Chapter 5 – Cost Accounting for Government Projects (excerpt)

Hot Issues

Cost Rates

When producing average man-hour cost rates, be sure that the project manager's categories are reproducible when preparing payroll data for an audit. Many firms only need to produce average man-hour rates once or twice a year. When a firm prepares many different contracts for state departments of transportation, contracting officers often request a payroll ledger that ties to the pay rates.

Best Practice Tip

Cost Rate Backup. When cost rate submittals are frequent, save the cost rate proposal with the payroll ledger that ties to it for future questions on subsequent audits.

Man-hour categories do not necessarily match the individuals' titles, labor categories, or staff types. The government agency may have its own staff categories. The firm may use Dept Head, Project Manager Architect, Designer, CADD, and the government agency needs Sr. Architect, Jr. Architect, and CAD. A person may have a Director of Health Facilities title, but their man-hour category is project manager or senior architect. To ensure the employees are in the appropriate government staff categories, the Financial Manager preparing the rates must consult with the PM before creating the average man-hour rate schedule.

Bonuses and Bonus Plans

For discretionary distributions or bonuses to be allowable, the firm must have a bonus plan. It must be a written plan; it must be in place at the beginning of the year; and it must be communicated to the employees. It cannot be a distribution of profit, but it may be tied to profitability. It may also address several bonus pools with different rules allowable, for example:

- Shareholders/partners
- Salaried
- Hourly employees

If a bonus calculation component is a return on investment (for the shareholders/partners), that portion of the bonus is unallowable. During the audit, the bonus calculation will be requested. The following is an example of an incentive salary plan with the components necessary to fulfill FAR requirements.

Design Firm, Inc. Incentive Salary Plan

At its sole discretion, the Board of Directors may elect to annually distribute a portion of the annual operating profit to its employees. The firm makes distributions by one or more of the following:

- Shareholder Plan
- Salaried Employee Plan
- Hourly Employee Plan

Incentive Payments are accounted for separately on the general ledger within the accounting system as 7025.000, Bonuses. They are paid as wages to individual employees.

Information regarding this plan is distributed to employees when they are hired.

Shareholder Plan. Shareholders as a class and based on a percentage of ownership shall receive an initial distribution of a return on investment at a rate to be determined each year. Shareholders are also included in the salaried employee plan identified below.

Salaried Employee Plan. The incentive salary plan for salaried employees is based on three components.

COMPONENT 1

Employees must meet all of the following criteria to be eligible for this plan:

- Salaried
- Full time @ ≥ 30 hours per week
- Date of employment before July 1 of the plan year
- Employed on December 15 prior to distributions

COMPONENT 2

The second component recognizes hours worked above a base of 40 hours per week. Hours above regularly scheduled hours are determined by reviewing time record charges. The Board of Directors determines the level of compensation for total additional hours worked as a percentage of the base of 40 hours per week within the four bands identified below:

- More than 5% but less than 10% additional hours
- More than 10% but less than 15% additional hours
- More than 15% but less than 20% additional hours
- More than 20% additional hours

Full-time employees who started work after March 31 of the bonus year may be eligible for a bonus at the Boards discretion.

COMPONENT 3

The remainder of the incentive pool is distributed amongst the salaried employees (both shareholders and non–shareholders) based on the following criteria:

- Performance amount based on supervisor performance evaluations in four bands:
  1. Exceptional
  2. Above Average
  3. Average
  4. Below Average

     Note that the Board of Directors may elect to assign a value to the fourth band to offset the Component 2 value and account for below average or poor performance. It is not the company's policy to reward below-average performance.
- An optional additional amount determined entirely at the Board of Directors' discretion for each employee to recognize their contributions to the company's profitability. This amount shall not exceed 5% of the entire incentive pool for any employee.

Hourly Employees Plan: Based on supervisor performance evaluations, hourly employees are categorized into four performance bands: Exceptional, Above Average, Average, Below Average. The Board of Directors will determine the amount awarded to each employee, depending on the band in which they are categorized. A below-average performance will not be rewarded.

Overtime Premium

Maintain records that correctly classify overtime premium amounts as direct or indirect costs. Overtime policies must be established and applied consistently such that equitable cost allocations are the result. Overtime must be treated consistently for all contracts regardless of whether it is a government or commercial client or the billing type (lump sum vs. hourly) involved.

Several alternative methods may be used to allocate the cost of overtime premium, including as an indirect cost and spread across all projects or both as direct and indirect costs. The AASHTO Guide, Chapter 5, Section 3, Overtime Premium, describes the acceptable parameters of allocation.

The uncompensated overtime class addresses the accounting for labor of salaried employees who work more than 40 hours in a week and receive no compensation for the additional hours worked. Effectively, it reduces the cost of each hour worked. For example, an employee earns $800/week or $20/hour. The employee works 50 hours one week. The per-hour cost of that employee's time is $16/hour ($800 salary / 50 hours worked = $16/hour effective rate).

If the accounting system used does not automatically account for uncompensated overtime and assign the effective cost to each project individually, this allocation is difficult to correct manually. Proper accounting systems must be in place for government contractors.

Executive Compensation

FAR 31.205-6(P)(1), Executive Compensation. Firm executives may have higher than average salaries. There is an overall cap for executive compensation of $568,000 (2021 – varies annually). Also, A|E firms must follow other rules to determine the reasonableness of salaries. The government has concluded that the excess over average must be unallowable as an overhead component. There are two ways to establish an executive salary matrix.

Firm Determined Compensation Matrix. This matrix is calculated by researching and obtaining salaries for your firm's individual executive positions from three different sources. The firm may determine the level included in the executive group. The Board or other governing body determines and adopts the executive group. The group may consist of the Board of Directors or the Executive Committee, or an executive group with the following enumerated titles. These positions usually include: 1. Chairman of the Board, 2. CEO, 3. COO, 4. President, 5. Vice President, and 6. Marketing Director, but are typically unique for each firm.

Step 1. Research and calculate an average salary for each position. Use nationally-published compensation surveys that match the A|E firm in terms of revenue, industry, geographic location, and other relevant factors. The firm must match the job description and duties of each of its executives to the survey data.

Step 2. From these surveys, develop an estimated reasonable compensation amount for each position **(Fig. 5-3)**.

Position: President/CEO *Figure 5-3*

	Survey Method Used	Salary (Median)	Bonus	Other Compensation	Total Compensation
Survey 1	Staff size	$145,000	$32,000	$11,000	$188,000
Survey 2	Revenue $5 – $10MM	$127,000	$35,000	$15,000	$177,000
Survey 3	Revenue $5 – $15MM	$146,000	$42,000	$14,000	$202,000
			Average		$189,000
			ROR factor*		10%
			Adjustment for 10% ROR		$207,900

*DCAA guidance allows for a 10% ROR (Range of Reasonableness) to be applied in developing estimated reasonable compensation.

Step 3. Once the individuals are determined for each category, calculate their total compensation and compare it to the average for that position. The excess is unallowable. A compensation table will look similar to this **(Fig. 5-4)**.

Executive Compensation
Schedule of Executive Positions *Figure 5-4*

	Actual Salary	Actual Bonus	Other compensation	Total Compensation	Estimated Reasonable Compensation	Potential Unreasonable Compensation
President /CEO	$264,000	$82,000	$48,000	$394,000	$375,865	$18,135
HR Director					$124,090	
CFO					$219,487	

Step 4. Perform this analysis for each executive and accumulate total potential unreasonable compensation that will be unallowable.

Step 5. Adjust the Rate of Reasonableness if necessary. The Rate of Reasonableness may be different based on exceptional performance by the executive. This concept is discussed in Section 7.6 of the AASHTO guide.

National Compensation Matrix (NCM). Another method that firms may use is the NCM to evaluate executive compensation. This method may be required if the original analysis was not acceptable or the state

DOT prefers. The NCM does the research and analysis of average executive compensation for the firm and provides a formulaic salary with benefits to use depending on the firm's size (by revenue). The Matrix Tool includes position descriptions. Search for National Compensation Matrix Tool [Year] on the Internet and download the latest matrix. https://www.transportation.ohio.gov/programs/external-audits/audit-consultant/03-ncm.

Step 1. Assess the categories and determine the best ones needed. Not all are titled as you may have them. Read the descriptions and fit the position to the description **(Fig. 5-5).**

Figure 5-5

The following position descriptions apply to the NCM:

Chairman (non-CEO). This position represents the executive in the firm who functions in the role of Chairman of the Board, in firms that have a separate Chief Executive Officer (CEO) position. Day-to-day responsibility for managing the firm is passed to the CEO. Typically, the Chairman (non-CEO) is responsible for the overall direction of the business and for achieving maximum return on invested capital. Often, however, the position focuses on one area of the firm, such as marketing or strategic growth, rather than overall firm management. In firms where the Chairman and CEO roles are combined in one position, the CEO/President position description should be used.

CEO/President. This is the top ranking executive in most firms; the principal organization leader, who plans, develops and establishes policies and objectives of the organization in accordance with board directives. Typically, this position is responsible for the overall direction of the business. The CEO/President coordinates the efforts of senior executives and members of the board and works with them to develop current and long-range objectives, policies, and procedures for the organization. Titles used among companies vary; depending on the organization, the position may have the title of Chairman of the Board & Chief Executive Officer, Chief Executive Officer, Chief Executive Officer & President, President, or similar titles. This position reports to Board of Directors and often is a member of the board, or may preside over the Board of Directors. This position is to be mapped to a single executive - see note **(‡)** at NCM Tool tab for further details.

Step 2. On the following tab, NCMTool, enter the positions. Enter the firm's gross revenue, and the tool calculates the maximum compensation for the position to use in your own calculation of excess compensation. Note that in the matrix, gross revenue is set for $10MM in revenues. When the Revenue amount is changed, the compensation figures also adjust **(Fig. 5-6)**.

Figure 5-6

National Compensation Matrix Tool - 2022

Automated Tool for Compensation Allowability

Enter Gross Revenues for Target Firm: **10,000,000**

Position	Formulaic Result	+RoR	Computed Compensation
Chairman (non-CEO)	223,567	40,893	**264,460**
CEO/President	402,050	66,978	**469,028**
Executive Vice President / Chief Operating Officer	270,810	35,802	**306,612**
Senior Vice President	250,256	31,375	**281,631**
Vice President	221,833	30,060	**251,892**
Chief Financial Officer	230,038	37,678	**267,716**
Top Engineering Executive	238,479	7,933	**246,413**
Human Resources Director	131,008	13,332	**144,339**

Statutory Compensation Cap for Calendar Year 2021:	**568,000**
NCM Revenue Floor:	**1,500,000**
NCM Revenue Ceiling:	**500,000,000**

Note that the Executive Statutory Compensation Cap for 2022 is $568,000, This amount changes each year with a cost-of-living increase. If the firm is still looking for higher executive compensation amounts, the firm can choose which surveys it uses to reach a higher amount. Three such surveys are from The Economic Research Institute, Zweig White, and PSMJ.

Bid and Proposal vs. Selling

No one can market to the government; therefore, any marketing costs are unallowable. Selling costs and the costs involved with government proposal/bid preparation are allowable. For example, your attendance and the purchase of a booth at the Association of Higher Education Facilities Officers are not allowed, but attending the Governor's Conference on Transportation is allowed. In the former, you are marketing yourself to non-government entities (even if some of the schools are public universities). In the latter, you are attending a conference with updates on your state's transportation plan, future needs, and possibly some educational seminars.

The cost (time and expense) of preparing an SF330 is allowable, but the preparation of your company brochure is not.

Develop labor codes for the different activities. Marketing personnel, including Principals who market, need to accurately account for their time between allowable and unallowable activities. Develop a list of allowable and unallowable activities, clients, and conferences; Train personnel on the differences.

A reconciliation of indirect marketing labor is required at the end of the year to calculate the percentage of each person's salary you must deduct as unallowable.

Marketing Requests

Financial Statements and a DD254 form, Financial Condition Assessment, may be requested by the marketing team as part of a government agency submittal. These should be submitted separately with a nondisclosure statement and a disclaimer on the package that they will be used only for this one intended purpose, i.e., the bid submittal for Project XYZ.

Best Practice Tip

Suppose your accounting system has the ability to create user-defined fields in the database. In that case, set up several fields to facilitate information requested from the marketing department, for example, percentage of revenue by project type or client type.

- Project Database
    - Project Type – school, office building, highway, water plant
    - Client Type – federal, state, local, K-12, higher education.
    - Fee Type – fixed fee, cost plus
- Employee Database
    - Minority
    - Gender
    - Labor Categories
    - EEO
    - Workers Comp
- Vendor Database
    - Small Business
    - Minority
    - Woman-Owned
    - HBCU
    - HUB Zone