

Guest Column

By T. Wayne Owens

AASHTO Uniform Audit & Accounting Guide: New Solutions for an Old Problem

Updating the American Association of State Highway and Transportation Officials' (AASHTO) new *Uniform Audit & Accounting Guide* took two years to finalize and required much time and effort from the AASHTO Task Force and ACEC.

Calling the *Audit Guide* an update or a guide probably is unfair. This new version contains more meaningful information and clearly defines what should be included in an overhead rate. In addition, it recognizes that staffing issues at state DOT audit agencies result in more reliance on external CPAs. Plus, standard forms have been created to help build trust between states and create more consistency in reporting for consultants.

The Federal Highway Administration (FHWA) plans to issue a rulemaking, which will incorporate this document into regulation by reference and make it authoritative, meaning all of the guidelines as they apply to federally funded projects must be followed.

The guide is effective after Dec. 31, 2009, and all states have agreed to drop individual policies in favor of a uniform standard. Any departure from the guide must comply with state.

Cognizance at Last

Consultants who contract with multiple states spend considerable time trying to comply with the various "interpretations of the Federal Acquisition Regulation (FAR)" and other limitations established by various states. Firms that have presented a cognizant letter have been forced to modify their overhead rates to comply with unique state requirements. Indiana, for example, can handle only one rate, forcing firms to contract on a blended rate as opposed to, say, their home office rate. Such practices have resulted in as much as a 50-point drop in the overhead rate. Other states have salary limitations (caps are illegal), and cognizant rates have been modified for "excess compensation" or "unallowable bonuses."

The problem of multiple rates is not simply one of lost time. Firms in cognizant states with policy limitations have been forced to use artificially low overhead rates, thus putting them in the position of having a lower profit than firms from non-policy states.

Starting this year, the guide will become authoritative, and states must comply or risk losing federal highway funds. FHWA will monitor state compliance and provide guidance where necessary.

Reasonable Compensation Defined

Labor and benefits are the single largest items of overhead and represent the greatest risk to the government. Unlike other

costs, there is no single piece of documentation that supports the allowance of this cost. In addition, executive compensation represents the greatest risk, since the owners typically are the executives. For the purposes of overhead, "executives" are defined as the five highest compensated individuals, plus 2 percent shareholders and family members of this group.

Under prior guidance, firms enjoyed significant flexibility

in their compensation policies—so much so that it was not unusual for firms to achieve the 75th percentile in allowable compensation. Compensation levels of firms that earned a majority of revenues from commercial clients were set by the market. The only limitation to allowable compensation was the Benchmark Compensation Amount, the highest amount firms can charge to a government contract. With the new guide, these presumed levels of compensation no longer are available. To achieve maximum allowable compensation, firms must use a combination written compensation policy and a written bonus plan.

The written compensation policy must include an analysis of the compensation structure. Practically speaking, standardized job titles must be used along with three surveys to establish a base compensation for all executives. Although a lower compensation level could be established and the difference made up in bonuses, there is a risk of the bonus plan being unallowable, thus the firm would have much lower compensation.

Scrutiny of bonus plans has increased with the new guide. Plans must be written and cover an entire group or class of employee with a reasonable, justifiable basis. A reasonable exclusion would be non-exempt employees who receive premium overtime, which compensates them for extra efforts. Care should be taken to develop bonus plans that eliminate the possibility that such plans are seen as a distribution of profits. This can happen if the only participants in the plan are owners. Even if the bonus percentages do not match the ownership, a DOT could successfully challenge these efforts.

The guide recommends the development of a compensation matrix by FHWA that can be used to determine reasonable-



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ness. This matrix will be based on survey medians and will be updated annually. The significance of the matrix is that it limits compensation if a firm does not conduct its own compensation analysis. This is because the median (midpoint) can be as much as 20 percent lower than the mean (average). This is useful for firms that do not expect to achieve high levels of compensation by eliminating some unnecessary work.

An important point to remember is that the government cannot tell a firm what its compensation policy is, only what it is willing to reimburse. If flexibility in compensation structure is important for a firm, then that should be the driver, but it must be weighed against the level of government work and the overall profit picture.

Accounting Systems

There has been a great deal of flexibility among states when dealing with small firms. States have allowed noncompliant accounting practices and estimated overhead rates. The new guide, however, eliminates this flexibility. All government contractors, regardless of size, must have a functioning job cost system under general ledger control using the accrual basis of accounting.

Overhead Audits

The guide is consistent with CPA professional standards and addresses many of the problems to blame for poor-quality audits. The starting point is the selection of a CPA firm. To perform an overhead audit, a firm must be proficient in three areas: the FARs, the cost systems and business practices of an engineering firm, and compliance auditing for a government contract. The starting point for this knowledge is the *Audit Guide*; however, a thorough understanding of these three areas is necessary. It is up to the consultant to understand the selection criteria and to choose based on qualifications as determined by an interview process.

Conclusion

It has been a long road, but the new AASHTO *Uniform Audit & Accounting Guide* is complete and is a very workable document. AASHTO, FHWA, ACEC and AICPA all had input into the guide, and the finished product reflects the dedication of these groups. Consultants now must apply this same commitment to government contracting processes. Consultants must understand their responsibilities and manage their policies, procedures and decisions. Over time, this will result in a business that is more proactive in its management and will enhance bottom-line profits. ■

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Uniform Audit and Accounting Guide Seminar Downloads Available

All four recent online seminars regarding the new AASHTO *Uniform Audit and Accounting Guide* are available for purchase and download on-demand through the ACEC Bookstore at www.acec.org/publications.

Available on-demand downloads include:

- *New State DOT Compensation and Audit Rules That Will Affect Your Bottom Line*
- *New Rules on Allowable and Reasonable Compensation*
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