below.
- (7) 31.202 – Depreciation on costs charged to a specific contract are direct.  
31.205-49 – Amortization of goodwill is unallowable.
- (8) 31.202 – Contractual services charged to a contract are direct costs

### Sample Engineering, Inc. Schedule of Direct Labor, Fringe Benefits and General Overheads For the Year Ended December 31, 2001

- (1) Principal Business Activity – Sample Engineering, Inc. (the company) was incorporated in 1994. The company primarily provides engineering, survey, and construction management services to both the public and private sector.
- (2) Basis of Accounting – The Company's indirect cost schedule was prepared on the basis of accounting practices prescribed in Part 31 of the Federal Acquisition Regulations (FAR). Accordingly, the schedule of indirect costs is not intended to present the results of operations of the Company in conformity with generally accepted accounting principles.
- (3) Distribution of Direct Labor Costs – The Company distributes labor costs to direct projects for all employee classifications. Overtime premium costs are distributed directly to projects when applicable.
- (4) Direct Costs – The schedule excludes the following classifications of costs that were related to projects:
  - (a) Automobiles
  - (b) CADD charges
  - (c) Subcontracts: The source of the direct charge is the vendor invoice received by the Consultant.
- (5) Related Party Transactions – The firm incurred rental costs through the rental of a facility from a related party under common control. Common control is determined to exist when:
  - (a) The combined direct or indirect ownership of individual shareholders common to each entity equals 50% or more in each entity, or
  - (b) One entity leases property from another and either entity has 50% or more ownership in the other.
  - (c) Allowable rental charges between any divisions, subsidiaries, or organizations under common control are limited to the actual costs of ownership as per the SHA guidelines. Any adjustment reflects the difference between the rents paid and the actual costs of ownership.

Example: (Showing Field Plus Home Office Rates)

The following sample Schedule of Direct Labor, Fringe Benefits and General Overheads including the FAR references and descriptions is recommended for use when a separate rate is required for the home and field offices.

**Schedule of Direct Labor, Fringe Benefits and General Overheads**  
**Example – Includes Home Office and Field Office Rates**

Account Description	Account Total	Unallowable Expenses	FAR Ref.	Allowable Expenses	Allocation	
					Field Office	Home Office
<b>Direct Labor</b>	\$2,291,885.00			\$2,291,885.00	\$948,220.00	\$1,343,665.00
<b>Fringe Benefits</b>						
Insurance - Group	\$111,354.00			\$111,354.00	\$46,070.00	\$65,284.00
Insurance - Life	\$4,197.00	(\$670.00)		\$3,527.00	\$1,459.00	\$2,068.00
Payroll - Bonus	\$164,650.00			\$164,650.00	\$68,121.00	\$96,529.00
Payroll - Holiday	\$83,722.00			\$83,722.00	\$34,638.00	\$49,084.00
Payroll - Sick	\$22,343.00			\$22,343.00	\$9,244.00	\$13,099.00
Payroll - Vacation	\$90,838.00			\$90,838.00	\$37,582.00	\$53,256.00
Payroll - Taxes	<u>\$240,003.00</u>			<u>\$240,003.00</u>	<u>\$99,296.00</u>	<u>\$140,707.00</u>
<b>Total Fringe Benefits</b>	<u>\$717,107.00</u>	<u>(\$670.00)</u>		<u>\$716,437.00</u>	<u>\$296,410.00</u>	<u>\$420,027.00</u>
					31.26%	31.26%
<b>General Overhead</b>						
Indirect Labor	\$621,191.00			\$621,191.00	\$257,005.00	\$364,186.00
Accounting & Legal	\$9,357.00			\$9,357.00	\$1,224.00	\$8,133.00
Advertising & Promotion	\$3,362.00			\$3,362.00	\$440.00	\$2,922.00
Auto Expense	\$60,665.00	(\$3,413.00)		\$57,252.00	\$7,489.00	\$49,763.00
Computer Service	\$6,288.00			\$6,288.00	\$822.00	\$5,466.00
Continuing Education	\$7,407.00	(\$972.00)		\$6,435.00	\$842.00	\$5,593.00
Convention & Seminars	\$5,144.00			\$5,144.00	\$673.00	\$4,471.00
Depreciation & Amortization	\$138,625.00			\$138,625.00	\$18,132.00	\$120,493.00
Dues, Memberships, Licenses	\$4,590.00	(\$320.00)		\$4,270.00	\$559.00	\$3,711.00
Employee Welfare	\$11,197.00			\$11,197.00	\$1,465.00	\$9,732.00
Equipment Rental	\$23,481.00	(\$1,622.00)		\$21,859.00	\$2,859.00	\$19,000.00
Insurance - Auto & Trucks	\$29,683.00	(\$2,908.00)		\$26,775.00	\$3,502.00	\$23,273.00
Insurance - General	\$204,035.00	(\$49,973.00)		\$154,062.00	\$20,151.00	\$133,911.00
Insurance - Workers' Comp	\$17,584.00	(\$5,455.00)		\$12,129.00	\$1,586.00	\$10,543.00
Miscellaneous Expenses	\$5,189.00			\$5,189.00	\$679.00	\$4,510.00
Office Supplies & Expenses	\$79,429.00			\$79,429.00	\$10,389.00	\$69,040.00
Postage & Delivery	\$15,557.00			\$15,557.00	\$2,035.00	\$13,522.00
Professional Fees	\$32,259.00			\$32,259.00	\$4,220.00	\$28,039.00
Rent - Building	\$100,173.00			\$100,173.00	\$13,103.00	\$87,070.00
Repairs & Maintenance	\$42,831.00			\$42,831.00	\$5,602.00	\$37,229.00
Subscriptions	\$6,178.00			\$6,178.00	\$808.00	\$5,370.00
Survey Supplies	\$24,318.00			\$24,318.00	\$3,181.00	\$21,137.00
Taxes	\$11,923.00			\$11,923.00	\$1,560.00	\$10,363.00
Telephone	\$38,299.00			\$38,299.00	\$5,010.00	\$33,289.00
Travel	\$15,476.00	(\$65.00)		\$15,411.00	\$2,016.00	\$13,395.00
Utilities	\$20,732.00			\$20,732.00	\$2,712.00	\$18,020.00
Gain on Sale of Assets	\$0.00	\$500.00		\$500.00	\$65.00	\$435.00
Contributions	\$698.00	(\$698.00)		\$0.00	\$0.00	\$0.00
Entertainment	<u>\$9,851.00</u>	<u>(\$9,851.00)</u>		<u>\$0.00</u>	<u>\$0.00</u>	<u>\$0.00</u>
<b>Total General Overhead</b>	<u>\$1,545,522.00</u>	<u>(\$74,777.00)</u>		<u>\$1,470,745.00</u>	<u>\$368,129.00</u>	<u>\$1,102,616.00</u>
<b>General Overhead Rate</b>					38.82%	82.06%
<b>Combined Indirect Cost Rate</b>				95.43%	70.08%	113.32%

(1) Indirect salaries were allocated to field office on the basis of direct labor.

(2) Indirect expenses were allocated to field office based on a ratio of allocated indirect salaries to total home office