



Chapter 1—Organization of this Guide and Defined Terms

1.1—Organization of This Guide

This Uniform Auditing and Accounting Guide is organized in chapters. Chapters are subdivided into sections, subsections, and paragraphs. For the sake of brevity, internal references to this guide most commonly follow the “short reference” format as illustrated in the following examples:

Short Reference

Section 2.4

Section 3.2.D

Section 5.6.A.2

Full Reference

Chapter 2, section 4

Chapter 3, section 2, subsection D

Chapter 5, section 6, subsection A, paragraph 2

1.2—General Terms

In this guide, words not defined shall be given their plain meaning. The following defined words and terms are used throughout this guide—

- “AASHTO” refers to the American Association of State Highway and Transportation Officials.
- The terms “A/E firm,” “engineering consultant,” “consultant,” “contractor,” or “firm” refer to Architectural and Engineering design companies that perform work on Government contracts.
- “AICPA” refers to the American Institute of Certified Public Accountants, the national, professional organization for all Certified Public Accountants.
- The terms “the CPA auditor,” or “the CPA” refer to independent CPA firms that perform audits, reviews, or other types of attestation engagements for A/E firms.
- The “*Code of Federal Regulations*” (CFR) is the codification of the general and permanent rules published in the *Federal Register* by the executive departments and agencies of the Federal Government. The CFR is divided into 50 titles that represent broad areas subject to Federal regulation. 48 CFR Chapter 12 sets forth the general guidelines used by State DOTs.
- The “*Cost Accounting Standards*,” or “CAS,” are issued by the Cost Accounting Standards Board (CASB), a section of the Office of Federal Procurement Policy within the U.S. Office of Management and Budget. The CASB has the exclusive authority to issue and amend cost accounting standards and interpretations designed to achieve uniformity and consistency in the cost accounting practices governing the measurement, assignment, and allocation of costs to contracts that involve Federal funds. The CAS are codified at 48 CFR Chapter 99. Certain CAS provisions are incorporated into FAR Part 31 and therefore apply to most Federal-aid highway program (FAHP) projects, while other provisions apply only to large contracts.

- The “*DCAA Contract Audit Manual*” (CAM or DCAA Manual 7640.1) is an official publication of the Defense Contract Audit Agency (DCAA). The CAM prescribes auditing policies and procedures and furnishes guidance in auditing techniques for personnel engaged in performing audits in compliance with FAR Part 31 and related laws and regulations. The CAM is published semiannually by the DCAA.
- The “*Federal Acquisition Regulation, Part 31*” (FAR). The FAR is codified at 48 CFR Part 31. The FAR is the primary regulation governing the acquisition of supplies and services with Federal funds. 48 CFR Part 31 sets the criteria for determining costs eligible for reimbursement on Federally- funded agreements and may be used to determine allowable costs for contracts funded solely by State funds.
- “FAR-Compliant Audit” refers to a formal audit or examination of the indirect cost rate schedule and associated notes, to obtain reasonable assurance that the costs presented in the schedule substantially comply with the Cost Principles of FAR Subpart 31.2. When performing FAR-compliant audits, auditors must apply the standards applicable to financial audits or examination-level attestation engagements as contained in the Government Auditing Standards issued by the Comptroller General of the United States.
- The “*Federal Travel Regulation*” (FTR) is contained in 41 CFR Chapters 300 through 304. The FTR implements policies for travel by Federal civilian employees and others authorized to travel at the Federal Government’s expense. The FAR incorporates certain FTR provisions for use in determining the allowability of contract costs incurred by engineering consultants.
- “GAAP” refers to the *Generally Accepted Accounting Principles*, a widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board (FASB).
- “*Generally Accepted Auditing Standards*” (GAAS) are published by the American Institute of Certified Public Accountants (AICPA). GAAS apply to financial statement audits and contain guidance regarding auditors’ professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports.
- The “*Government Auditing Standards*,” also known as “Generally Accepted Government Auditing Standards” (GAGAS) or “Yellow Book” standards, are issued by the U.S. Government Accountability Office (GAO).³ GAGAS prescribe general procedures and professional standards that examiners must apply when performing audits or attestation engagements of firms that conduct business with governmental entities. GAGAS standards also incorporate the Generally Accepted Auditing Standards specific to financial-related audits.
- “Indirect cost rate schedule” refers to the primary document used by engineering consultants to compute indirect cost rates (overhead rates) used for billings on Government projects. An indirect cost rate schedule is based on amounts obtained from the engineering consultant’s general ledger (after the adjusting entries have been posted to the accounts), as well as from amounts in the engineering consultant’s cost accounting system. This schedule must be in agreement with, or must be reconciled to, amounts from the engineering consultant’s general ledger or post-closing trial balance. An indirect cost rate schedule also is commonly referred as an “overhead schedule,” “schedule of indirect costs” or “Statement of Direct Labor, Fringe Benefits, and General Overhead.”
- “Management” refers to A/E firm owners, officers, and/or others responsible for the formulation and execution of the firm’s policies and procedures, including, but not limited to, internal controls, personnel policies, compensation policies, and labor-charging practices.
- “Overhead” or “indirect cost” refers to any cost that is not directly identified with a single final cost objective, but is identified with two or more final cost objectives or with at least one intermediate cost objective. Engineering consultants charge their indirect costs by applying an overhead rate to an allocation base (e.g., direct labor cost).

³ *Government Auditing Standards*, GAO-12-331G (Washington, D.C.: December 2011 Revision).

- “Overhead rate” or “indirect cost rate” refer to a factor/ratio computed by adding together all of a firm’s costs that cannot be associated with a single cost objective (e.g., general and administrative costs and fringe benefit costs), then dividing by a base value (usually direct labor cost) to determine a rate. This rate is applied to direct labor, as incurred on projects, to allow a firm to recover the appropriate share of indirect costs allowable per the terms of specific agreements. In this guide, the terms “indirect cost rate” and “overhead rate” are used synonymously.
- “State DOT” or “DOT” refers to a State department of transportation or other State transportation agency.
- “Statements on Auditing Standards” or “SASs” are interpretations of U.S. Generally Accepted Auditing Standards as issued by the Auditing Standards Board (ASB), the senior technical committee of the AICPA designated to issue auditing, attestation, and quality control standards and guidance.

1.3—Other Defined Terms

Actual Costs

Amounts determined based on costs incurred. Actual costs are supported by original source documentation, such as invoices, receipts, and cancelled checks. Actual costs generally are not determined based on forecasts or historical averages.

Actual Cost Agreement

Costs reimbursed under an Actual Cost Agreement are limited to the specified criteria (actual allowable costs) described in the agreement. These limitations are based on the Cost Principles found in FAR Subpart 31.2 and may include additional restrictions mandated by the laws of specific State DOTs. Direct and indirect costs billed against Actual Cost Agreements must exclude all unallowable costs, including certain costs that may be fully or partially deductible for the purpose of computing income taxes (e.g., interest, entertainment, and bad debts).

Advance Agreement

Contract language that specifies the treatment of special or unusual costs. For example, the use of statistical sampling methods for identifying and segregating unallowable costs should be the subject of an advance agreement under the provisions of FAR 31.109 between the engineering consultant and the cognizant audit agency. The advance agreement should specify the basic characteristics of the sampling process. FAR 31.109 provides that advance agreements must be “in writing, executed by both the contracting parties, and incorporated into applicable current and future contracts. An advance agreement shall contain a statement of its applicability and duration.”

Agreement

A contract between a State DOT and an A/E firm. An Agreement is a binding, legal document that identifies the deliverable goods/services to be provided, under what conditions, and the method of reimbursement for such goods/services. An Agreement may include both Federal and State requirements that must be met by the State DOT and the engineering consultant. Agreements usually indicate start and finish dates, record retention requirements, and other pertinent information relative to the work to be performed.

All-Inclusive Hourly Rate Agreement

A contract using a provisional hourly billing rate based on a firm’s estimated direct labor and overhead costs, plus a negotiated profit margin. Generally, provisional hourly rates are temporary and are adjusted during the audit process. Negotiated hourly rates may be used for the life of an Agreement or instead may be adjusted periodically based on the provisions of the agreement.

Allocable Cost

FAR 31.201-4 provides that a cost is *allocable* to a Government contract if the cost—

- (a) Is incurred specifically for the contract;
- (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

Allowable Cost

Depending on the nature of specific cost items, allowable costs may either be billed directly to contracts or included as overhead costs; however, FAR 31.201-2 provides that a cost is an *allowable* charge to a Government contract only if the cost is—

- reasonable in amount,
- allocable to Government contracts,
- compliant with Generally Accepted Accounting Principles and standards promulgated by the Cost Accounting Standards Board (when applicable),
- compliant with the terms of the contract, and
- not prohibited by any of the FAR Subpart 31.2 cost principles.

Audit

A formal examination, in accordance with professional standards, of accounting systems, incurred cost records, and other cost presentations to verify their reasonableness, allowability, and allocability for negotiating agreement fees and for determining allowable costs to be charged to Government contracts. Audits include an evaluation of an engineering consultant's policies, procedures, controls, and actual performance. Audit objectives include the identification and evaluation of all activities that contribute to, or have an impact on, proposed or incurred costs related to Government contracts.

Audit Cycle

The series of steps that auditors perform in completing an audit engagement. The procedures performed may vary somewhat, but the Audit Cycle generally includes audit planning, review of the auditee's permanent file, preliminary analytical review, audit fieldwork (including entrance and exit conferences), submittal of the draft audit report to the auditee for review and comment, and the issuance of the final audit report.

Audit Resolution Process

The process that State DOTs and the auditee engage in to resolve audit findings. This process may include the negotiation of a settlement and/or may involve legal counsel and court procedures.

Audit Trail

A record of transactions in an accounting system that provides verification of the activity of the system. A complete audit trail allows auditors to trace transactions in a firm's accounting records from original source documents into subsidiary ledgers through the general ledger and into general-purpose financial statements and billings/invoices prepared and submitted by the engineering consultant.

Billing Rates (Hourly Labor Rates)

Generally refers to the hourly labor rates invoiced by an engineering consultant for work performed on an agreement. For a cost plus fixed fee agreement (the most common type of agreement), billing rates are determined based on employees' actual payroll rates. By contrast, for an all-inclusive hourly rate agreement, billing rates are determined based on actual payroll rates with additional amounts included for overhead and net fee (profit).

Contracting Officer

A position title used in FAR Part 31 to identify a person with the authority to bind a State or Federal agency to a contract. Within State DOTs, contracting officers are the individuals who enter into, administer, and/or terminate contracts and make related determinations and findings. In State DOTs, auditors generally act at the request of, and on behalf of, contracting officers.

Corporation

A business structure where stock is issued and sold to shareholders. A corporation typically has a president, numerous vice presidents, a chief financial officer and/or treasurer, and a secretary. Corporate employees usually are paid based on an hourly wage rate or annual salary. The liability of individual stockholders (owners) is limited to their investments in the corporation's stock.

Depending on how a corporation is formed, it will be taxed under either Subchapter C or Subchapter S of Chapter 1 of the Internal Revenue Code. A C-Corporation is taxed on its income at the corporate level, and stockholders pay a second layer of tax on the dividends they receive from the corporation. By contrast, S-Corporations are not taxed at the corporate level; instead, the S-Corporation's income or losses are passed through to its shareholders, who then report the income or loss on their individual tax returns.

Cost Center

A non-revenue-producing element of a business organization. Cost centers are used to accumulate and segregate costs.

Cost Objective

An agreement/contract, function or organizational subdivision, or other work unit for which the costs of processes, products, jobs, or projects are accumulated and measured. An "intermediate cost objective" is a cost objective used to accumulate costs that are subsequently allocated to one or more indirect cost pools and/or final cost objectives.

Cognizant Audit

This concept was developed to assign primary responsibility for an audit to a single entity (the "cognizant agency") to avoid the duplication of audit work performed in accordance with Government Auditing Standards to obtain reasonable assurance that claimed costs are accordance with the FAR Subpart 31.2 cost principles. Such audit work may be performed by home-State auditors, a Federal audit agency, a CPA firm, or a non-home State auditor designated by the home-State auditor.

Common Control

Exists in related-party transactions when business is conducted at less than arm's length between businesses and/or persons that have a family or business relationship. Examples are transactions between family members, transactions between subsidiaries of the same parent company, or transactions between companies owned by the same person or persons. Common control exists when a related party has *effective control* over the operating and financial policies of the related entity. Effective control may exist even if the related party owns less than 50 percent of the related entity. (For further discussion, see Section 8.23.B and Section 11.4.G.1, Example 11-8.)

Cost Plus Fixed Fee Agreement

An agreement in which all the cost factors, except the fixed fee, are based on the engineering consultant's actual allowable costs. The fixed fee is a specific, predetermined amount, as identified in the agreement.

Facilities Capital Cost of Money (FCCM)

Although interest costs associated with the financing of capital are unallowable, some costs associated with the engineering consultant's investment in fixed assets are allowable. Specifically, Facilities Capital Cost of Money (FCCM) is an imputed cost determined by applying a charge rate to the engineering consultant's fixed assets used in contract performance. FCCM is not required to be recorded in the engineering consultant's formal accounting records; instead, FCCM is computed as a charge rate based on the following factors:

- The average annual net book value of the engineering consultant's investments in the fixed assets used for allowable business activities (in accordance with the cost principles of FAR Subpart 31.2),
- The prorated average Prompt Payment Act Interest Rate⁴ determined by the U.S. Secretary of the Treasury for the accounting period in question, and
- The engineering consultant's direct labor base used to determine overhead rates.

(See Section 8.6 for further discussion regarding FCCM.)

Cost Principles of FAR Subpart 31.2

These principles establish the framework for determining allowable and unallowable charges against Federal-aid highway program (FAHP) contracts. FAR Subpart 31.2 lists expressly unallowable costs and establishes criteria for determining the allocability and reasonableness of cost items.

Directly Associated Cost

Refers to a cost generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not also been incurred (see FAR 31.001 and FAR 31.201-6(a)). If a cost is determined to be unallowable, then its directly associated costs also must be disallowed.

Direct Cost

Any cost that is identified specifically with a particular final cost objective. Direct costs are not limited to items that are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.

Direct costs include labor, materials, and reimbursable expenses incurred specifically for an agreement. All direct labor costs allocable to design and engineering contracts (regardless of the contract type, e.g., lump-sum versus actual cost) must be included in the direct labor base regardless of whether the costs are billable to a client.

Entrance Conference

A meeting between the auditor and the auditee during which the purpose and scope of the audit are discussed.

Exit Conference

A meeting held after the completion of audit field work. The exit conference generally focuses on a discussion of the preliminary audit findings, which are subject to change based on further audit testing, supervisory review, and additional information submitted by the auditee.

Federal-Aid Highway Program (FAHP) Contracts

Refers to agreements for the acquisition of supplies and services that are partially- or fully-funded from Federal sources. "Government contracts" is a more encompassing term, as it includes FAHP contracts and all other contracts with governmental entities, including contracts that are fully funded by State or municipal governments.

⁴ Current Treasury rates are available at: http://www.treasurydirect.gov/govt/rates/tcir/tcir_opdprmt2.htm.

Field Office

A field office is a facility that the engineering consultant specifically establishes, or has furnished to it, at or near the project site. The field office must be used exclusively for project purposes. The use of a field office allows for the computation of a field office overhead rate, which is designed to reimburse the engineering consultant for the fringe benefits of the field personnel and associated home office support. Field offices may exist in several forms. For example, an engineering consultant's employees may work for a period of time in an on-site office maintained by a State DOT. Since the engineering consultant's employees do not work out of their own offices and do not receive office support in their daily activities, the hours billed for these employees may not qualify for the engineering consultant's full overhead rate. Instead, a field rate may need to be established to allocate a reasonable portion of the engineering consultant's indirect costs to a field office.

Financial Statements

Financial statements are formal records that summarize a firm's business activities. Financial statements usually are compiled on a quarterly and annual basis. In this guide, the term "General Purpose Financial Statements" is used to refer to the basic financial statements, which include an Income Statement, Balance Sheet, and Statement of Cash Flows. This guide also makes reference to an indirect cost rate schedule, which is a Special Purpose Financial Statement used to report specific financial information to governmental agencies such as State Departments of Transportation and the U.S. Department of Defense.

Finding (Audit Finding)

An audit finding may result from an engineering consultant's deficiencies in internal control, fraud, illegal acts, the violation of contract or grant provisions, and/or abuse. When auditors identify deficiencies, they should plan and perform procedures to develop the elements of the findings that are relevant and necessary to achieve the audit objectives. In accordance with GAGAS, when documenting a finding, the auditor should include the condition, criteria, cause, effect, and a recommendation for correction. See GAGAS Chapters 4.10 to 4.14 for more details. Attestation engagements are discussed in GAGAS Chapters 5.11 to 5.15.

General and Administrative (G&A) Expenses

Costs of operating a company that are incurred by, or allocated to, a business unit and are not directly linked to the company's products or services.

Interim Audit

An audit conducted during the life of an agreement and designed to determine the actual allowable costs as of the audit date, including costs billed by the prime engineering consultant and any subconsultants. During an interim audit, auditors typically adjust the engineering consultant's billed costs (including direct labor, overhead, and other direct costs) to the allowable costs actually incurred. Interim audits generally involve the use of a standard audit program, although the procedures used may vary somewhat depending on the agency performing the audit.

Internal Controls

Include the plan of organization and the methods and procedures adopted by management to ensure that the firm's goals and objectives are met; that resources are used consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Limited Liability Companies (LLCs) and Limited Liability Partnerships (LLPs)

Business entities in which the members (owners) generally are liable only to the extent of their invested capital. LLCs and LLPs usually are taxed as partnerships (no taxation at the corporate level); although some LLCs elect to be taxed like C-Corporations (taxation applies at the corporate level, before the distribution of dividends).

Lump Sum (Fixed Price) Agreement

An agreement in which the method of payment for delivered goods and/or services is a fixed amount that includes salaries, overhead, and profit. Once the lump-sum amount is determined, the goods and/or services must be provided regardless of the engineering consultant's actual costs. No adjustments are permitted to compensate the engineering consultant for costs in excess of the contract's fixed amount unless there is a significant change in the scope of work that results in an approved change order.

Negotiated Hourly Rate Agreement

An agreement in which hourly billing rates (including labor, overhead, and net fee) are negotiated in advance and are listed for a period of one year or more.

Overtime Compensation

Generally, this is compensation paid to employees who work more than 40 hours per week or 80 hours in a pay period. Overtime pay rates may be based on employees' normal hourly rates or may include "premium overtime" such as time and a half or double time. In accordance with the Fair Labor Standards Act (FLSA), premium overtime pay generally is required for hourly workers but is optional for certain salaried employees (exempt employees).

Partnership

A business with two or more co-owners, who may or may not have established salaries. Generally, partners are jointly responsible for the firm's debts and other liabilities, and this liability exposure is not limited to the partners' individual investments in the firm. When establishing hourly pay rates that may be billed to Government contracts, partners may be treated the same as sole proprietors.

Post Audit (Project Close-Out Audit)

An audit done after an engineering consultant completes all scheduled work on a project. The scope of a post audit may include all costs billed to the project, including direct costs, overhead costs, and costs for subconsultants. Post audits generally involve the use of a standard audit program, although the procedures used may vary somewhat depending on the agency performing the audit.

Pre-Award Review

An examination conducted by, or on behalf of, a State DOT to verify financial information supplied by an engineering consultant. The examination may involve a desk review performed at the audit office and/or fieldwork at the engineering consultant's place of business. Upon completion, the audit results are provided to the State DOT contracting officer for use during contract negotiations.

Provisional Hourly Rate Agreement

An agreement in which hourly billing rates, including labor, overhead, and net fee, are negotiated in advance but are subject to adjustment after actual labor and overhead costs are determined through an audit.

Reasonable Cost

A cost is reasonable, 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. See Section 4.2 for additional discussion.

Sole Proprietorship

A business with only one owner. Sole proprietors commonly do not have established salaries, but instead may rely on draws from the firm's profits to obtain payment for their services.

Source Documents

Original documents that support the costs recorded in an engineering consultant's accounting records, including general and subsidiary ledgers. Source documents include, but are not limited to: time sheets, payroll registers, invoices, hotel receipts, rental slips, gasoline tickets, cancelled checks, tax returns, insurance policies, and minutes of corporate meetings.

Task Assignment (Task Order) Agreement

An agreement that specifies a time period for performance but does not include a complete description of all the work to be completed under the agreement. Tasks that require the engineering consultant's expertise are assigned as needed, and each task has its own maximum payable amount. The total amount paid on all the tasks may not exceed the total amount of the agreement.

Total-Hour Accounting System

A total-hour accounting system records all hours worked by all employees, regardless of whether the employees are exempt from overtime pay or whether all direct labor hours are billed to specific contracts. All engineering consultants that receive compensation under actual cost agreements must maintain a total-hour accounting system. See DCAAP 7641.90 Chapter 2-302.1(5) for details. DCAAP 7641.90 is available at www.dcaa.mil/chap6.pdf.

Unallowable (Cost)

An item of cost that is ineligible for cost reimbursement. Unallowable costs must not be billed to Government contracts either directly or through the application of an overhead rate. When an unallowable cost is incurred, its directly associated costs also are unallowable.

Uncompensated Overtime

FAR 52.237-10 defines *uncompensated overtime* as "hours worked without additional compensation in excess of an average of 40 hours per week by direct charge employees who are exempt from the Fair Labor Standards Act. Compensated personal absences such as holidays, vacations, and sick leave must be included in the normal work week for purposes of computing uncompensated overtime hours."