

# **Audit of the Indirect Cost Rate Awarded in Contract Y13-813PH**

**Report by the  
Office of County Comptroller**

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August 22, 2016

Teresa Jacobs, County Mayor  
and  
Board of County Commissioners

We have conducted an audit of the Indirect Cost Rate Awarded in Orange County Contract Y13-813PH for engineering services. The scope of the audit was limited to determining the Contractor's compliance with Article IX: "Truth in Negotiation and Maintenance and Examination of Records" of Contract Y13-813PH. This included reviewing financial data supporting the "Calculation of Combined Rate for the year ended December 31, 2012" and the "Fee Quotation Proposal" submitted to Orange County by the Contractor on March 4, 2014.

Our review was conducted in accordance with generally accepted government auditing standards and included such procedures as we considered necessary in the circumstances. In this regard, we reviewed applicable laws and regulations, data provided by the Contractor, his agents, and personnel of the Orange County Procurement Division. Our review was limited to the specific matters described earlier and was based on selective tests and procedures. Had we performed additional procedures, other information might have come to our attention that would have been included in this report.

We appreciate the cooperation of the Orange County Procurement Division, the contractor and their agents.

Martha O. Haynie, CPA  
County Comptroller

c: Ajit Lalchandani, County Administrator  
Carrie Woodell, Manager, Procurement Division

## EXECUTIVE SUMMARY

## Executive Summary

Section 287.055, Florida Statutes titled the “Consultants’ Competitive Negotiation Act”, requires government agencies to select “professional services” based upon qualifications of the firm and not price. After a professional services firm is selected, the County negotiates the price to be paid for projects based on the proposed direct and indirect costs of the selected vendor (Contractor). The direct costs are typically comprised of the hourly rates for the personnel assigned to the project and a multiplier representing the firm’s indirect costs to provide the required services. The indirect costs are computed based on the allowable costs outlined in 48 CFR Federal Acquisition Regulations System (FAR).

The scope of the audit was limited to determining the Contractor’s compliance with Article IX: “Truth in Negotiation and Maintenance and Examination of Records” of Contract Y13-813PH (Contract). This included reviewing financial data supporting the “Calculation of Combined Rate for the Year Ended December 31, 2012” and the “Fee Quotation Proposal” submitted to Orange County by the Contractor on March 4, 2014.

The objectives of the audit were to determine if:

- The indirect costs reported by the Contractor materially represented the Contractor’s actual indirect costs and complied with the terms of the Contract;
- The Fee Quotation Proposal’s schedule of basic hourly wage by labor position classification was representative of the actual wage rate paid by the Contractor when submitted; and,
- The indirect cost rate awarded complied with the Division’s procedures.

Based on the results of our testing, the indirect cost rates reported by the Contractor materially represented the Contractor’s actual indirect costs and were in compliance with the terms of the Contract; the Fee Quotation Proposal’s schedule of basic hourly wage by labor position classification was representative of actual wage rate paid by the Contractor; and, the indirect cost rate awarded complied with the Division’s procedures.

Opportunities for improvement are discussed herein. Specifically, we noted the following:

The Contract did not specifically cite that the Contractor’s cost accounting system and computation of indirect cost rate must comply with standards set by FAR.

We identified a total of \$437,281 in questioned costs of general overhead cost that FAR does not allow. We also identified \$158,883 of questioned direct labor costs, and \$11,292 of questioned fringe benefits. Although removal of these

questioned costs reduces the total indirect costs allowed, cumulatively they do not materially reduce the calculated indirect cost rate below the amount that was awarded for the Contract.

The Contract does not require the Contractor to disclose transactions between organizations under common control (related parties) that are included in the indirect cost rate.

Recommendations for Improvement were developed and discussed with the Division. The Division concurred with our recommendations and steps to implement the recommendations are underway. Responses to the Recommendations for Improvement are included herein.

# ACTION PLAN

**INDIRECT COST RATE AWARDED IN CONTRACT Y13-813PH REVIEW  
ACTION PLAN**

NO.	RECOMMENDATIONS	MANAGEMENT RESPONSE			IMPLEMENTATION STATUS	
		CONCUR	PARTIALLY CONCUR	DO NOT CONCUR	UNDERWAY	PLANNED
1.	We recommend the Procurement Division standardizes all contracts to specifically cite and require indirect cost rates be computed in accordance with 48 CFR Federal Acquisition Regulations System.	✓			✓	
2.	We recommend the Division require contractors to disclose transactions between organizations under common control that are included in the costs used to calculate the indirect cost rate.	✓			✓	



# INTRODUCTION

### Background

Section 287.055, Florida Statutes titled the "Consultants' Competitive Negotiation Act", requires government agencies to select "professional services" based upon qualifications of the firm and not price. The Section defines professional services as "...those services within the scope of the practice of architecture, professional engineering, landscape architecture, or registered surveying and mapping, as defined by the laws of the state, or those performed by any architect, professional engineer, landscape architect, or registered surveyor and mapper in connection with his or her professional employment or practice."

In 2013, the Utilities Water Distribution Division worked with the Procurement Division to obtain engineering services for the Innovation Place Project. Contract Y13-813PH (Contract) was executed and awarded in June 2014 to an engineering firm (Contractor). Part of the negotiations to establish a fair price involves setting a multiplier (consisting of a ratio of indirect costs and profit to direct labor) that is applied to a project's direct labor costs to determine the amount due to the Contractor. The multiplier is determined by reviewing historical financial information of indirect labor and other operating costs.

Article IX of the Contract requires the Contractor to follow Federal, State, and Local laws and rules. Title 48 CFR, Federal Acquisition Regulations System (FAR), provides the cost accounting standards as well as identifies specific indirect costs that are allowable and unallowable for allocation of overhead costs to a government project.

Business costs are often classified as either direct or indirect costs (overhead). A direct cost is typically any expense that can be attributed to a single cost objective (e.g. a specific job, contract, or project). Conversely, indirect costs are business expenses that benefit more than one job, contract, or project. Certain costs such as labor by a specific individual may be split between the direct labor associated with specific projects and indirect labor for general administrative tasks.

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### **Scope, Objectives, and Methodology**

The scope of the audit was limited to determining the Contractor's compliance with Article IX: "Truth in Negotiation and Maintenance and Examination of Records" of Contract Y13-813PH. This included reviewing financial data supporting the "Calculation of Combined Rate for the Year Ended December 31, 2012" and the "Fee Quotation Proposal" submitted to Orange County by the Contractor on March 4, 2014.

The objectives of the audit were to determine whether:

- The indirect costs reported by the Contractor materially represented the Contractor's actual indirect costs and complied with the terms of the Contract;
- The Fee Quotation Proposal's schedule of basic hourly wage by labor position classification was representative of the actual wage rate paid by the Contractor when submitted; and,
- The indirect cost rate awarded complied with the Division's procedures.

We reviewed the Contract terms and supplemental instructions provided to the Contractor during the negotiation stage of the contract award process. We interviewed Contractor personnel, as well as the Contractor's agents to obtain an understanding of their cost accounting system, payroll system, and timekeeping system.

To verify the indirect cost rate reported by the Contractor represented the Contractor's actual costs we performed the necessary procedures, including:

- Comparing the Contractor's adjusted detailed general ledger accounts as of December 31, 2012 to the Groupings Schedule and then to the Calculation of Combined Rate for FYE December 31, 2012 (CCR12);

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- Comparing the total labor expenses per general ledger accounts to the amounts reported as direct and indirect labor on the CCR12;
- Comparing the total direct and indirect labor on the CCR12 to the amounts reported on IRS Form W-3 Transmittal of Wage and Tax Statements Report; and,
- Selecting a sample of employees and tracing the hours reported on a sample of the employees' timesheets and rates of pay in the labor distribution system and to the payroll register.

To determine if the indirect cost rate was in compliance with the terms of Orange County Contract Y13-813PH, we performed the following:

- Compared the classifications of costs included in the schedule of indirect costs to the FAR to determine the appropriateness of the cost classifications used in the schedule;).
- Reviewed the financial, banking, and supporting documentation for a sample of transactions from the detailed general ledger; and,
- Examined the records of organizations with common control to determine the normal cost of ownership compared to costs recorded in the general ledger of the Contractor for rental expenses claimed.

We determined if the Fee Quotation Proposal's schedule of basic hourly wage by labor position classification was representative of actual wage rate paid by the Contractor by tracing a sample of rates of pay included in the contract to the detailed support by position classification.

To determine that the indirect cost rate awarded was in compliance with the Division's policy, we compared the Contractor's indirect cost rate, adjusted for identified questioned costs, and compared the adjusted indirect cost rate to the indirect cost rate awarded by the County.

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## INTRODUCTION



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### Overall Evaluation

Based on the results of our testing:

- The indirect cost rates reported by the Contractor materially represented the Contractor's actual indirect costs and were in compliance with the terms of the Contract;
- The Fee Quotation Proposal's schedule of basic hourly wage by labor position classification was representative of actual wage rates paid by the Contractor; and,
- The indirect cost rate awarded complied with the Division's procedures.

Opportunities for improvement are discussed herein.

# RECOMMENDATIONS FOR IMPROVEMENT

## RECOMMENDATIONS FOR IMPROVEMENT



Audit of the Indirect Cost Rate  
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### 1. The Division Should Specifically Require Contractors' Compliance with 48 CFR Federal Acquisition Regulations System

Orange County Contract Y13-813PH (Contract) did not specifically cite that the Contractor's cost accounting system and computation of indirect cost rate must comply with standards set by 48 CFR Federal Acquisition Regulations System (FAR). Although the supplemental instructions for the Contract listed six types of costs that were not to be included in the computation of indirect cost rate, the instructions did not refer to FAR part 31. FAR provides contract cost principles and procedures that identify the costs allowed in the computation of indirect costs. The use of indirect cost rates provide contractors with a fair value to cover the costs incurred when providing engineering services for a project.

Our review of the Contractor's financial data supporting their computation of the indirect cost rate identified a total of \$437,281 in questioned costs that FAR do not allow. We also identified \$158,883 of questioned direct labor costs and \$11,292 of questioned fringe benefits. The following chart identifies the cost categories and amounts questioned.

Cost Category	Costs Submitted to County	Questioned Costs	Allowable Costs Per Audit
<b>Direct Labor Base</b>			
Salaries and wages	\$1,887,374	\$(158,883)	\$1,728,491
<b>Fringe Benefits</b>			
Other employee benefits	\$136,542	\$(11,292)	\$125,250
<b>General Overhead Expenses</b>			
Indirect Labor	\$1,756,746	\$(274,755)	\$1,481,991
Rent	273,097	(98,210)	174,887
Computer, supplies, reproductions	120,920	(12,000)	108,920
Consultant fees	69,000	(47,000)	22,000
Miscellaneous Expense: Bank and Line of Credit Fees	4,255	(3,386)	869
Insurance- Other	119,913	(1,930)	117,983
<b>Total Questioned General Overhead</b>	<b>\$2,343,931</b>	<b>\$(437,281)</b>	<b>\$1,906,650</b>

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## RECOMMENDATIONS FOR IMPROVEMENT



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While the questioned costs are significant, cumulatively they did not reduce the calculated indirect cost rate below the amount that was awarded for the contract. The submitted rate for the Contractor was limited to the County's maximum allowed multiplier rate of 2.99. However, this indicates that better communication of the required standards is necessary.

**We Recommend** the Procurement Division standardizes all contracts to specifically cite and require indirect cost rates be computed in accordance with 48 CFR Federal Acquisition Regulations System.

### **Management's Response:**

Concur. Boiler plate language for professional service contracts selected in accordance with the Consultant Competitive Negotiation Act (CCNA) have been updated to state that all indirect costs shall be computed in accordance with 48 CFR Federal Acquisition Regulations.

## **2. The Division Should Clarify that Transactions Between Organizations Under Common Control (Related Parties) Must Be Disclosed**

Our review identified three organizations in which the Contractor had a controlling interest during the period used to calculate the indirect cost rate. The contract does not require disclosure of organizations under common control or the related costs included in the indirect costs rate submitted to the County. During our review, we noted the Principal of the Contractor is also a principal or lender to the other three organizations that had costs included in the indirect cost rate. Common control exists in related party transactions when business is conducted at less than arm's length, and the related party has effective control over the operating and financial policies of the related entity.

We examined the appropriate records of the organizations with common control or agreements between the Contractor and these organizations in order to determine the normal



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## RECOMMENDATIONS FOR IMPROVEMENT



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cost of ownership compared to costs recorded in the general ledger of the Contractor for rental expenses claimed and networking services provided. When examining the Contractor's general ledger accounts classified as Rent Expense, we noted that rental expenses between the Contractor and the organizations under common control exceeded the amount allowed in FAR. These additional claimed rental costs are included in our computation of questioned costs noted in Recommendation for Improvement No. 1.

**We Recommend** the Division require contractors to disclose transactions between organizations under common control that are included in the costs used to calculate the indirect cost rate.

### **Management's Response:**

Concur. Boiler plate language for professional service contracts selected in accordance with the Consultant Competitive Negotiation Act (CCNA) have been updated to require submittal of a detailed summary of any transactions between organizations under common control that are included in the indirect costs.