



**Washington State
Department of Transportation**

Interpretive Guidance Document
Allowable Bonus
Architectural & Engineering Firm Overhead

WSDOT Internal Audit Office

May, 19 2011

This Interpretive Guidance Document will address **Bonus**, which is one of the most significant indirect cost items incurred by Architectural and Engineering (A/E) Consultants. We currently are working with the A/E firms to help them account for those costs correctly and make appropriate adjustments in accordance with Part 31 of the Federal Acquisition Regulations (FAR).ⁱ To promote compliance, we also are discussing this item with CPA firms that perform audits of Consultants' overhead schedules.

Allowable Bonus Costs

The Federal Acquisition Regulations (FARS) 48 CFR 31.205-6 (f) include the requirements for bonus expenses to be allowable overhead costs for A&E firms. The 2010 edition of the American Association of State Highway & Transportation Officials (AASHTO) Audit Guide, Chapter 7, provides additional guidance.

Written Bonus Policy

First, bonus payments should be made pursuant to a written bonus policy to ensure that they are supported and allowable. Written bonus plans should include, at a minimum, the following components—(See AASHTO Audit Guide, Chapter 7.12-C)

- Eligibility criteria
- Period of the bonus plan
- Performance criteria (e.g., individual expectations—must be measurable and verifiable criteria)
- Incentives awards/spot bonuses must be related to performance, as measured by quantitative and qualitative factors
- Form of payment to be received
- Distribution timeline

We have been notifying consulting firms by email & phone of such requirements in the 2010 AASHTO Audit Guide, and we also have information on the Guide in our FAQ document at <http://www.wsdot.wa.gov/Audit/FAQs.htm>.

It is the firm's responsibility to demonstrate that their bonus is paid in compliance with FARs. This can be extremely difficult without a written policy. We will require documentation to evaluate a firm's compliance with bonus requirements in FARS, the recommendations of the current AASHTO Audit Guide, and make the necessary adjustments for bonus expenses that do not comply with the federal rules.

Established and Communicated Before the Services Are Rendered

Allowable bonus costs are paid or accrued under an agreement entered into in good faith between the firm and the employee, established & communicated before the services are rendered. The basis for the award must be supported by sufficient documentation. The bonus plan and the awards paid under the plan should be based strictly on measurable performance criteria such as productivity, cost containment, individual contributions toward revenue, or individual employee performance.

Bonus Pool – Managed & Paid or Accrued

Best Practices indicate that the bonus pool should be determined early in the fiscal year with documentation of management's intent to use that pool for bonuses, and the overhead should be managed to that bonus amount. Many firms accrue their bonus, and then pay out that accrual before year end, which is an appropriate method.

Basing bonus payments *solely* on the profitability of the firm does not comply with FARsⁱⁱ. However, firms may wait until at or near year end to establish the bonus pool, and base their bonus *in part* on the profitability of the firm. When firms base their bonus *in part* on profitability, it's important to remember they will need to demonstrate that this overarching condition of profitability and/or funds available was communicated to the employees before the services were rendered.

Two criteria are key to allowable bonuses when a firm waits toward year end to establish the bonus pool and/or bases their bonus *in part* on the profitability of the firm:

- Communication to the employees prior to the services being rendered that an overarching condition of receiving a bonus is the firm's profitability and/or available funds.
- Measurable performance criteria (quantitative or qualitative) having been met by the individual employee, as the basis for a bonus award. The auditor should be able to verify the employee bonuses using the company's methods.

Accrued Bonus Expenses

Your overhead schedule should include expenses that are applicable to the current accounting period . If a firm reports bonus expenses that are not paid during the year but rather accrued as a current liability at fiscal year end, these bonus expenses must be paid using current assets, typically in the next fiscal year, under Generally Accepted Accounting Principlesⁱⁱⁱ .

Deferred Bonus Payments

If bonus payments are reported as *deferred compensation*, rather than reported as current liabilities, they will be subject to the rules in 48 CFR 31.205-6 (k) for *deferred compensation*, and the costs will also be subject to Cost Accounting Standards (CAS) 9904.415.

ⁱ The Federal Acquisition Regulation is codified at 48 CFR Part 31

ⁱⁱ 48 CFR 31.205-6 (f), and Chapter 7.12-C of the AASHTO Audit Guide

ⁱⁱⁱ Accounting Research Bulletin-43, Ch 3A