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INTERMODAL TRANSPORTATION DIVISION
ENGINEERING CONSULTANTS SECTION
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December 23, 1997

Engineering Consultants Section

INFORMATION BULLETIN 98-05

TO: Consultants

FROM: Engineering Consultants Section

SUBJECT: Accounting For Other Direct Costs

The ADOT Office Of Audit & Analysis, External Team has provided the attached Policy Memorandum titled Accounting for Other Direct Costs. This is a supplement to their Revised Advance Agreement Checklist, item 7, Other Direct Costs which was distributed by Information Bulletin 98-03.

If you have any questions in regard to this bulletin please contact the Engineering Consultants Section at 255-7525 or Audit & Analysis at 255-7734.

ARIZONA DEPARTMENT OF TRANSPORTATION
OFFICE OF AUDIT & ANALYSIS
EXTERNAL TEAM

POLICY MEMORANDUM

DATE: NOVEMBER 20, 1997

TO: ADOT ENGINEERING CONSULTANTS SECTION

THROUGH: ROBERT J. GILLESPIE, AUDIT MANAGER

FROM: MICKEY SCHWARTZ AND JOHN KLEIN, AUDIT SUPERVISORS

SUBJECT: ACCOUNTING FOR OTHER DIRECT COSTS

Background:

Refer to ADOT's Engineering Consultants Section INFORMATION BULLETIN 98-03—Revised Advance Agreement Checklist, item 7.—Other Direct Costs. "It will be expected that Other Direct Costs (any expense/cost other than Direct Labor and Subconsultants) be included in the Overhead cost pool. If a Consultant/Subconsultant proposes Other Direct Costs, it will need to obtain prior approval of its accounting methods by ADOT's Office of Audit & Analysis—External Audit Team before it can include such costs in its Derivation of Costs Proposal...."

Policy:

The accounting practice of treating any portion of indirect costs as a direct cost is in violation of the FAR. FAR 31.203(a) states, "An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. *It is not subject to treatment as a direct cost.*" (Italics added for emphasis.)

To date, many Consultants have accounting practices that treat portions of costs contained in indirect cost pools as direct costs. Such costs are billed as a direct cost to the project. For example, most Consultants do not maintain a separate cost pool for their vehicles; vehicle-related costs are generally charged to an overhead (indirect) cost pool. Whenever mileage is incurred on a project, an agreed-to amount per mile, multiplied by miles driven, is considered a direct cost of the project. This amount is generally billed to the customer and credited as a "cost recovery" to the overhead (indirect) cost pool.

Even though this accounting treatment violates FAR cost principles (31.202—Direct costs, and 31.203—Indirect costs), ADOT recognizes that Consultants following such a practice will need time to evaluate acceptable alternatives, before making a change. The Consultant should be given ample opportunity to redefine its accounting treatment for subsequent fiscal years.

ADOT also recognizes the FAR cost principle dealing with credits (31.201-5), which states, "The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund." Therefore, until a Consultant makes a change in its accounting treatment to an acceptable alternative, it is expected that the billing of allowable indirect costs will be credited to the appropriate indirect cost pool.

In addition, ADOT:

- Will not allow Consultants to bill ADOT for such costs since it violates FAR Subparts 31.202 and 31.203, and

- Will accept this accounting treatment, only as a stop-gap measure, for the purposes of determining provisional overhead rates, and subsequent audits of ADOT contracts. (It is understood the Consultant will change its accounting treatment to an acceptable alternative in the near future.)

Materiality may be a factor that needs to be considered.

At this time, there are audits and reviews underway by ADOT and the Defense Contract Audit Agency (DCAA) that may have a bearing on this Policy. Should the outcome suggest a change in this policy, such a change will be made. Until then, the position in this Memorandum is effective for all prior and future ADOT contracts.

This Policy Memorandum is an interpretation of implementing Federal Acquisition Regulations, not a new policy that should have a future effective date.

Referencing paragraph three on the preceding page, "The Consultant should be given ample opportunity to redefine its accounting treatment for subsequent fiscal years." The following alternatives are available:

- Develop appropriate cost pools for groups of expenses and allocate them on a consistent and appropriate basis to all jobs and to other cost objectives, such as a G&A cost pool. See the following references:

  - See FAR Part 31.203 (b) thru (e) Indirect Costs
  - CAS 9904.401--Cost Accounting Standard—Consistency in Estimating, Accumulating and Reporting costs
  - CAS 9904.402--Cost Accounting Standard—Consistency in Allocating Costs Incurred for the Same Purpose
  - CAS 9904.403—Allocation of Home Office Expenses to Segments
  - CAS 9904.410—Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives
  - CAS 9904.418—Allocation of Direct and Indirect Costs
  - CAS 9904.420—Accounting for Independent Research and Development [IRD] Costs and **Bid and Proposal [B&P] Costs** (bold added for emphasis since IRD costs are not normally incurred by Consultants)

- Leave such costs (e.g., Company vehicles and other reimbursable costs) in the indirect cost pool(s) and not invoice customers for such costs.

- Remove particular costs from the indirect cost pool(s) that will be invoiced direct to those customers who will pay for them. Therefore, such costs will not be subject to the FAR or included in the Indirect Cost reimbursement percentage.

  For example, if a Consultant wants to invoice customers for office copies, remove all related costs for making office copies from the indirect cost pool so that neither the related costs nor billings affect the reimbursable cost pool(s).