**I. BACKGROUND**

The Ohio Department of Transportation (ODOT) is participating in a pilot program that allows for the use of a “Safe Harbor” indirect cost rate of **110 percent** to be used by qualifying engineering consulting firms. The fundamental purpose of the Safe Harbor Indirect Cost Rate is to allow time for small engineering consulting firms, new engineering consulting firms, and engineering consulting firms that may not have previous experience with Federally-funded contracts, to become compliant with Federal and State laws and Part 31 of the Federal Acquisition Regulation.

Each engineering consultant opting to participate in the Safe Harbor program must, at a minimum, account for and allocate labor costs appropriately to direct and indirect cost objectives in sufficient detail to demonstrate that such costs have been appropriately incurred in connection with design and engineering efforts. For example, labor costs incurred in connection with all projects must be allocated directly to said projects, regardless of whether the labor costs are billable/reimbursable by a specific contract. Additionally, labor hours expended on non-project activities must be properly allocated to indirect cost codes, such as paid leave, general office/administrative, training, proposal development, etc.

These engineering consultants also must establish a “Pathway to Compliance.” The Pathway must include the following characteristics:

1. An accounting system that segregates indirect costs and direct costs.
2. An accounting system that segregates allowable and unallowable costs, as defined in Part 31 of the Federal Acquisition Regulation (FAR).
3. A compliant job-cost system that is managed through the use of a general ledger.
4. A project cost estimation system that agrees with the job-cost system.
5. Training for accounting personnel and key management on FAR Part 31.
6. An adequate written internal control policy, including a policy and procedures manual, and consistent implementation of such policies and procedures.

(These characteristic are discussed in the following paragraphs.)

**II. DETAILED REQUIREMENTS**

**1. An accounting system that separates indirect costs and direct costs**.

In evaluating an engineering consultant’s overhead, consulting firms should consider direct as well as indirect costs. A direct cost is any cost that can be identified specifically with a particular contract or project. Costs identified specifically with a contract or project are direct costs and must be allocated/charged directly to the contract or project. All costs specifically identified with a project are direct costs of that project and may not be allocated to another project, either directly or indirectly. Finally, a cost may not be charged as direct and also be included in an indirect cost pool. For reasons of practicality, any small dollar direct cost may be treated as an indirect cost if the accounting treatment is consistently applied to all projects and produces substantially the same results as treating the cost as a direct cost. However, any variances and credits should then also be treated as indirect costs.

Indirect costs should be accumulated by logical cost groupings with due consideration of the reasons for incurring such costs. Commonly, manufacturing overhead, selling expenses, and general and administrative (G&A) expenses are separately grouped. The engineering consultant must record indirect costs in accordance with Generally Accepted Accounting Principles (GAAP) and must consistently allocate these costs to intermediate or final cost objectives, as appropriate.

Guidance:

* FAR 31.202 - direct costs.
* FAR 31.203 - indirect costs.

**2. An accounting system that separates allowable and unallowable costs, as defined in Part 31 of the Federal Acquisition Regulation (FAR)**.

Management[[1]](#footnote-1) bears the sole responsibility for identifying, segregating and removing unallowable costs from all government contracts. This applies to direct costs, indirect costs, and any cost proposals that are submitted for government contracts. A cost is allowable when the cost is allocable, reasonable and complies with the cost principles of FAR Part 31. The consultant must account for costs appropriately and must maintain adequate records to demonstrate that costs claimed have been incurred, are reasonable, and are allocable.

Guidance:

* Chapter 7 of The AASHTO Audit Guide discusses the reasonableness and allowability of Labor Costs.
* Chapter 8 of The AASHTO Audit Guide provides FAR interpretations on the allowability of selected areas of costs.
* Appendix C of The AASHTO Audit Guide provides a keyword index to Part 31 Federal Acquisition Regulation.

**3. A compliant job-cost system that is managed through the use of a general ledger**.

The job cost system should integrate with or otherwise reconcile to the financial accounting control accounts (general ledger accounts). It should record all direct labor and other direct costs, whether billable or not, to projects on a consistent basis.

**4. A project cost estimation system that agrees with the job-cost system**.

The method that a consulting firm’s uses to prepare job estimates should be consistent with its job cost system. For example, a company that uses direct labor cost as a base should prepare project cost estimates based on direct labor.

**5. Training for accounting personnel and key management on FAR Part 31**.

Training of accounting personnel and key management on FAR Part 31 is important to ensure compliance with Federal Cost Principles. This training will:

* Promote a uniform interpretation and consistent application of FAR Part 31 in A/E contracting. (For example, costs are consistently classified as either indirect costs or direct costs, and costs are correctly classified as either allowable or unallowable.)
* Increase compliance with the Federal rules and regulations that govern A/E contracts.
* Promote clarity in communications between management and the auditor; thereby improving the quality of overhead cost rate audits.

*Note: Because an indirect cost rate uses direct labor cost as the primary allocation base, all employees should be instructed to prepare timesheets on a total-hour basis. This requires all worked hours to be recorded, regardless of whether the employees are paid for all the hours. Additionally, employees should be trained regarding the generally allowable types of costs and what documentation must be maintained to establish the allowability of costs.*

**6. An adequate internal control policy, including a policy and procedures manual, and consistent implementation of such policies and procedures.**

Internal controls include the plans of the organization and the methods and procedures adopted by management to ensure that the firm’s goals and objectives are met; that resources are used consistent with laws, regulations and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. These policies and procedures must be applied consistently and must apply to all employees, owners, and managers.

Guidance:

* Chapter 6.4 of the AASHTO Audit Guide provides guidance on the development of an effective internal control system.
* Defense Contract Audit Agency (DCAA) Pamphlet No. 7641.90 (DCAAP 7641.90), Information for Contractors. 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 internal control, labor charging system internal control, timecard preparation methods, and timekeeping policy.
* Table 6-1 of the AASHTO Audit Guide provides a checklist of the model characteristics of a labor charging system.
* Appendix B of The AASHTO Audit Guide provides an Internal Control Questionnaire for Consultant Engineers.
1. In this document, “management” refers to the managers, owners, and/or principals of the engineering consulting firm. [↑](#footnote-ref-1)