



DIRECT AND INDIRECT LABOR RELATED-PARTY RENT

Audit Office

Paula Rivera, Chief Auditor



FINANCIAL MANAGEMENT SYSTEM

A Financial Management System should:

- *Accumulate and segregate direct and indirect costs*
 - » *A direct cost is any cost that can be identified specifically with a particular contract or project*
 - » *Indirect costs are those that are not specific to a contract or project*
- *Track reasonable, allocable, allowable and unallowable costs*
 - » *Reasonableness is a consideration in determining allowability*
 - » *Allocable refers to distinguishing the type of cost (direct, indirect, unallowable)*

ALLOWABILITY AND REASONABLENESS

CFR 31.201-2 A cost is allowable only when the cost complies with the following requirements:

- (1) Reasonableness
- (2) Allocability
- (3) Cost Accounting Standards (CAS), if applicable
- (4) Terms of the contract
- (5) Any limitations, in this subpart

- **31.201-3 Determining Reasonableness**

- » *If, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.*
- » *No presumption of reasonableness shall be attached to the incurrence of costs by a consultant.*
- » *Generally recognized as ordinary and necessary for the conduct of the consultant's business or the contract performance.*
- » *Generally accepted sound business practices, arm's length bargaining, and Federal and State laws and regulations.*
- » *Significant deviations from the consultant's established and documented practices.*

TOPICS

- *Labor*
 - » *Labor Rates*
 - » *Timesheets*
 - » *Promotions*
 - » *Compensation*
- *Related-Party Transactions*
 - » *Rent*

LABOR RATES

Labor rates can be

- A specific hourly rate
- A calculated hourly rate based on hours recorded for salaried employees
 - » *When salaried employees only record 40 hours a week on timesheets, the calculation of the hourly rate is monthly salary * 12 months / 2,080 hours*
 - *\$5,300 salary * 12 / 2,080 hours is an hourly rate of \$30.58*
 - » *When salaried employees are paid for approved hours in excess of 40 hours per week at straight time the hourly rate calculation is the amount paid / hours worked*
 - *\$1,225 weekly pay + \$61.16 / 42 hours worked is an hourly rate of \$30.58*
 - » *Uncompensated overtime is when salaried employees record all hours worked, but the amount paid does not change. There are two ways to account for uncompensated overtime – effective hourly rate or payroll variance.*

UNCOMPENSATED OVERTIME

Uncompensated overtime is when salaried employees record all hours worked, but the amount paid does not change. There are two ways to allocate uncompensated overtime – effective hourly rate or payroll variance.

» *Effective Hourly Rates: When salaried employees record all approved hours worked on timesheets, the calculation of the hourly rate is the salary divided by hours worked.*

- *\$1,225 weekly salary / 42 hours is an effective hourly rate of \$29.17*

» *Payroll Variance: When calculating the annual indirect rate all employee who recorded in excess of 2,080 hours are identified by direct and indirect categories. Excess direct labor is calculated and a credit is made to the indirect rate. The AASHTO Uniform Audit & Accounting Guide is an excellent resource.*

TIMESHEETS

- Timesheets must be prepared by all employees.
- Timesheets must be signed by the employee and approved by their supervisor.
- Timesheets must segregate direct and indirect hours. Direct hours must identify the project or contract.
 - » *Unallowable time must be properly identified.*
 - *Unallowable direct time must be recorded as direct labor (unauthorized overtime, non-reimbursed travel time, etc.)*
 - *Unallowable indirect time must be recorded to a separate general ledger account (directly associated time with unallowable activities, unallowable activities)*

PROMOTIONS

- Key personnel and classifications identified to work on our contracts are those necessary to complete the scope of work
- Promotions of key personnel or employees working on our contracts may not be allowable if determined unnecessary or unreasonable
 - ❖ *For example, if Paula Rivera is a Senior Engineer on a contract and is promoted to a Project Manager, her new classification may not be necessary or the increased pay rate may not be eligible for reimbursement.*
 - ❖ *To complete the scope of work a senior engineer is needed, not a project manager. The consultant will need to replace Paula with a senior engineer that has her same qualifications and experience.*

COMPENSATION

Compensation includes wages, bonuses, fringe benefits, deferred compensation, and employer contributions to pension plans.

- » *Total compensation must be reasonable for the work performed.*
- » *Individual elements must also be allowable and reasonable.*

Special considerations for closely-held firms that cause disproportionate allocation of direct and indirect labor

- » *Principals take infrequent draws in lieu of regular salaries*
- » *Principals take low salaries coupled with high bonuses*
- » *Principals wait until the firm's profitability is known at year-end and treat any remaining cash surplus as compensation.*

BONUS PLANS

Bonus payments must be reasonable in amount and must not represent a distribution of profits to owners.

31.205-6(a)(6)(ii)(B)

- *Best practice is to have bonus plans documented*
- *Bonus amounts must be pursuant to an agreement before the services are rendered*
- *Allowable bonus payments are based on clear eligibility requirements and determination of payment amounts*
- *Other best practices are to identify the period of the plan, the form of payment to be received, and the distribution timeframe*

RELATED-PARTY TRANSACTIONS

Charges for rental property costs between divisions, subsidiaries, or organizations under common control are allowable to the extent that the charges do not exceed the normal costs of ownership.

- ❖ *An owner, or owners, of a consulting firm who also own(s) a building where the company pays rent is common control of both entities by the individual(s). Exercising control over the rental property is key.*
- ❖ *Allowable indirect costs for rent under common control are depreciation, taxes, insurance, maintenance, and facilities capital cost of money (FCCM)*
- ❖ *FCCM is a calculation based on the capital asset, 31.205-10, using average net book value and the Treasury Rate.*

ADVICE

Maintain all relevant documentation for the record retention period.

For example:

Compensation – salary survey data and calculations

Labor – payroll registers, Personnel Request Forms, timesheets

Related Party rent calculations

Allocation methodologies

Accounting records – trial balance, general ledger detail, invoices, cancelled checks or bank statements

Travel receipts

Correspondence related to the Agreement

Questions?

THANK YOU

Paula Rivera, *Chief Auditor*

(916) 403-2679 paula.rivera@hsr.ca.gov

Lisa Moreno, *Senior Manager*

(916) 908-1190 lisa.moreno@hsr.ca.gov

Mary Phongmany, *Senior Manager*

(916) 902-1210 mary.phongmany@hsr.ca.gov

Tsira Lashkarava, *Senior Manager*

(916) 902-1157 tsira.lashkarava@hsr.ca.gov

California High-Speed Rail Authority
770 L Street, Suite 1160
Sacramento, CA 95814
www.hsr.ca.gov



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