

FAR Overview: Who, What, Why, and How

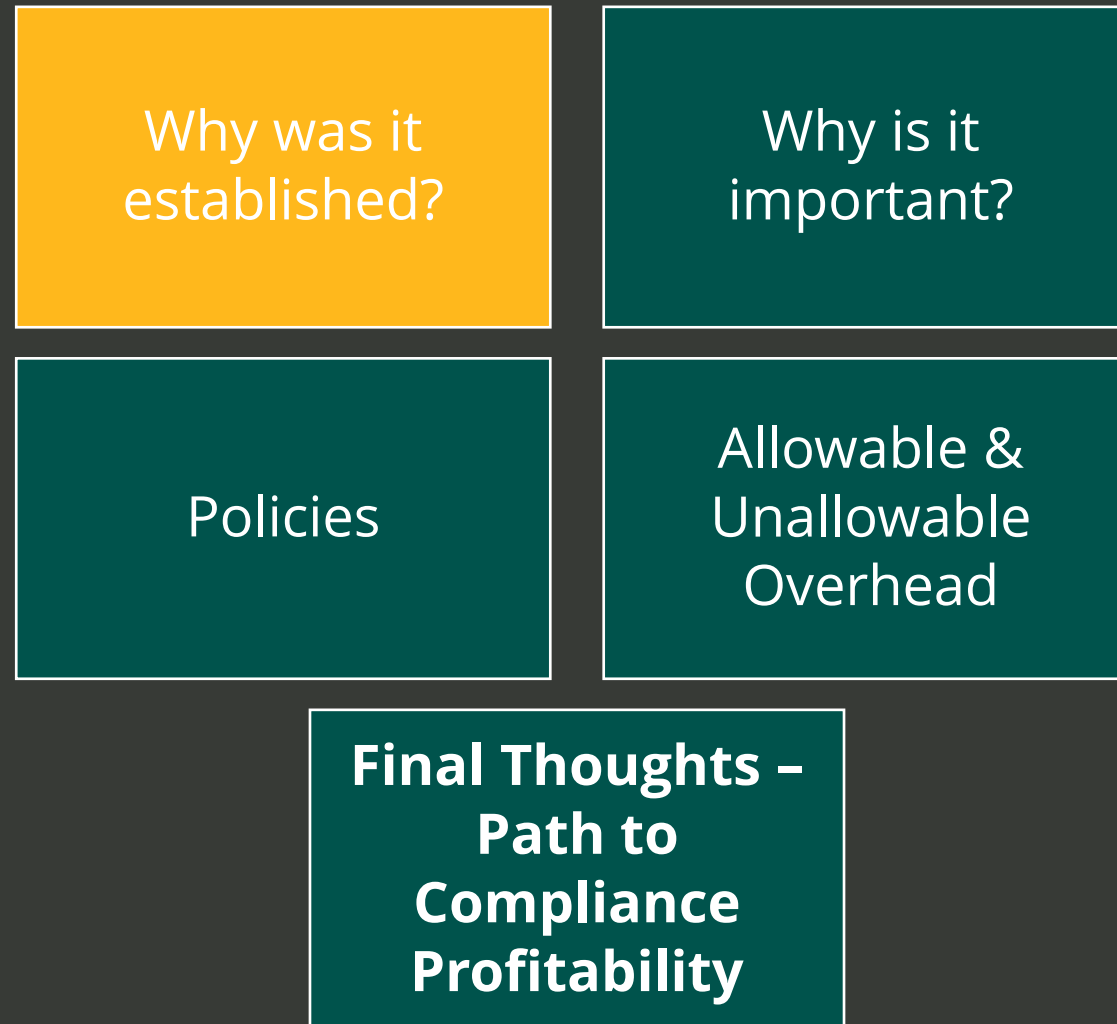
PRESENTED BY:

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Agenda

- Overview
- Why FAR established
- Why FAR is important
- Key policies
- Unallowable costs
- Manage profitability
- Final Thoughts – Path to Compliance Profitability

Overview



Why was the FAR established?

- Federal government procurement spending in 2019 exceeded \$586 billion.
- In the commercial marketplace, price is typically determined by market forces.
- Price in the governmental marketplace is based on incurred costs.
- Thus, determining what constitutes a “cost” is critically important to both the government and the contractor.

Why was the FAR established? Part 2

- Throughout history, there have been concerns about contractor “profiteering.”
- Congress has enacted:
 - Authorizing price fixing –google “Emergency Price Control Act of 1942.”
 - Establishing profit limitations
 - Compulsory renegotiation of contracts
 - Requiring the disclosure of cost and pricing data
 - Mandating the use of uniform cost accounting practices
- Two principal regulations govern the negotiation, administration, and settlement of Government Contracts:
 - The Federal Acquisition Regulation (FAR)
 - The Cost Accounting Standards (CAS)

Why was the FAR established? Part 3

- The Federal Acquisition Regulation (FAR)
 - Result of a 1979 statute directing the Office of Federal Procurement Policy within the Office of Management and Budget to “issue policies...for the purposes of promoting the development and implementation of [a] uniform procurement system.”
 - Partly in response to this directive, the FAR was issued in 1983, and took effect in 1984.
 - It has been revised frequently since then, in response to legislation, executive orders, litigation, and policy considerations.

Why was the FAR established? Enable Procurement

- The FAR enables procurement by establishing an overhead rate based on uniform guidelines.
- Calculation:
 - $\text{Overhead \$'s} / \text{Direct Labor \$'s} = \text{Overhead Rate}$
 - Overhead rate is applied to DL and its intent is for a firm to breakeven on incurred and allowable costs when doing business with the Government.
 - **Important to know - due to unallowable costs, a firm never recovers all incurred overhead costs. Hence the importance of profit or fee.**
 - Haircuts to overhead can quickly eliminate your profit resulting in doing work for no profit or even at a loss.

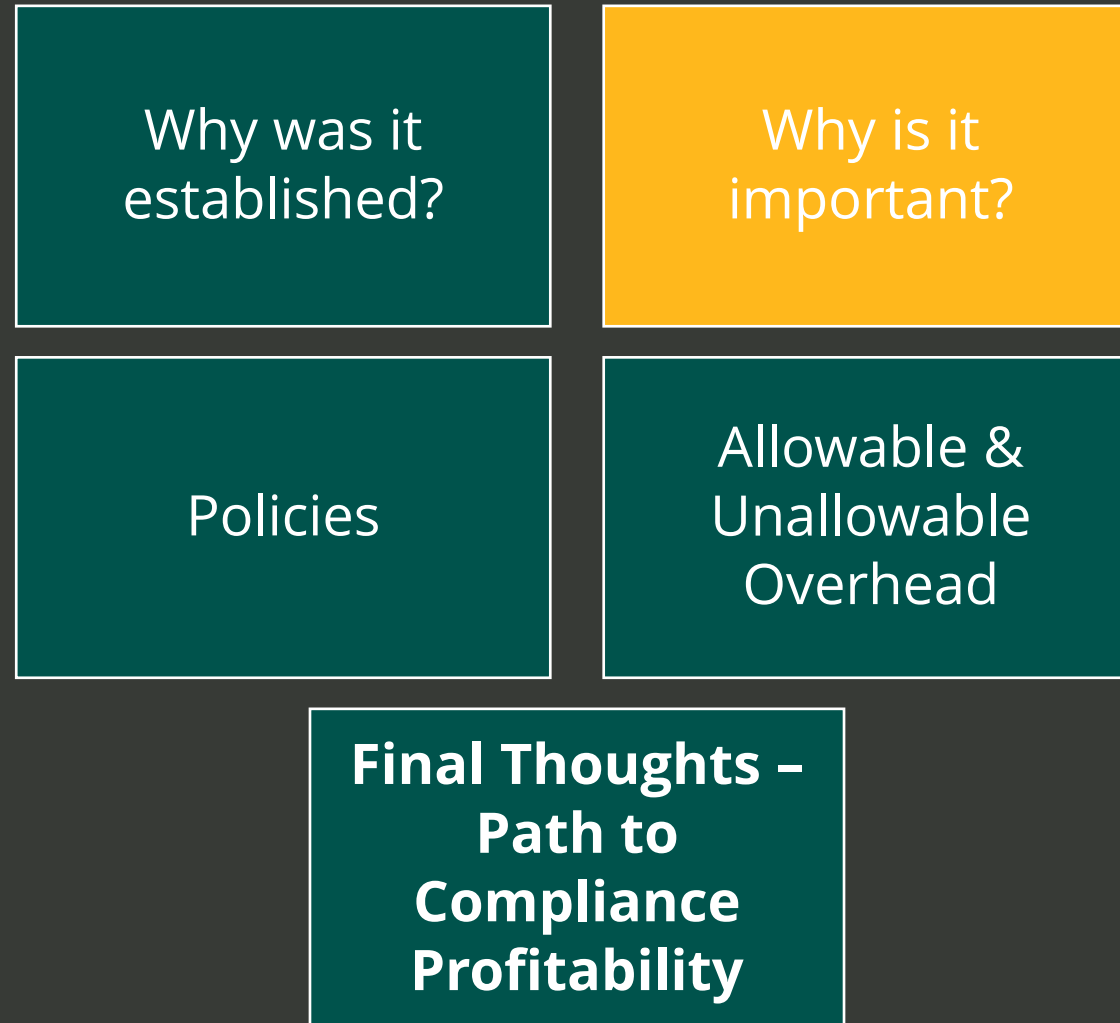
History specific to our Industry!

- 2009 OIG audit sparked by state DOT concerns over executive compensation and indirect costs
- 21 of 41 firms claimed ~\$15.7M in unallowables — mostly executive pay outside FAR limits plus luxury vehicles
- 6 of 9 CPA firms lacked FAR training, missing obvious disallowed costs and casting doubt on audit reliability
- FHWA/DOT oversight gaps allowed errors to slip through
- Result: AASHTO Audit Guide tightened, additional certifications of unallowed costs, National Compensation Matrix (NCM) highly promoted, support for vehicle costs

References:

https://www.oig.dot.gov/sites/default/files/Overhead_FINAL_2-5-09_508.pdf

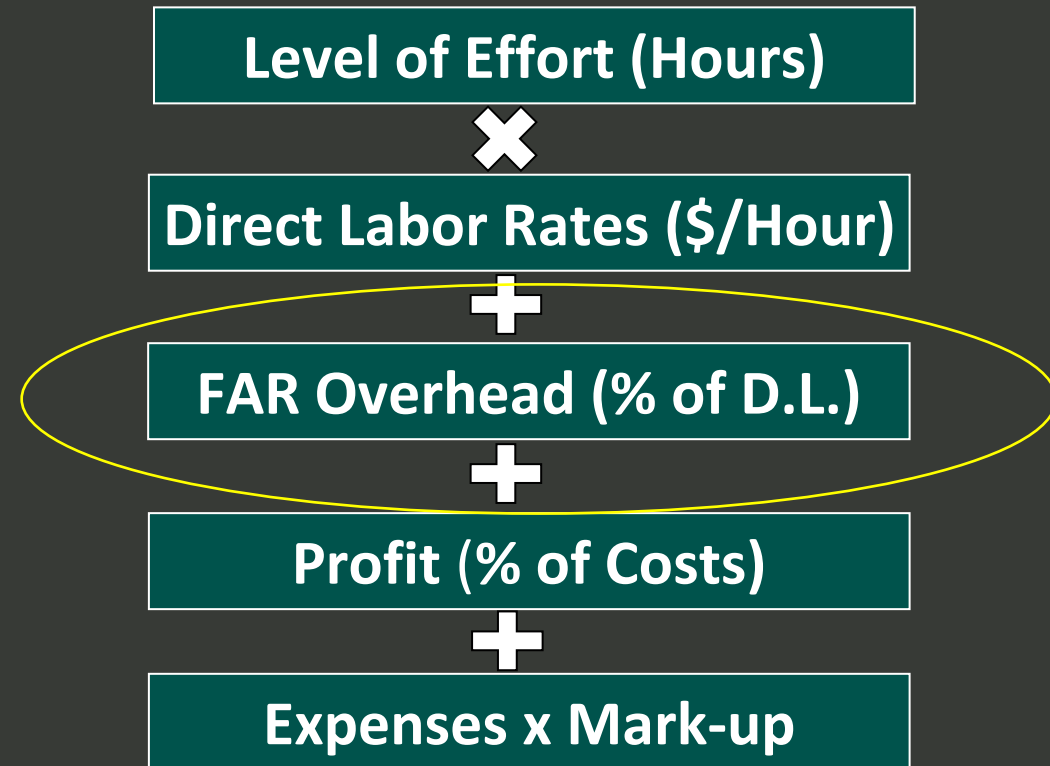
Overview



The FAR Compensation Formula

It's **HOW** you make money!!

Consultant Fees =



Consultant Fees = ((DL+(Ovh Rate*DL))*Profit), per PennDOT Pub.93

It's the Law!



40 U.S.C. 1101-1104 (Brooks Act)




23 U.S.C. 112 – Letting of Contracts



23 CFR 172 - Administration of Engineering and Design Related Service Contracts



FAR Part 31 – Contract Cost Principles and Procedures



Other parts of the FAR may be used by a contracting agency if they formally adopt, by statute or within approved written policies and procedures.

Priorities

Federal Law – Legislative passage; QBS is KEY; FAR is required in various federally funded programs



Boards of Contract Appeals – overrules regulations and policies, if applicable



Federal Regulation – Adopted by an open formal rule making process by agency; must not conflict with the law; most of the FAR is regulatory



State Law – must be legislation; may not override federal law; may override federal regulation



State Regulation – Must be adopted by an open formal rule making process; must not conflict with the law



Court Decisions – may be interpretive; usually for narrow circumstances; may apply retroactively

Federal Law MUST be Followed if Federal Funds are Used

- Even if state/local funding is used for local matching, it is still a Federal Project.
- State law may override Federal regulations or policies.
- State law may NOT override Federal law.
- Federal regulations take precedence over state regulations or local regulations.
- No state policies for Federal projects.

Regulation, Principles, Standards, & Guidance

- ✓ Federal Acquisition Regulation (FAR) Part 31
- ✓ Generally Accepted Accounting Principles (GAAP)
- ✓ Cost Accounting Standards (CAS)
- ✓ Government Auditing Standards (GAS, GAGAS, or Yellow Book)
- ✓ DCAA Contract Audit Manual (DCAM)
- ✓ Generally Accepted Auditing Standards and AICPA guidance (GAAS, Auditing Standards or Guidance)
- ✓ AASHTO Uniform Audit and Accounting Guide (AUAAG)

Summary of the Laws and Regulations - FHWA

- Consulting firms are required to account for and bill in accordance with Federal cost principles (FAR Part 31). Failure to do so could result in:
 - Suspension
 - Debarment
 - False Claims Act
 - Imprisoned not more than 5 years
- Contracting agencies are required to provide reasonable assurance to FHWA that costs paid are in accordance with the Federal Cost Principles



Revolutionary FAR Overhaul - RFO

Overview



Establishing Policies

What is best for YOUR firm? **A path to managing profitability.**

Typical Policies

Compensation Philosophy

Bonus

Labor Costing

Premium Overtime

Bid and Proposal/Design Build

Vehicle Costing/Charging Rates

Equipment Costing/Charging Rates

Printing

Phones

Level of Effort

×

Direct Labor Rates

+

FAR Overhead

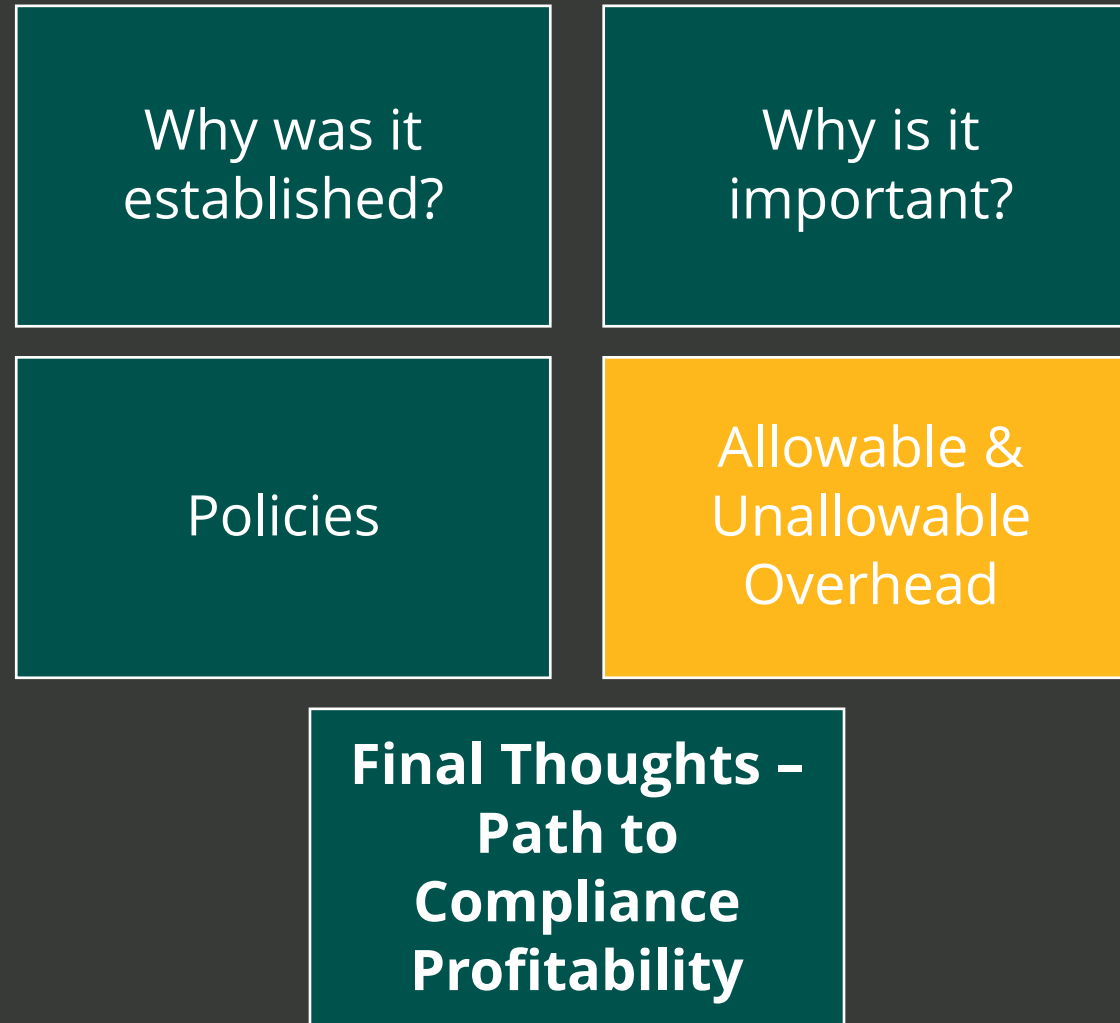
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Profit (% of Costs)

+

Expenses x Mark-up

Overview



Allowable & Unallowable Costs (FAR Part 31) and their Connection to Profitability



The Keys to Allowability

(FAR 31.201-2(a))

- A cost is allowable only when the cost complies with all of the following requirements:
 - (1) Reasonableness.
 - (2) Allocability.
 - (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
 - (4) Terms of the contract.
 - (5) Any limitations set forth in this subpart.

What it Means

- Reasonable (FAR 31.201-3(a))
 - Prudent businessperson
 - Ordinary and necessary
 - Contractor's established practices
- Allocability (FAR 31.201-4)
 - Benefits the Government and other work
 - Necessary for the overall operation of the business
- Documentation (FAR 31.201-3(d))
 - "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation..."

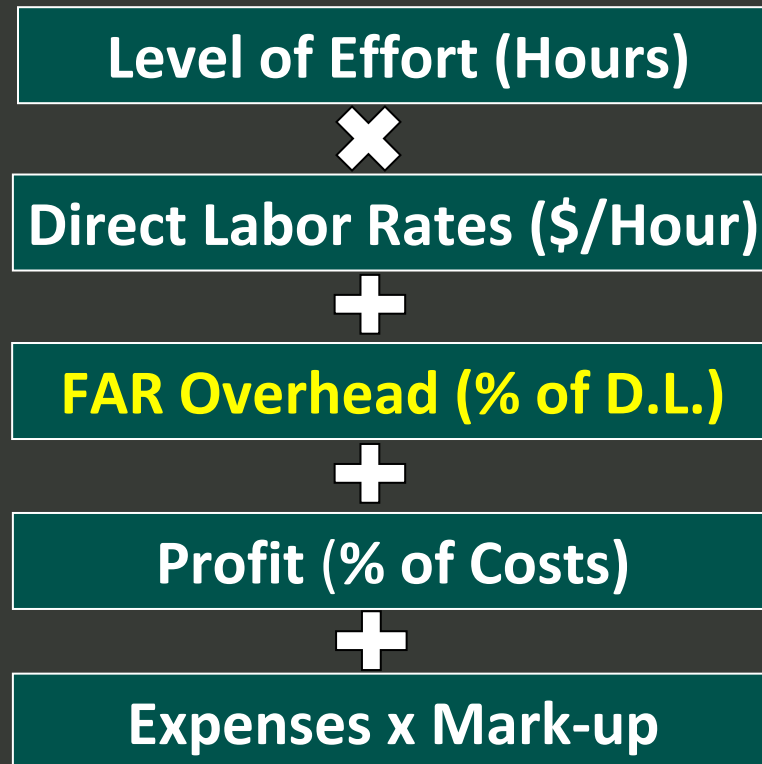
Why Unallowable?

- Certain costs are not required to conduct business with the government.
- Certain costs are associated with public policy issues.
- Certain costs are not associated with the normal operation of the business the government is contracting with.



Allowable OH is the Most Important Part of the FAR Compensation Formula

Consultant Fees =



$$\text{Consultant Fees} = ((\text{DL} + (\text{Ovh Rate} * \text{DL})) * \text{Profit})$$

Compensation



Reasonable Compensation: What & Why?

Compensation Philosophy

- FAR requires “reasonable” compensation by labor category
- Must be benchmarked using published salary surveys and/or NCM
- For executives, reasonableness considers firm size and performance metrics
- Consultants may justify up to the 75th percentile if performance is documented



(examples, not endorsements)

Reasonable Compensation: Using the NCM to Justify Executive Pay

Plan for and Manage Executive Comp – **participate in surveys**

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National Compensation Matrix Tool - 2025

Automated Tool for Compensation Allowability

Enter Gross Revenues for Target Firm: **31,000,000**

Position	Formulaic Result	+RoR	Computed Compensation
Chairman (non-CEO)	282,306	19,564	301,869
CEO/President	589,241	68,902	646,000
Executive Vice President / Chief Operating Officer	394,458	28,131	422,590
Senior Vice President	350,976	30,761	381,737
Vice President	280,596	19,750	300,347
Chief Financial Officer	342,170	33,560	375,730
Top Engineering Executive	284,686	5,915	290,602
Human Resources Director	161,834	11,214	173,049

NOTE: CEO/President may only be applied to a single executive. (‡)

**** At the time of this release, all positions are subject to a statutory compensation cap of \$646,000 until a new authorized amount is published by OFPP.**

Statutory Compensation Cap for Calendar Year 2024:	646,000
NCM Revenue Floor:	2,000,000
NCM Revenue Ceiling:	500,000,000

References:

FAR 31.205-6(b), 31.205-6(p),
31.201-2(d), & AAG Ch. 7 & Appendix B

Travel Costs

A person in business attire (light blue shirt, dark tie, light-colored trousers) is shown from the waist down. They are holding a dark blue passport in their right hand and the handle of a black suitcase in their left hand. The background is a blurred city street with a red umbrella visible in the distance.

Travel Costs: Vehicle Costs

- **AASHTO Guide - 8.26.D. Vehicle Costs**
 - Personal use discussion
 - Mileage logs or no mileage logs?
 - Yes on mileage logs
 - How about vehicle allowances? Not mentioned in the guide.
 - Adequate support must be provided to document business/personal use
 - Luxury vehicles
 - FAR does not define “luxury”
 - Beauty is in the eye of the beholder

Section H – Expense Accumulation and Billing

2009 OIG Investigation

H.7. Vehicle Expenses. Does the Company provide vehicles to employees for business purposes?

☐ Yes ☐ No

a. If “yes,” are the vehicles leased or owned?

☐ Leased ☐ Owned

b. Identify the total number of vehicles owned

____ Leased ____ Owned

c. Are mileage logs maintained for all vehicles?

☐ Yes ☐ No

Explanation: _____

d. Is mileage separated by direct and indirect classifications, and is mileage incurred in connection with unallowable activities tracked? ☐ Yes ☐ No

Explanation: _____

e. What recovery/billing rate is used for Company vehicle mileage reimbursement?

\$ ____ per mile.

Explanation: _____

f. How was the rate developed? _____

-If the company has vehicles, check back to H.2 and H.4 for consistency.
-If the company does not keep mileage logs, this is an internal control issue.
-If the company does not track direct, indirect, unallowable, this is an issue.

Basic Travel Rules

- Federally funded contracts limited to Federal Travel Regulation (FTR) rates.
- Establishes per diem rates for hotels and general expenses on a county by county basis (also country by country) based on travel destination.
- Establishes rules for purchasing transportation.
- Covers both direct costs on government contracts and overhead.

Specific Issues

- The rule is “maximum of actual or per diem, whichever is lower” limiting a firm’s ability to pay less than billed, and requires detailed comparisons.
- Many costs are excluded from the basic per diem amounts
- Hotel taxes
- Cabs, hotel tips
- Airfare is coach or actual available fare “at time of purchase”.
- Attendance at conferences, using conference hotel permits up to 300% of standard per diems. (31-205-46(a)(3))
- Partial day travel.
- May be subject to state laws.

Non-Travel Meals

- There is no federal requirement for travel status.
- In town meals are expressly allowable (31.205-43(c))
- The big issue is business purpose and reasonableness
 - Firms should DOCUMENT
- Meals for Lunch & Learns are common and allowable
 - Documentation should include:
 - Agenda
 - Attendees sign-in/out sheet
 - Receipt for meal
 - MUST be reasonable

Unallowable Costs Under the FAR

- Interest (31.205-20)
- Bad debts (plus related collection costs) (31.205-3)
- Officer's life insurance (31.205-19(e)(2)(v))
- Organizational costs (31.205-27)
- Promotion & advertising (31.205-1)
- Employee social events (31.205-13(c))
- Fines & penalties (31.205-15)
- Amortization of goodwill (31.205-49)
- Owner-only benefits (31.201-3(b)(1))
- Unrelated business costs (31.201-3(b)(1))
- Lobbying costs (31.205-22(a))
- Costs in excess of ownership (related party) (31.205-36(b)(3))
- Federal income taxes (31.205-41(b)(1))
- Donations
- Never paid accruals (other than paid leave)

State DOT Contractors Certification

- Contractors must certify cost submissions for overhead rates annually and with proposals.
- Contractors who knowingly charge unallowable costs to overhead could face:
 - Suspension
 - Debarment
 - False Claims Act
 - Imprisoned not more than 5 years



Overview

Why was it
established?

Why is it
important?

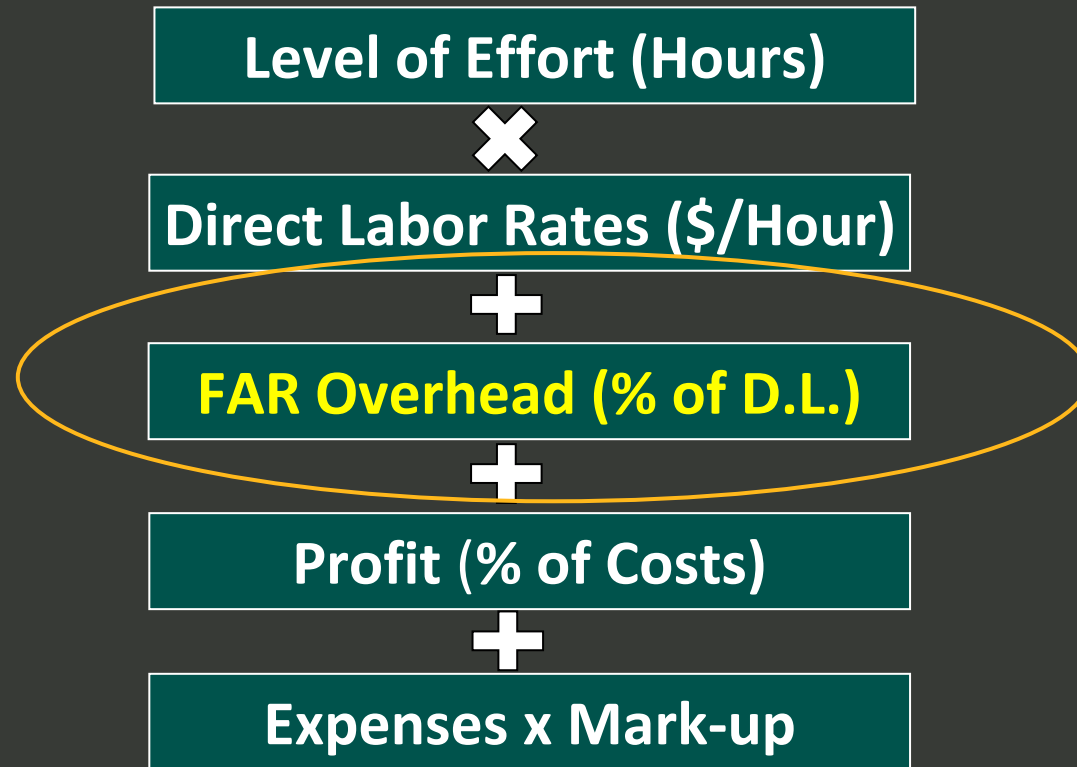
Policies

Allowable &
Unallowable
Overhead

**Final Thoughts –
Path to
Compliance
Profitability**

The FAR Compensation Formula

Consultant Fees =

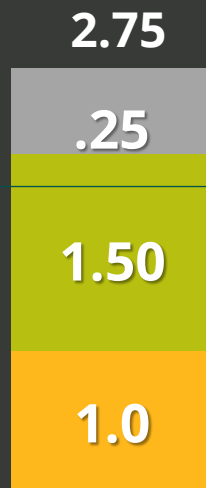


$$\text{Consultant Fees} = ((\text{DL} + (\text{Ovh Rate} * \text{DL})) * \text{Profit})$$

Incurring Costs to FAR Allowable Costs

Incurring Rate = 150%

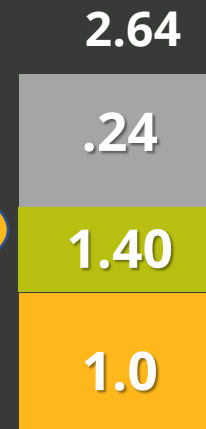
FAR rate = 140%



Fee = 10%

Difference is Unallowables

Direct Labor



\$0.24 fee is really netting only a 5.6% profit due to the cost of incurred unallowables.

In reality, a 10% fee allows you to make \$0.14 more than you incurred.
 $(\$0.14 / \$2.50 = 5.6\%)$

10% fee is generating funds to cover incurred costs plus \$0.14, a 5.6% profit

Questions?



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Thank You!

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