



State of New Jersey

DEPARTMENT OF TRANSPORTATION

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JON S. CORZINE
Governor

KRIS KOLLURI
Commissioner

Date: July 3, 2008

Subject: Indirect Cost Rates

Dear Consultant:

As you know, the New Jersey Department of Transportation is in the process of changing the method by which Cost Plus Fix Fee contracts are audited. In concert with those changes we would also like to address three policy questions which have been raised by consultant firms from time to time. These questions involve the allowability of multiple indirect cost rates, the impact of unanticipated indirect costs billings on total compensation agreement ceilings, and the eligibility of Facilities Capital Cost of Money (FCCM) in the calculation of firm indirect cost rates. A discussion of each issue follows.

Split/Field vs. Home Office Overhead Rates

Effective August 1, 2008, applicable only to new agreements with the Department, firms can decide to use either split (field vs. home office) rates or company-wide rates to estimate project costs and for final audit purposes. Firms that provide construction inspection services may have employees who work for a period of time in an on-site office maintained by the Department. The hours associated with these employees would not qualify for the consultant's full overhead rate since they are not working out of their own offices and not receiving office support on a day-to-day basis. The purpose of a field rate is to pay the consultant for the fringe benefits and home office support they do provide to their field employees. Conversely, the home office rate applicable to all other services provided by the firm would exclude the overhead costs and direct labor associated with these employees. Although field offices may exist in many forms, it is critical that a firm maintain consistency in their allocation of the cost.

Firms that currently maintain accounting systems which support the development of split rates and who prepare overhead schedules that include field and home office rates must respond in writing to the Bureau of Auditing (BOA) as to whether they want to continue to use their total company rate for NJDOT projects or whether they want to begin using their field overhead rate for construction inspection work and the home office rate for all other work. Once reviewed and approved by the BOA (the Department will also accept overhead audits which have been approved by the cognizant home state agency in accordance with Federal regulations), the separate rates will be utilized for all new agreements from this point forward. Any firms opting to use split rates must certify in their

letter that the methodology utilized to allocate costs between field and home office will remain consistent from year to year.

Firms that currently develop single overhead rates that wish to continue to do so do not need to respond. However, if they now choose to change their accounting system to develop split rates, they must notify the BOA in writing of their intention to do so. At the time the firm submits its first split rates and they are approved, separate rates will be used for new NJDOT contracts from this point forward. The new policy is effective August 1, 2008 for new agreements only. For work performed under previously executed agreements/CAM's, the specified rate as based on the firm's total company overhead will continue to be used for billing and final audit purposes.

Impact of Unanticipated Indirect Costs on Agreement Ceilings

In February 1996 the New Jersey Department of Transportation discontinued its cap on indirect cost rates that could be used in Cost Plus Fixed Fee agreements. This policy change was instituted in order to place NJDOT in conformity with Section 307, Quality Through Competition, of the National Highway System Designation Act. Professional service firms are entitled to the recovery of indirect cost as defined by Federal Acquisition Regulations (Part 31 of Title 48). Since then, consultant firms have been entitled to use their actual audited indirect cost rates without any limitation on NJDOT projects. However, there are situations where a final audit determines a higher indirect cost rate than the negotiated interim rate specified in the original agreement. In some of these situations the additional overhead costs generated by the audited indirect cost rate cannot be accommodated within the total compensation agreement ceiling. Some consultant firms have asked whether or not the agreement ceiling can or should be automatically adjusted to absorb the additional indirect costs.

The negotiated contract ceiling constitutes a firm limit on the extent of the State of New Jersey's reimbursement for the agreement based on the scope of work as amended by any additional or extra work modifications. This contract reimbursement limit is based on several cost components including direct labor, direct expenses, subconsultant expenses, indirect costs, and a fixed fee. The fact that one cost component of the agreement is higher than anticipated does not justify that the overall project ceiling should be increased by that amount. The consultant firm's indirect cost rate is not capped and all indirect costs incurred can be billed without limitation within the agreement ceiling. However, in those instances where the consultant is seeking to bill indirect costs which would force total costs to be in excess of the agreement ceiling, an offsetting reduction of previously billed direct labor, direct expenses, subconsultant expenses or fixed fee must accompany the invoice such that total contract compensation is still within the agreement ceiling. The consultant firm is responsible for monitoring all of its costs, including indirect cost rates, and adjusting its work to stay within the budget for the project as established by the total contract compensation ceiling. Accordingly, requests for increases in agreement ceilings based solely on the payment of final audited overhead rates will not be approved.

Facilities Capital Cost of Money (FCCM)

FCCM is an imputed cost related to investment in facilities used in contract performance which is based on a cost of money calculation by the United States Department of Treasury. It requires a series of detailed schedules from the firm which appropriately classify, measure, and allocate to contracts the cost of owning the occupied facility in accordance with Cost Account Standards (CAS) 414. These schedules must be submitted at the time of the original agreement negotiation and repeated each year thereafter. The consultant must maintain, in a manner that permits audit and

verification, all relevant schedules, cost data, and other data necessary to support the amount claimed.

It is the Department's policy that if, at the time of audit, it is determined that the claimed amount is proper in accordance with FAR 31.205-10, it will be considered as an eligible overhead expense for final audit purposes for those agreements under which the cost was negotiated. Since the estimated FCCM must be specifically identified in the cost proposals relating to the contract under which the cost is to be claimed, it will only apply to future agreements effective August 1, 2008.

If you have any questions regarding these issues or others related to the audit process, please contact the Bureau of Auditing at (609) 530-2350.

Sincerely,



Steve Hanson
Chief Financial Officer

c: Commissioner Kris Kolluri
Deputy Commissioner Stephen Dilts
Assistant Commissioner Hammer
Assistant Commissioner Stout
Assistant Commissioner Callahan
Executive Director Hogan
Judith Sigle
Anthony Genovese
Karen Abbott