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FAR Goes Beyond the A/E Firm to Affect Contractors

By Michelle Johnson and Robert Mercado | Wednesday, November 3, 2021

When people in the construction industry hear the term “FAR,” most assume by default it is in reference to architectural and engineering firms. However, this is a misperception, as the FAR can affect any company or contractor that performs services for the federal government, whose contracts incorporate, by reference or full text, the entire contents of Title 48, Chapter 1 of the Code of Federal Acquisition Regulations.

Federal Acquisition Regulation, Part 31 is the primary regulation governing the acquisition of supplies and services with federal funds (appropriated funds). Title 48 CFE Part 31 sets the criteria for determining costs eligible for reimbursement under federally funded contracts.

So what does this mean for non-A/E firms? While FAR is not a new concept for experienced A/E firms, it is a foreign concept for most contractors and can be confusing and complex to navigate through the process. The biggest concern is that without the proper guidance or understanding, contractors may be at a disadvantage when bidding on these governmental jobs, leaving money on the table when negotiating contracts.

All companies negotiating government-funded contracts need to prepare an indirect cost rate schedule (also known as an overhead schedule, schedule of indirect costs, or statement of direct labor, fringe benefits and general overhead). This is the primary document used by A/E firms or contractors to compute indirect cost rates (overhead rates) for billings on government projects.

We have all heard the term “maximizing your overhead rate,” but what does it mean? In short, maximizing the overhead rate means first ensuring that contractors are calculating the rate correctly by using the correct direct labor base and, second, that all allowable overhead is included and not disallowing any costs that should be allowable, thereby maximizing the rate.

The first part—calculating the overhead rate—is the easy part. The rate is the factor or ratio computed by adding together all of the firm’s/contractor’s costs that cannot be associated with a single cost objective, then dividing that total by a base value (typically direct labor cost). That rate is then applied to direct labor as incurred on projects, to allow a firm/contractor to recover the appropriate share of indirect costs allowable per the terms of specific agreements.

The second part is a more complex. There are certain cost principles under FAR regulations, which explicitly list what costs are unallowable, as well as those that are allocable and the reasonableness for each cost item. For a cost to be allowable, it has to be reasonable in amount, allocable to government contracts, compliant with the terms of the contract, and not specifically prohibited by any FAR cost principles.

The FAR specifically prohibits certain costs, such as advertising, bad debts, contributions, personal use of company vehicles, fines and penalties, lobbying and political activities, and interest expense. As these costs are always unallowable, they can easily be identified; however, it is the unallowable costs that are not specifically identified that contractors needs to be aware of. Some of the unallowable costs that could require analysis include rent paid to a related party, travel allowances, excessive compensation and use of personal automobiles, to name a few.

One key factor to remember when looking to maximize the rate is to not get hung up on incurring unnecessary expenses, as they will only reduce the company's overall profitability. The focus instead should be on minimizing any disallowances between the actual overhead and the FAR overhead.

Contractors who understand the complexities of working with government entities can have profitable opportunities. The key identifying allowable and unallowable costs, which will assist in maximizing the contractor's overhead rate.

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