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Government Contracting & Uncompensated Overtime Whitepaper

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Companies of all sizes conducting business with the U. S. Government should be aware of a unique requirement in the Federal Acquisition Regulations applicable to accounting for uncompensated overtime on federal contracts. The Fair Labor Standards Act (FLSA) requires employers to compensate hourly workers for hours worked in excess of 40 hours per week, but the FLSA does not require employers to similarly compensate salaried employees; hence the hours worked by salaried employees in excess of the normal 40 hours per week are commonly called uncompensated overtime. Prior to the January 29, 2015, change to FAR 52.237-10 there was no regulatory requirement to account for uncompensated overtime, although DCAA read into this requirement in their implementation of accounting system adequacy and other business systems audits.

The Federal Government does not encourage the use of uncompensated overtime as stated in FAR 37.115 *Uncompensated Overtime* which also sets forth several contractor disclosure requirements in the related solicitation provision FAR 52.237-10. On January 29, 2015, FAR 52.237-10 was revised to more explicitly define requirements surrounding uncompensated overtime. The provision previously defined uncompensated overtime as "hours worked without additional compensation in excess of an average of 40 hours per week by direct charge employees who are exempt from the FLSA." If further defined an uncompensated overtime rate as the rate that results from multiplying the hourly rate for a 40-hour work week by 40, and then dividing by the proposed hours per week. The prior provision required the following:

- **Prior Paragraph (b):** For any proposed hours against which an uncompensated overtime rate is applied, the offeror shall identify in its proposal the hours in excess of an average of 40 hours per week, by labor category at the same level of detail as compensated hours, and the uncompensated overtime rate per hour.
- **Prior Paragraph (c):** A contractor's accounting practice for estimating "uncompensated overtime" must be consistent with the accounting practice for accumulating and reporting these hours.
- **Prior Paragraph (d):** A contractor shall include a copy of its policy on "uncompensated overtime" with its proposal.

Be aware that on January 29, 2015, a final rule published changes to FAR 52.237-10. For contracts issued prior to March 2, 2015, FAR 52.237-10 ***implicitly*** required that the accounting for uncompensated overtime is only necessary if the proposal includes estimated uncompensated overtime hours; moreover, that clause is ordinarily only a solicitation provision that was not pulled into the awarded contract. There was no defined regulation that stated uncompensated over time must be accounted for, however, the absence of recording uncompensated overtime could, in some circumstances, result in inequitable movement of labor charges to government contracts.

Contracts issued on or after March 2, 2015, will include the revised FAR 52.237-10 which ***explicitly*** requires the accounting for uncompensated overtime. The changes to FAR 52.237-10 include revising the formerly defined uncompensated overtime rate to be now referred to as an adjusted hourly rate.

> *Adjusted hourly rate (including uncompensated overtimeis the rate that results from multiplying the hourly rate for a 40-hour work week by 40, and then dividing by the proposed hours per week. For example, 45 hours proposed on a 40-hour work week basis at $20 per hour would be converted to an uncompensated overtime rate of $17.78 per hour ($20.00 x 40 divided by 45 = $17.78).*

Further, an addition of a new paragraph (d) and revised paragraph (b) of the clause requires the application of the "adjusted hourly rate" to all proposed hours, whether regular or overtime. This requirement applies to all FLSA exempt employees whether at the prime or subcontract level and includes uncompensated overtime hours that are in indirect cost pools for personnel whose regular hours are normally charged direct.

- **Revised Paragraph (b):** For any proposed hours against which an uncompensated overtime rate is applied, the offeror shall identify in its proposal the hours in excess of an average of 40 hours per week, by labor category at the same level of detail as compensated hours, and the uncompensated overtime rate per hour, whether at the prime or subcontract level. This includes uncompensated overtime hours that are in indirect cost pools for personnel whose regular hours are normally charged direct.
- **Unchanged Paragraph (c):** The offeror's accounting practices used to estimate uncompensated overtime must be consistent with its cost accounting practices used to accumulate and report uncompensated overtime hours.
- **Added Paragraph (d):** Proposals that include unrealistically low labor rates, or that do not otherwise demonstrate cost realism, will be considered in a risk assessment and will be evaluated for award in accordance with that assessment.
- **Unchanged Paragraph (e):** The offeror shall include a copy of its policy addressing uncompensated overtime with its proposal.

DCAA and its auditors have always been concerned with uncompensated overtime as a contractual "requirement" for an adequate accounting system. DCAA devotes a section of its *Information for Contractors* manual to defining uncompensated overtime and the impact on labor rates and overhead allocations. The DCAA Contract Audit Manual (CAM 6-410) includes significant guidance and direction to auditors with respect to the matter. Of particular note it states that if auditors determine that contracts are being over charged due to an inequitable allocation of costs because all time worked is not recorded, a contractor should be cited as being noncompliant with FAR 31.201-4 *Determining Allocability* and CAS 418 *Allocation of Direct and*

Indirect Costs. DCAA also acknowledges that the absence of total time accounting by a contractor ordinarily becomes a compliance issue only if there is a significant impact to the government. The current (as of May 2015) guidance in CAM 6-410 states in part that the auditor should "determine whether the failure of the contractor to record all time worked results in a material difference in the allocation of costs to final cost objectives". In actual practice, however, we've noted that auditors rarely even consider the impact or lack thereof. Computing or estimating an impact takes critical analysis and time; hence, DCAA auditors simply default to reporting a significant deficiency because of the "risk" of an unfavorable impact to the government. With the change to FAR 52.237-10 it is expected that this evaluation criteria will be removed entirely, and the new guidance stating that accounting for uncompensated overtime is explicitly required for contractors subject to FAR 52.237-10.

Although the January 2015 FAR change seems to eliminate alternatives for estimating and accounting for UCOT hours, it does not answer some fundamental questions including:

- Is there any regulation which requires "total time accounting" versus the option of only recording 40 hours per workweek (for exempt employees)? DCAA asserts that cost allocation principles require total time accounting (all hours are recorded by every employee); however, DCAA is ignoring the regulatory history wherein final regulations explicitly removed requirements for total time accounting which had been included in the proposed rule). If a contractor does not currently use total time accounting, the January 2015 FAR change certainly does not impose total time accounting.
- FAR 52.237-10 is "service contracting" specific; thus, not in all government contracts and its requirement for consistency only applies to a bid proposal and the resulting contract. Just like CAS 401, comparability (bid proposal to accumulating and reporting costs) applies to the specific contract. Although it may be operationally impractical and potentially at odds with other regulations (i.e. other Cost Accounting Standards/CAS), a contractor could have different methods for estimating and recording UCOT (adjusted hourly rates for contracts subject to FAR 52.237-10 and another method for all other contracts).
- If a contractor currently uses total time accounting, but not the adjusted hourly rate method for estimating and recording UCOT rates, does a contractor immediately change to the adjusted hourly rate method? If the contractor is CAS covered, the answer is to wait until a solicitation/proposal triggers the potential change, then propose and disclose it as a FAR 52.230-7 change (i.e. award of the contract will trigger a required change to remain compliant). If a contractor never encounters a solicitation which will invoke FAR 52.237-10, that contractor would have no reason to ever change practices for estimating or recording UCOT.

Therefore, it is important that all government contractors not only comply with the FLSA, but also be knowledgeable of government requirements (FAR 52.237-10) and DCAA interpretations with

respect to accounting and reporting "requirements" for uncompensated overtime. Although previously there was no explicit FAR requirement which prescribed a method for accounting for uncompensated overtime, now with the change to FAR 52.237-10 it is clear that for contracts containing the updated clause there is no choice but to account for uncompensated overtime. For those contractors whose estimating and accounting already use automatic rate adjustment features (salary divided by total worked and paid-time-off hours for the pay period), the January 29, 2015 FAR change is a non-event. For those contractors who use alternative methods for estimating and accounting for UCOT hours, this could be a traumatic event given that it eliminates those alternative methods, at least for any contractor submitting a bid on a services contract subject to 52.237-10. To avoid issues Contractors should adhere to one of the accepted methods described in the DCAA CAM 6-410.4.