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How to increase the likelihood of success on your next FAR overhead rate audit

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Architectural and engineering firms that work on government projects know that regular audits of overhead rates are frequently a requirement of the contracts. While Federal Acquisition Regulation (FAR) compliance puts a strain on already stretched resources, firms should also know that they can increase their likelihood of a successful audit by focusing on the following key issues:

1. Related party rent

Costs of related party rent are limited to the actual costs incurred to maintain the property (including real estate taxes and insurance). Mortgage interest, however, is not an allowable cost under FAR.

2. Time reporting and labor cost accounting

The preferred practice is to record all labor hours worked, including unpaid hours worked by salaried employees. If all labor hours are not recorded, the consultant must prove that labor costs are not materially misstated.

Direct labor should include all chargeable time, whether or not it is billable. If standard hourly rates are used to assign labor costs, 100% of the job cost variance for uncompensated overtime should be allocated to indirect labor. Bonuses should be based on objective, performance-based criteria written into a policy that is communicated to staff. Distributions of profit are not an allowable cost under FAR.

Timesheet codes should be used to separate direct and indirect labor costs, as well as allowable and unallowable labor costs. Any timesheet corrections must be initiated by the employee and supervisor approval must be documented. In addition, a formal written policy on time reporting and approval should be drafted and communicated.

3. Segregation of direct and indirect costs

The project-costing system used should be reconciled to the general ledger accounts, and a policy for recording direct and indirect costs should be documented and communicated. Direct costs are costs incurred specifically for a final cost objective (i.e. contract) and generally must be excluded from a firm's overhead pool.

4. Exclusion of unallowable costs

Unallowable costs should be identified at the point of entry and the chart of accounts should provide proper segregation of unallowable amounts. One of the key areas firms should focus on is segregating allowable selling costs from unallowable advertising and public relations expenses.

Under certain circumstances, statistical sampling may be used as a basis to estimate unallowable costs. Prior approval should first be obtained from the appropriate agency. If it is not, the burden of proof will be on the contractor.

5. Travel and meal costs

For employees who are traveling, costs for lodging, meals and incidentals may be based on per diem rates, actual expenses or a combination of the two, as long as the daily amounts do not exceed the maximum per diem rates. Amounts in excess of maximum per diem rates should be segregated as unallowable costs in the general ledger.

Meals are also allowable when provided in connection with a meeting, convention, conference or seminar where the principal purpose is the dissemination of trade, business, technical or professional information. Meal charges must be reasonable and reimbursement for alcohol is not allowed. Documentation of the place, number of people and business purpose must be provided.

Summary

Competition for government contracts has increased in recent years. Architectural and engineering firms that seek to win more government contracts should do their best to ensure that they complete their audits successfully. Accordingly, staff should be trained to comply with FAR and firms should put procedures in place to ensure that compliance is documented and communicated.

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