Washington State
Department of Transportation

Interpretive Guidance Document
Allowable Bonus
Architectural & Engineering Firm Indirect Cost Rate

WSDOT Internal

Audit Office

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Update

(Originally published May 19, 2011; the guidance in this document applies to indirect costs incurred after August 31, 2016)

This Interpretive Guidance Document will address **Bonus**, which is one of the indirect cost items incurred by Architectural and Engineering (A/E) Consultants. The American Association of State Highway & Transportation Officials (AASHTO) recently updated its guidance on this topic in the revised Uniform Audit & Accounting Guide. We've updated this document to reflect the revised guidance from AASHTO.

Allowable Bonus Costs

48 CFR 31.205-6 (f) [1]discusses the requirements for bonus expenses to be an allowable indirect cost for A&E firms. The 2016 edition of the AASHTO Audit Guide[2], Chapter 7, provides additional guidance.

Documentation for Allowable Bonus Costs

There are 3 steps that should[3] be documented in order to support the bonus award and to ensure your firm is following your own bonus policy.

- Step 1 starts with communicating the bonus policy and performance criteria to individuals prior to the work being performed.
- Step 2 is documenting that employees met the performance criteria in Step 1 and are eligible to receive the bonus.
- Step 3 needs to show the procedures on how each individual's bonus was calculated and awarded along with the corresponding entry into the payroll system.

Written Bonus Policy

Consulting firms should prepare and maintain written bonus plans that identify eligibility requirements and provide details regarding how bonus payments are

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[1] 48 CFR 31.205-6 (f) *Bonuses and incentive compensation.*
(1) Bonuses and incentive compensation are allowable provided the—
(i) Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; and
(ii) Basis for the award is supported.

[2] Formally Approved by AASHTO in 2016

[3] The term "should" is used throughout this guidance document within the context that it is the firm's duty to adequately support costs.

determined.

Written bonus plans should include, at a minimum, the following components–*(See AASHTO Audit Guide, Chapter 7.11-C)*

- Eligibility criteria
- Period of the bonus plan
- Performance criteria (e.g. employee performance ratings, contributions toward the firm's revenue growth, and responsibilities for cost containment)
- Incentive awards/spot bonuses must be related to performance, as measured by quantitative and qualitative factors
- Form of payment to be received
- Distribution timeline

It is the firm's responsibility to demonstrate that their bonus is paid in compliance with the Federal Acquisition Regulations (FARs)[4]. This can be quite difficult without a written policy. We may require documentation to evaluate a firm's compliance with the bonus requirements in FARs and the recommendations of the current AASHTO Audit Guide, and determine any adjustments needed for bonus expenses to comply with the federal rules.

Profit-Distribution Plan

A firm should also maintain a written profit-distribution agreement. Although not required under 48 CFR 31-205-6(f), a written plan will serve to reduce confusion and properly identify costs as bonus or profit distribution.

48 CFR 31.205-6(a)(6)(ii)(B) states that for owners of closely-held firms, allowable bonus amounts may not represent a distribution of profits. Accordingly, there must be clear distinctions of the various portions of total compensation; specifically, which portion is a true bonus based on stated objectives and which portion is a profit distribution.

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

[4] Federal Acquisition Regulations are codified at 48 CFR

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 FARs[5]. 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. The following 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

The indirect cost rate 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 within a reasonable period after the end of the cost accounting period.

[5] 48 CFR 31.205-6(f) and Chapter 7.11-C of the AASHTO Audit Guide

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.

Hiring/Recruitment Bonus
A firm may have a hiring bonus or referral bonus as part of its recruitment process. These types of payments should be clearly outlined in a firm's policies and procedures. The parameters for why, to whom, and when these types of payments are made should be documented.

For example, if a firm has hiring bonus in its human resource (HR) toolkit, the guidelines for employing this option should be specified in the HR manual. The HR manual should answer such questions as which class of employees a hiring bonus is warranted is work experience a factor, and how the hiring bonus amount is determined. We would expect to see a copy of the company policy along with a history of payments that is consistent from year to year.