U.S. Department of Transportation
Federal Highway Administration

Memorandum

Subject: **ACTION:** FHWA Policy for Contractor Certification of Costs in Accordance with Federal Acquisition Regulations (FAR) to Establish Indirect Cost Rates on Engineering and Design-related Services Contracts

Date: October 27, 2010

In Reply Refer To: HIPA-20

From: King W. Gee
Associate Administrator for Infrastructure

Elissa K. Konove
Chief Financial Officer

To: Division Administrators

This memorandum is to inform you of a new policy which has been issued as FHWA Order 4470.1A dated October 27, 2010, regarding contractor certification of the costs used to establish indirect cost rates for application to Federal-aid engineering and design-related services contracts (as defined in 23 U.S.C. §112(b)(2)(A), 23 CFR §172.3, and State/local laws and regulations). The Order is attached and is available on FHWA's Consultant Services web site at http://www.fhwa.dot.gov/programadmin/consultant.cfm.

The subject Order directs Federal-aid Division Offices to encourage contracting agencies to incorporate a certification of cost requirement for contractor indirect cost rate proposals submitted for agency acceptance, whereby an official of a contractor shall certify that the indirect cost rate submitted does not include any costs which are expressly unallowable and that the indirect cost rate was established only with allowable costs in accordance with the applicable cost principles contained in the Federal Acquisition Regulations (FAR) of 48 CFR part 31. Proposed indirect cost rates should not be accepted or approved by a contracting agency for use in contract estimation, negotiation, administration, reporting, or payment, unless the costs have been certified by an official of the contractor as being allowable in accordance with the applicable FAR cost principles. This policy is issued in support of existing audit and certification provisions specified in 23 U.S.C. §112(b)(2), 23 CFR §172.7, 49 CFR §18.22(b) and 48 CFR §31.110.

The policy for contractor cost certification reflects FHWA's commitment to improve the stewardship and oversight of the procurement, management, and administration of engineering and design-related Federal-aid consultant services contracts. The policy also addresses recommendations contained in the Office of Inspector General's Audit Report entitled, "Oversight of Design and Engineering Firms' Indirect Costs Claimed on Federal-aid Grants" (http://www.oig.dot.gov/library-item/4710).

Application of this policy is expected to:

- Increase audit quality and consistency;
- Increase compliance with FAR cost principles;
- Reduce risk of payment of unallowable costs and waste in the consultant services program; and
- Reinforce the responsibility and accountability of consultants/contractors to comply with Federal laws and regulations.

FHWA Order 4470.1A containing the policy for contractor cost certification became effective upon signature by the Administrator on October 27, 2010. January 1, 2011, is the date by which State DOTs and local public agencies are encouraged to have integrated the contractor cost certification into their policies, procedures, and consultant services contracting practices. Engineering and design-related consultant services contracts procured, awarded, or modified after January 1, 2011, should include a contractor certification of the allowability of costs used to establish the final indirect cost rate for the applicable term of the contract, or verification that this certification was previously submitted and accepted by the contracting agency.

As provided in the Order, Federal-aid Division Offices are directed to work with State DOTs and other contracting agencies, as appropriate, to integrate a contractor cost certification whereby:

- Indirect cost rate proposals submitted on an annual basis, or proposals to modify previously accepted rates, should include a contractor certification of the allowability of costs in accordance with the FAR cost principles as described in the Order, prior to contracting agency acceptance and/or agreement to finalize an indirect cost rate.
- Contract cost proposals to provide engineering and design-related services on specific Federal-aid projects should include a contractor certification of the allowability of costs in accordance with the FAR cost principles as described in the Order, or a verification indicating this certification was previously submitted and accepted by the contracting agency for the appropriate accounting period.

We appreciate your support with implementation of this policy and collaboration to incorporate a contractor cost certification requirement into the policies, procedures, and consultant services contracting practices of your State DOT and local public agencies to improve the effectiveness of Federal-aid funds expended on engineering and design-related consultant services.

If you have any questions regarding the policy for contractor cost certification, please contact Mr. Scott Wolf at scott.wolf@dot.gov or Mr. David Bruce at david.bruce@dot.gov.

Attachment

U.S. DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

Order

Subject

FHWA Policy for Contractor Certification of Costs in Accordance with Federal Acquisition Regulations (FAR) to Establish Indirect Cost Rates on Engineering and Design-related Services Contracts

Classification Code	Date	OPI
4470.1A	October 27, 2010	HIPA-20 HCFM-10

Par.

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1. **What is the purpose of this directive?** This directive establishes the Federal Highway Administration's (FHWA) policy for contractor certification of the costs used to establish indirect cost rates in accordance with the applicable cost principles contained in the Federal Acquisition Regulations (FAR) for engineering and design-related service contracts funded with Federal-aid highway program (FAHP) funding and administered by State departments of transportation (State DOTs), local public agencies, and other grantees and subgrantees of FAHP funding (as specified under Section 112(b)(2) of title 23 of the United States Code (U.S.C.) (23 USC §112(b)(2)) and defined in Section 172.3 of title 23 of the Code of Federal Regulations (CFR) (23 CFR § 172.3).

2. **Does this directive cancel an existing directive?** No, this is a new directive.

3. **What is the background of this directive?**

a. Grantees and subgrantees of Federal grants are required to apply the FAR cost principles (48 CFR, part 31) to determine the allowable costs for contracts with commercial, for-profit organizations (as specified in 49 CFR §18.22(b)).

b. The provisions of Section 307 of the National Highway Systems Designation Act (NHSDA), passed by Congress in 1995, require the use of the FAR cost principles (48 CFR, part 31) as the basis to determine the allowance of incurred costs when performing indirect cost rate audits of design and engineering contractors, eliminated duplicate audits of design and engineering contractors by multiple entities, and removed ceilings established by certain States for indirect cost rates, direct salaries, and bonuses. These changes in law, as well as other subsequent changes made by Section 174 of the Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act in 2006, were incorporated into 23 U.S.C. §112(b)(2). As such, grantee and subgrantee contracts funded with FAHP funds are required to use the indirect cost rate of a contractor established by a cognizant agency audit in accordance with the FAR cost principles.

c. The FHWA's commitment to improve the stewardship and oversight of the procurement, management, and administration of engineering and design-related consultant service contracts prompted the need for development and implementation of guidance to improve the quality of consultant contracting procedures, increase audit quality, and enhance consistency in FAR cost principles interpretation and compliance.

d. Although compliance with the cost principles of 48 CFR, part 31 is tested through performance of audits and other evaluation and analytical procedures, as appropriate, it is the responsibility of the design and engineering contractor to account for costs appropriately and maintain adequate records and supporting documentation to demonstrate costs claimed have been incurred, are allocable to a contract, and comply with applicable cost principles (as specified in 48 CFR §31.201-2(d)). Requesting certification by an executive or financial official of a contractor's organization regarding the allowability of costs used to establish indirect cost rates in accordance with the applicable FAR cost principles reinforces the responsibility and accountability of the contractor to comply with Federal laws and regulations.

4. **What authorities govern this directive?**

a. Title 23, CFR, Section 1.32 provides the following: "The Administrator shall promulgate and require the observance of policies and procedures, and may take other action as he deems appropriate or necessary for carrying out the provisions and purposes of Federal laws, the policies of the Federal Highway Administration, and the regulations of this part. The Administrator or his delegated representative, as appropriate, is authorized to issue (Orders). Orders are directives limited in volume and contain permanent or long lasting policy, instructions, and procedures."

b. Title 23, U.S.C., Section 112(b)(2)(B) to (D) provides the following: "Any contract or subcontract (engineering and design related service contracts directly related to a construction project subject to 23 U.S.C §112(a)), whether funded in whole or in part with Federal-aid highway funds, shall be performed and audited in compliance with cost principles contained in the Federal Acquisition Regulations of part 31 of title 48, Code of Federal Regulations. Instead of performing its own audits, a recipient of funds under a contract or subcontract shall accept indirect cost rates established in accordance with the Federal Acquisition Regulations (48 CFR, part 31) for 1-year applicable accounting periods by a cognizant Federal or State government agency. Once a firm's indirect cost rates are accepted, the recipient of the funds shall apply such rates for the purposes of contract estimation, negotiation, administration, reporting, and contract payment and shall not be limited by administrative or de facto ceilings of any kind."

c. Title 23, CFR, Section 172.7(b) provides the following: "Contracting agencies shall use the indirect cost rate established by a cognizant agency audit for the cost principles contained in 48 CFR part 31" for application to engineering and design related service contracts funded with Federal-aid highway program funds and directly related to a construction project subject to 23 U.S.C §112(a). "Contracting agencies shall apply these indirect cost rates for the purposes of contract estimation, negotiation, administration, reporting, and contract payment and the indirect cost rates shall not be limited by any administrative or de facto ceilings."

d. Title 49, CFR, Section 18.22(b) provides the following: "Allowable costs will be determined in accordance with the cost principles applicable to the organization incurring the costs. For the costs of a for-profit organization, use the principles in 48 CFR part 31." This provision also specifies the applicable Federal cost principles for each kind of organization that receives payment under a Federal grant. Consultant engineering firms performing under a personal services contract are

considered commercial, for-profit organizations for determination of applicable cost principles.

e. Title 48, CFR, Section 31.110 provides the following: "Certain contracts require certification of the indirect cost rates proposed for final payment purposes."

5. **What definitions are used in this directive?**

a. **Allowability/allowable costs**. See FAR 48 CFR §31.2 for definition of allowable costs and cost principles for determination of allowability.

b. **Certification**. A document attesting to the truth of a fact or statement.

c. **Consultant/Contractor**. The individual or firm providing engineering and design-related services as a party to the contract (as defined at 23 CFR §172.3).

d. **Contracting agency**. State DOTs, local public agencies, or other grantees and subgrantees that are responsible for the procurement, management, and administration of engineering and design related services (as defined at 23 CFR §172.3).

e. **Engineering and design-related services**. Program management, construction management, feasibility studies, preliminary engineering, design, engineering, surveying, mapping, or architectural-related services with respect to a construction project subject to 23 U.S.C. §112(a) (as defined at 23 U.S.C. §112(b)(2)(A) and 23 CFR §172.3). Also, professional services of an architectural or engineering nature, as defined by State law, which are required to or may logically be performed or approved by a person licensed, registered, or certified to provide the services (as defined at 40 U.S.C. §1102(2)).

f. **Indirect costs (rates and proposals)**. See FAR 48 CFR §31.203 for definition of indirect costs.

g. **Official (of the contractor)**. An individual executive or financial officer of the contractor's organization at a level no lower than a Vice President or Chief Financial Officer, or equivalent, who has the authority to represent the financial information utilized to establish the indirect cost rate proposal submitted in conjunction with the contract.

6. **What is FHWA's policy for contractor certification of costs in accordance with FAR to establish indirect cost rates on engineering and design-related services contracts?** To ensure overall compliance with cost principles of the FAR (as specified in 23 U.S.C. §112(b)(2)(B)-(D), 23 CFR

§172.7(b), and 49 CFR §18.22(b)), it is FHWA's policy that an indirect cost rate proposal should not be accepted and no agreement should be made by a contracting agency to establish final indirect cost rates, unless the costs have been certified by an official of the contractor as being allowable in accordance with the applicable FAR cost principles of 48 CFR, part 31. This contractor certification of costs policy applies to:

a. all indirect cost rate proposals submitted, whether on an annual basis, on a contract basis, or as an amendment to contracts or the contractor's approved indirect cost rate, for acceptance by a contracting agency;

b. indirect cost rate proposals by the prime contractor and any sub-contractors; and

c. all grantee and subgrantee contracts for engineering and design-related services (as defined in 23 U.S.C. §112(b)(2)(A), 23 CFR §172.3, and State/local laws and regulations) that are funded in whole or in part with FAHP funds, and directly related to an ultimate highway construction project (as specified in 23 U.S.C. §112(a)).

7. **Will a standard contractor cost certification form or language be required?** No. Federal-aid Division Offices are encouraged to work with contracting agencies to develop contractor cost certification language, forms, and implementation procedures to address the FHWA policy. Whether submitted on an annual basis, on a contract basis, or as an amendment to modify a previously accepted rate, indirect cost rate proposals should not be accepted for application to Federal-aid engineering and design-related services contracts, as defined in this Order, unless certified by the contractor as allowable in accordance with the FAR cost principles of 48 CFR, part 31. An example contractor cost certification is provided for reference in Appendix A of this Order.

8. **What are the consequences if a contractor knowingly charges unallowable costs on Federal-aid funded contracts?**

a. A contractor found to have knowingly charged unallowable costs to a Federal-aid funded contract is subject to suspension and debarment actions by the FHWA (as specified in FHWA Order 2000.2A, FHWA Nonprocurement Suspension and Debarment Process (Federal-Aid Program), dated June 19, 2000, and 2 CFR §180). Suspension and debarment actions protect the Federal Government by excluding certain firms or persons from participation in Federal programs government wide. This ensures that the Federal Government does not conduct business with a person or firm that has an unsatisfactory record of integrity. In addition, the FHWA will consult with the Department of Justice to pursue a potential cause of action under the False Claims Act

(as specified in 31 U.S.C. §§3729-3733) or prosecution for making a false statement (as specified in 18 U.S.C §1001).

b. In addition to Federal suspension and debarment actions, the contractor cost certification will allow States and local public agencies to establish a framework, or strengthen an existing framework, to pursue a range of civil actions and penalties permitted under State and local laws, regulations, policies, and procedures when a contractor knowingly charges unallowable costs, contrary to the cost certification statement on State or other grantee or subgrantee awarded contracts funded with Federal-aid funds. In accordance with State and local laws, regulations, policies, and procedures, the range of actions and penalties a contracting agency may consider could include fines, cost recovery, contract termination, suspension, debarment, and criminal false statement actions.

9. **What are FHWA's roles and responsibilities with implementing this directive?** Federal-aid Division Offices are directed to work with the State DOTs and other contracting agencies, as appropriate, to encourage integration of a contractor cost certification requirement for engineering and design-related services contracts as follows:

a. **Stewardship (cost certification):** Encourage/work with State DOTs and other contracting agencies, as appropriate, to incorporate a requirement for contractor certification of the allowability of costs with each indirect cost rate submitted for engineering and design-related services contracts whereby:

(1) an official of the contractor shall certify that, to the best of the certifying official's knowledge and belief, the indirect cost rate developed includes only allowable costs in accordance with the applicable cost principles contained in the FAR of 48 CFR, part 31, and that it does not include any costs which are expressly unallowable in accordance with the same part cost principles (an example contractor cost certification is provided for reference in Appendix A of this Order); and

(2) proposed indirect cost rates, whether submitted on an annual basis, on a contract basis, or as an amendment to modify a previously accepted rate, should not be accepted or approved by a contracting agency, unless the costs have been certified by an official of the contractor.

b. **Stewardship (policies and procedures):** Encourage/work with State DOTs and other contracting agencies, as appropriate, to amend consultant procurement and audit (if applicable) policies, procedures,

and practices to incorporate a contractor certification of the allowability of costs as follows:

(1) **Policies and procedures:** Contracting agencies should amend written consultant procurement and audit (if applicable) policies and procedures to incorporate a contractor certification of the allowability of costs in accordance with FAR cost principles (48 CFR, part 31) prior to acceptance of a final indirect cost rate for application to engineering and design-related service contracts funded in whole or in part with FAHP funds (as specified in 23 CFR §172.9(a)). Depending on the organizational structure and currently approved processes and procedures, amendments to incorporate contractor certification of costs should consider/address the following:

(a) **Indirect cost rate proposals (annual basis):** Contractor certification of the allowability of costs used to establish indirect cost rates submitted for contracting agency acceptance on an annual basis (or shorter cycle in accordance with the fiscal accounting period of the contractor) or proposals to modify a previously accepted rate;

(b) **Indirect cost rates included in contract proposals:** Contractor certification of the allowability of costs used to establish a contractor's indirect cost rate, or a verification indicating this certification was previously submitted and accepted by the contracting agency, included in contract proposals submitted for contracting agency acceptance in conjunction with response to request for proposals (RFPs) to provide engineering and design related services on specific Federal-aid projects or contracts; and

(c) **Adequacy of contract documentation:** A copy of the contracting agency indirect cost rate approval letter (including cognizant agency approvals as appropriate) and contractor cost certification should be included within the documentation for each Federal-aid contract to substantiate the final indirect cost rate established for the term of the applicable accounting period of the contractor and applied to each contract and subsequent contract modification.

(2) **Contractor notification:** Contracting agencies should notify contractors of the changes to be implemented regarding cost certification procedures through memorandums, amended policies

and procedures, amended instructions for contracting with the agency, RFP response instructions, and/or other appropriate methods of communication. Contracting agencies should incorporate notice of contractor cost certification requirements in RFPs for Federal-aid engineering and design-related services contracts. Contractors that do not already have an accepted, or cognizant approved, indirect cost rate and certification of the allowability of costs for the appropriate accounting period may be required to submit the applicable cost certification in conjunction with a response to the RFP or within a specified time following selection as the most highly qualified contractor. Instructions for contracting with the agency and/or for responding to RFPs should clearly indicate contractor requirements with respect to providing a certification of the costs used to establish indirect cost rates.

c. **Oversight:** Incorporate the need for contractor cost certification into the Division Office's risk assessment of contracting agency procurement, management, and administration of consultant services. Inclusion within risk assessments and Standard Operating Procedures will support reviews of full-oversight projects, future program or process reviews of the State DOT's consultant services program, and the State DOT's stewardship and oversight of local public agency consultant services programs. It will also assist Division Offices in the review and approval of future updates to a State DOT's consultant services policies and procedures (as specified in 23 CFR §172.9(a)).

10. **Where can I find additional information?** Additional information about this policy and FHWA's consultant services program is available at http://www.fhwa.dot.gov/programadmin/consultant.cfm, or by contacting FHWA's Office of Infrastructure Pre-Construction Group (HIPA-20) or Office of the Chief Financial Officer Federal-aid Financial Management Team (HCFM-10).

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Administrator