



## The Federal Acquisition Regulation is an Important Yet Complex Component of Government Contracts

The Federal Acquisition Regulation (FAR) Part 31 is the main authoritative source for the acquisition of professional services with the State Department of Transportation offices and federal government. The FAR Part 31 establishes the framework for calculating the overhead rate and facilities capital cost of money for companies. The American Association of State Highway and Transportation Officials (AASHTO) also publishes an audit guide to help implement the FAR guidelines.

Many government agencies require overhead audits depending on the size of the contract. The Florida Department of Transportation generally requires an overhead audit for professional services contracts greater than \$500,000. A firm can enter into professional services contracts less than \$500,000 without an overhead audit; however their overhead rate and direct expense rate will be capped (usually a provisional or unaudited rate will be capped with conservative rates). Note that if your overhead rate exceeds the capped rate, you will not be able to recover all your costs without an overhead audit.

### **The Job Cost Accounting System Is Key to an Accurate Audit**

The most important part of an overhead audit is the job cost accounting system. A company must be able to demonstrate the ability to charge time and costs to a specific job. This is also important when establishing a correct direct labor base as well as being accountable to the contracting government agency for all costs charged to a project. A company must have a timekeeping system in place which separates the indirect and direct costs. Additionally, the company must have a chart of accounts to isolate unallowable costs under FAR.

Common unallowable costs include: advertising, bad debts, personal use of vehicles, contributions or donations, employee gifts and recreation, social activities, fines and penalties, life insurance on key employees, interest expenses, lobbying, goodwill, alcoholic beverages, personal expenditures, certain memberships (golf clubs, social clubs), and related party lease payments in excess of costs.

Common issues noted during overhead audits include inadequate job cost systems, missing time sheets, failure to maintain mileage logs, disclosure of related party activity, unallowable costs comingled with allowable costs, failure to provide a reasonable compensation analysis (the National Compensation Matrix is a great starting point), and failure to document a bonus policy.

### **The Overhead Audit Process**

Depending on the size of the company, an overhead audit will generally take about 85 to 150 hours depending on the accuracy of the accounting records and number of employees. If a company is looking to seek government contracts in the future, the company may spend additional resources making sure their accounting system is FAR compliant before the audit process begins (generally a year or two in advance) and by attending training seminars for FAR compliance. A good place to see if you are FAR compliant is the internal control questionnaire for consulting engineers included in Appendix B of the AASHTO audit guide. The internal control questionnaire summarizes all the key accounts system requirements.

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## **To Achieve the Best Results, Partner With an Expert**

You should strongly consider hiring a CPA firm who has performed numerous overhead audits and has knowledge of government procurement with several types of contracts and contract payment terms affecting the development and/or application of an allowable overhead rate. Firms without extensive overhead audit and industry expertise often use the government's Safe Harbor rates, which tend to be conservative and short-change the firm's reimbursement.

In addition, your CPA firm should meet all continuing professional education requirements in accordance with Government Auditing Standards. An incorrect overhead calculation can lead to lost revenue not billed or overbilling the government, which would need to be repaid. To achieve the best results, select a CPA firm with extensive industry experience.

By obtaining an overhead audit, a company can bid on larger contracts to help grow their business. And the audit costs are recoverable by the company. Additionally, a company with a FAR compliant accounting system can help manage their job cost profitability and help provide data for future job estimates.

### **About the Author:**

*Jon Stein specializes in overhead audits in the construction industry and not-for-profit audit and assurance. Mr. Stein and the team at Rivero, Gordimer & Company conduct more than 20 overhead audits per year as well as various consulting arrangements.*



*Rivero Gordimer & Company, P.A. has been performing overhead audits for over 30 years.*

*Contact Mr. Stein at 813-875-7774 or [jstein@rgcocpa.com](mailto:jstein@rgcocpa.com).*



**NEED MORE HELP?** Contact Rivero, Gordimer & Company in Tampa, Florida by calling 813-875-7774 or visiting our website at [www.rgcocpa.com](http://www.rgcocpa.com).

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