



# OHIO DEPARTMENT OF TRANSPORTATION

CENTRAL OFFICE, 1980 W. Broad St., 4<sup>th</sup> Floor, COLUMBUS, OHIO 43223

SUBJECT: Cost Recovery for Fringe Benefits and Overhead

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## I. DEFINITIONS

As used in this Memo—

1. The "*Code of Federal Regulations*" (CFR) is the codification of the general and permanent rules published in the *Federal Register* by the executive departments and agencies of the Federal Government. The CFR is divided into 50 titles that represent broad areas subject to Federal regulation. 49 CFR Chapter 18 (the Common Rule) set forth the uniform administrative rules for Federal grants and cooperative agreements and subawards to State and Local governments.
2. "OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*,<sup>1</sup>" establishes the principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and Local governments. The Circular is issued by the Office of Management and Budget, an Executive Office of the President of the United States.
3. "Cognizant agency" refers to the Federal agency responsible for negotiating and approving indirect cost rates for a non-profit organization on behalf of all Federal agencies that provide funds to that organization. The cognizant agency for non-profit organizations is determined by calculating which Federal agency provides the most grant funding.
4. An "incurred cost audit" is an examination of the accounting records and source documents that support the submitted costs billed against Federal-aid contracts. The examination may include, but may not be limited to, an assessment of the auditee's internal controls, timekeeping practices, and general operating policies.
5. A "Cost Allocation Plan" (CAP) summarizes, in writing, the methods and procedures that an organization uses to allocate costs to various programs, grants, contracts, and agreements. It includes, but is not limited to, a "Statement of Direct Labor, Fringe Benefits, and General Overhead."
6. An "indirect cost rate" is a device for determining in a reasonable manner the proportion of indirect costs each Federal program should bear. It is a ratio, expressed as a percentage, of the indirect costs to a direct cost base.
7. A "Safe Harbor" rate is an alternative accounting method used by ODOT to estimate reasonable fringe benefits and indirect costs. The Safe Harbor Rate method may be used in lieu of preparing an indirect cost rate.
8. "Base Wage Amount" is the amount of direct labor incurred less the premium portion of overtime. Indirect and safe harbor rates should be calculated using the base wage amount.
9. "Overtime Premium" is the difference between an employee's standard hourly wage rate and the hourly wage rate paid for hours worked in excess of 40 per week. For example, an employee with a standard hourly wage rate of \$10 and a wage rate of \$15 for hours worked in excess of 40 has overtime premium of \$5 for each hour worked in excess of 40. Overtime premium is excluded from

<sup>1</sup> As codified by 2 CFR 225. Hereinafter referred to as *Circular A-87*

the fringe benefit and overhead rate calculations in each of the three recovery methods described in this memo.

## II. SCOPE

This memo details processes and procedures LPAs must follow to recover overhead costs associated with internal labor forces performing contract work on Federally funded projects. The LPA can recover indirect expenses incurred on Federally funded projects through one of the three methods described below.

### SAFE HARBOR RATE METHOD

The Auditor of State (AOS)'s Bulletin 2003-003, *Legislative Changes Regarding Force Account Projects*<sup>1</sup>, set forth "safe harbor" rates that local governments can use when estimating project costs for force account projects. LPAs have the option to also use these safe harbor rates when calculating and billing LPA labor, fringe benefits, and indirect costs on Federally funded projects. This method for calculating total labor cost is hereinafter referred to as the "Safe Harbor Rate Method."

Under the Safe Harbor Rate Method, the LPA is able to invoice costs for the actual direct labor incurred on the project plus fringe benefit and overhead expenses. The fringe benefits are computed by using the safe harbor rate of 30 percent of the total base wage amount<sup>2</sup>. Overhead costs are computed by using the safe harbor rate of 38 percent of the total amount of the base wages and fringe benefits. Refer to Table 1 as an example of the total labor cost calculation for the Safe Harbor Rate Method.

The LPA is required to obtain written approval from ODOT prior to the incurrence of labor costs computed using the Safe Harbor Rate Method. The LPA should submit its request to the ODOT Office of External Audits<sup>3</sup>. The LPA is permitted to use the Safe Harbor Rate for a period of one year. The LPA must annually seek approval to continue sue of the Safe Harbor Rate Method.

The LPAs may only apply the Safe Harbor Rate Method to work performed by the LPAs own labor forces subject to the terms of the LPA Project Agreement executed between ODOT and the LPA.

### B. COST ALLOCATION PLAN METHOD

OMB Circular A-87 establishes the cost principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments. Attachment E of OMB Circular A-87 specifically addresses how LPAs should determine its indirect cost rate for Federal grants. LPAs that choose to use the Cost Allocation Plan (CAP) Method should submit a CAP in accordance with OMB Circular A-87 to ODOT's Office of External Audits.

The Office of External Audits will complete a desk inspection of the CAP which includes, but is not limited to,

- reconciling the CAP to the underlying account records;
- performing horizontal and vertical analytics;
- sampling of select transactions to source documents; and
- reviewing costs for allowability in accordance with OMB Circular A-87 and other Federal and State guidance.

CAPs must be submitted to ODOT's Office of External Audits within the first three months of the year. Written approval will be granted to the LPA for a one year period. The LPA must submit a new CAP request each year it elects to use the Cost Allocation Plan Method for calculating total labor costs on Federally funded ODOT projects administered by either ODOT or the LPA.

<sup>1</sup> The Auditor of State has additionally issued Bulletin 2007-001 and 2008-004 regarding the requirements for force account projects. All three bulletins should be consulted for force account projects. AOS bulletins can be accessed at <http://www.auditor.state.oh.us/services/lgs/bulletins/default.htm>.

<sup>2</sup> The fringe benefit and overhead rates are not applied to overtime premium costs. Overtime premium costs are reimbursed at the actual cost.

<sup>3</sup> The requests should be submitted directly to the ODOT Office of External Audits LPA Auditor. The contact information for the current LPA Auditor is located at <http://www.dot.state.oh.us/Divisions/Finance/Auditing/Pages/LocalPublicAgencies-LPA.aspx>

CAP rates are not applied to overtime premium costs. Overtime premium costs are reimbursed at the actual cost.

### C. ACTUAL COST METHOD

Alternatively, LPAs can recover the actual cost of fringe benefits incurred by its employees for work performed on Federally funded projects. LPAs choosing this method are able to recover the actual prorate share of fringe benefits paid to its employees for direct labor. The LPA would not recover any overhead expenses under this method. The fringe benefit rate is applied to the total base wage amount.<sup>1</sup>

The LPA is required to obtain written approval from ODOT prior to billing labor costs computed using the Actual Cost Method. The LPA should submit its request into the ODOT Office of Audits with documentation supporting the fringe benefit expense for each employee at both the regular and overtime pay rates. Written approval will be granted to the LPA for the current calendar year. The LPA will need to submit a new request each year it elects to use the Actual Cost Method for calculating total labor costs on Federally funded ODOT projects administered by either ODOT or the LPA.

### D. TIMEKEEPING REQUIREMENTS OF LPA

OMB Circular A-87 dictates the cost principles of state and local governments receiving federal awards. Attachment B Section 8(h) specifically addresses the support required for salaries and wages.

Timesheets must be completed for employees that work on:

- More than one Federal award,
- A Federal award and a non Federal award,
- An indirect cost activity and a direct cost activity
- Two or more indirect activities which are allocated using different allocation bases, or
- An unallowable activity and a direct or indirect activity.

Timesheets must meet the following standards:

- They must reflect an after the fact distribution of the actual activity of each employee,
- They must account for the total activity for which each employee is compensated,
- They must be prepared at least monthly and must coincide with one or more pay periods, and
- They must be signed by the employee.

**The LPA must meet the timekeeping requirements outlined in OMB Circular A-87 for any labor cost to be eligible for Federal aid funds.<sup>2</sup>**

### E. TIMEKEEPING BEST PRACTICES

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

- Supervisory observation of employee arrival and departure to prevent improper clock-in/clock-out.
- Employee possession of timecard/timesheet.
- The employee completes the timecard/timesheet in ink, as work is performed.
- Only one timecard/timesheet is prepared per employee per pay 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.

<sup>1</sup> The fringe benefit rate is not applied to overtime premium. Overtime premium is reimbursed at the actual cost.

<sup>2</sup> 23 CFR Section 1.9 states Federal aid funds shall not participate in any cost which is not incurred in conformity with applicable Federal and State law, the regulations in this title, and policies and procedures prescribed by the Administrator. Federal funds shall not be paid on account of any cost incurred prior to authorization by the Administrator.

- 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 identifier for a particular assignment. To ensure accuracy, a listing of project numbers and descriptions should be provided in writing to employees.
- Employees and supervisors sign the timecards/timesheets in accordance with procedures, verifying the accuracy of the recorded effort.

**b. 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.
- When an employee badge system is used, badge issuance must be sufficiently controlled so that no badge number is duplicated and badges are not issued to unauthorized periods. Additionally, employees should be required to report lost badges promptly.

**c. General Timekeeping Procedures.** General timekeeping policies and procedures should be documented and require 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.
- The procedures should state that the nature of the work determines the proper distribution of time, not availability of funding, type of contract, or other factors. Direct labor hours must be assigned to the project or cost objective that caused the hours to be incurred.
- 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.
- The policy should state that 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.

**TABLE 1.**

Employee ID	Base Rate	# of Hours	OT Rate	# of Hours	Total Cost	OT Premium
10	\$ 20.00	100	\$ 30.00	10	\$2,300.00	\$ 100.00
20	\$ 22.00	75	\$ 33.00	2.5	\$1,732.50	\$ 27.50
30	\$ 25.00	82	\$ 37.50	0	\$2,050.00	\$ -
					\$6,082.50	\$ 127.50
					<b>A</b>	<b>B</b>
	Direct Labor		\$ 6,082.50	<b>A</b>		
	Less OT Premium		\$ (127.50)	<b>B</b>		
	Subtotal Direct Labor		\$ 5,955.00	<b>C</b>		
	Fringe Rate @ 30%		30%			
	Fringe		\$ 1,786.50	<b>D</b>		
	Subtotal Direct Labor		\$ 5,955.00	<b>C</b>		
	Fringe		\$ 1,786.50	<b>D</b>		
			\$ 7,741.50			
	Overhead Rate 38%		38%			
	Overhead		\$ 2,941.77	<b>E</b>		
	Direct Labor		\$ 6,082.50	<b>A</b>		
	Fringe		\$ 1,786.50	<b>D</b>		
	Overhead		\$ 2,941.77	<b>E</b>		
	Total Cost		<u>\$10,810.77</u>			