



DEPARTMENT OF TRANSPORTATION

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Federal Highway Administration

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Guidance on Safe Harbor Rate Streamlining for Engineering and Design Services Consultant Contracts

AGENCY: Federal Highway Administration (FHWA), U.S. Department of Transportation (DOT).

ACTION: Notice.

SUMMARY: This Notice announces and outlines the final guidance for the implementation of a Safe Harbor indirect cost rate for certain engineering design service firms that find establishing such rates to be costly and a barrier to participating in engineering and design service contracts reimbursed with Federal-aid Highway Program (FAHP) funds.

DATES: This guidance is effective [INSERT DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

ADDRESSES: This document, the request for comments, and the comments received may be viewed online through the Federal eRulemaking portal at: <http://www.regulations.gov>. An electronic copy of this document may also be downloaded from the Office of the Federal Register's Website at:

<https://www.federalregister.gov> and the Government Publishing Office's Website at:

<http://www.gpo.gov/fdsys>.

FOR FURTHER INFORMATION CONTACT: Mr. John McAvoy, Consultant Services Program Manager, Office of Infrastructure, Federal Highway Administration, 1200 New Jersey Avenue, SE, Washington, DC 20590-9898, (202) 853-5593. For legal questions: Mr. Steven Rochlis, Office of the Chief Counsel, Federal Highway Administration, 1200 New Jersey Avenue, SE, Washington, DC 20590-9898, (202) 366-1395. Office hours are from 8:00 a.m. to 4:30 p.m. E.T., Monday through Friday, except for Federal holidays.

SUPPLEMENTARY INFORMATION:

Summary Discussion of Comments

The FHWA published a Federal Register Notice on July 17, 2018, at 83 FR 33288, seeking public comment on its proposed guidance for implementation of a Safe Harbor indirect cost rate and, its intention to notify all contracting agencies receiving FAHP funds that an agency-developed Safe Harbor indirect cost rate for eligible consulting firms may be used as a component of a risk-based oversight process to provide reasonable assurance to FHWA that consultant costs on FAHP-funded contracts are allowable in accordance with the Federal regulations. In preparing this guidance to assist in the implementation of a Safe Harbor program, FHWA considered all public comments submitted to the Federal Register Notice.

Based on the comments received, FHWA is finalizing the guidance. Since compliance with this guidance is voluntary for both the contracting agency and the consulting firm, it is not anticipated to impose any costs. Entities that choose to use this guidance would do so only if they anticipate a net positive impact. In particular, consulting firms that voluntarily comply could experience expanded business opportunities because they become eligible to work on contracts funded by a Federal grant, which they previously were not. This guidance may also result in cost savings due to a reduction in resources needed to conduct oversight and audits of small consulting firms.

Commenters included several State departments of transportation (State DOT), the American Council of Engineering Companies, and one individual. The respondents were in favor of the implementation of a Safe Harbor indirect cost rate program. Several commenters provided suggestions on how to make the program operate most efficiently. The following summarizes the comments and FHWA's response.

General Comments

- Multiple commenters expressed support for expansion of the Safe Harbor indirect cost rate program beyond the 10 States that are currently piloting the program. Multiple commenters noted that they were a pilot State for the Safe Harbor Indirect Cost Rate Experiment and Test and that the program is effectively meeting its stated goals.

- One commenter suggested that each State DOT implement its own Safe Harbor indirect cost rate, and that the rate apply to agreements within the respective State DOT only. If a Safe Harbor firm does work for multiple State DOTs, the Safe Harbor indirect cost rate for the respective State DOT would take precedence.

The FHWA agrees with the suggestion that each State DOT implement its own Safe Harbor indirect cost rate and that the rate apply to agreements within the respective State DOT only. The Safe Harbor indirect cost rate is applicable to individual specific contracts, and if a Safe Harbor firm does work on multiple contracts in multiple States, the Safe Harbor indirect cost rate for the respective State DOT should take precedent.

- Multiple commenters made recommendations regarding the indirect cost rate to be used in the Safe Harbor Program. One suggested a nationwide rate of 110 percent as was tested in the pilot program. Another suggested that States determine their own rate with a floor of 110 percent.

The FHWA disagrees with the recommendation that one nationwide Safe Harbor indirect cost rate be established. The FHWA believes that State DOTs should be able to determine their policy for accepting eligible firms into their program, applying the Safe Harbor indirect cost rate, and graduating firms into a cognizant agency approved indirect cost rate. This would be consistent with current indirect cost rate procedures where contracting agencies develop their own policy pertaining to application of cognizant agency approved indirect cost rates.

A rate that is set too low will not achieve the desired result of incentivizing new, small, or disadvantaged business enterprises into the professional services market.

A rate that is set too high is at risk for overpaying consultant actual costs.

- Multiple commenters suggested that once a firm has established a cognizant agency indirect cost, that firm should be allowed to immediately start using the new rate on existing contracts.

The FHWA agrees that the State DOT should be allowed to develop criteria for transitioning firms out of the program based on its own risk assessment.

- Multiple commenters suggested that the guidance should clearly indicate the Safe Harbor indirect cost rate program is voluntary for both the contracting agency and consultant and temporary in nature, intended to provide the consultant a window to work on Government contracts while developing its cost accounting procedures.

The FHWA agrees that use of the Safe Harbor indirect cost rate is voluntary for both the contracting agency and consultant. Existing regulations found at 23 CFR 172.11(b)(1)(iii) allow for the use of other methods to contract with firms that do not have a cognizant agency approved indirect cost rate and do not volunteer to use the Safe Harbor indirect cost rate.

- Multiple commenters suggested a consultant firm should be able to transition from the Safe Harbor indirect cost rate to a cognizant agency approved indirect cost rate within 3 years of entering the program.

The FHWA agrees that provided a relatively consistent contract workload, a consulting firm should be able to transition from the Safe Harbor indirect cost rate to a cognizant agency approved indirect cost rate within 3 years of entering the program.

- Some commenters recommended that a consulting firm have the option to utilize the Safe Harbor indirect cost rate indefinitely.

The FHWA disagrees with the recommendation to authorize an indefinite Safe Harbor indirect cost rate. Provided a relatively consistent contract workload, a consulting firm should be able to transition from the Safe Harbor indirect cost rate to a Federal Acquisition Regulation (FAR) indirect cost rate within 3 years of entering the program. However, FHWA agrees that the State DOT should be allowed to develop criteria for determining eligible firms and for transitioning firms out of the program based on its own risk assessment.

- Multiple commenters suggested the guidance should include the option for a field or project office indirect cost rate.

The FHWA sees the potential for benefit when applied to a field-based indirect cost rate as part of a State DOT's risk-based oversight process to provide reasonable assurance of consultant compliance with Federal cost principles.

Ultimately, it is up to the State DOT to include a field or project office indirect cost rate option when developing their Safe Harbor indirect cost rate program.

- One commenter recommended that if a consulting firm has not developed an accepted indirect cost rate within the past 3 years, it should be eligible for the Safe Harbor indirect cost rate program.

The FHWA agrees that a contracting agency could, as part of their risk-based oversight process, decide to make their Safe Harbor indirect cost rate available to a firm that has had their cognizant agency approved indirect cost rate lapse. However, contracting agencies should understand that participation in the program is voluntary and requiring a firm to use a Safe Harbor indirect cost rate because of a lapsed approved indirect cost rate may have the effect of imposing a de facto ceiling on an indirect cost rate, which is prohibited by statute. Existing regulations found at 23 CFR 172.11(b)(1)(iii) allow for the use of other methods to contract with firms that do not have a cognizant agency approved indirect cost rate.

- One commenter wrote to strongly support the existing statutory and regulatory framework governing the procurement, contracting, and administration of engineering and design-related services on Federal-aid highway projects, stating that the laws and regulations have brought a measure of uniformity and consistency to State transportation programs and help to ensure that Federal funds are administered efficiently and effectively. The commenter further stated that

education and training of engineering firms and State DOT officials on compliance, interpretation, and implementation of Federal rules in a fair and consistent manner protects the business interests of the firms and, more importantly, promotes transparency and accountability for taxpayer funds and protects against waste, fraud, and abuse.

The FHWA agrees that the existing statutory and regulatory framework governing the procurement, contracting, and administration of engineering and design-related services on Federal-aid highway projects promotes quality engineering services, provides transparency and accountability for taxpayer funds, and protects against waste, fraud, and abuse. Note that FHWA is not creating any new rules or regulations through this Federal Register notice. The FHWA is acknowledging that existing rules in 23 CFR 172 allow contracting agencies to develop their own risk-based oversight process, approved by FHWA, to provide reasonable assurance of consultant compliance with Federal cost principles and that a contracting agency-developed Safe Harbor indirect cost rate program can be a component of that process.

- One commenter expressed concern that the proposed Safe Harbor indirect cost rate program could be a step backwards if not implemented carefully. The notice gives broad latitude to State DOTs to set the parameters and procedures for such a program resulting in a wide array of approaches that treat firms differently from State to State. Such an outcome could undermine the coordinated efforts of

FHWA, American Association of State Highway and Transportation Officials, and American Council of Engineering Companies over the last 10+ years.

The FHWA recognizes that regional variances do exist and contracting agencies will have the opportunity to develop policies and procedures that reflect the needs of operating in different markets. We also note that FHWA is not creating any new rules or regulations nor are we amending current policy through this Federal Register notice. We acknowledge that existing rules in 23 CFR 172 allow contracting agencies to develop their own risk-based oversight process, approved by FHWA, to provide reasonable assurance of consultant compliance with Federal cost principles and that a contracting agency-developed Safe Harbor indirect cost rate program can be a component of that process. The FHWA believes that a continuing dialogue between the State DOTs and engineering firms are instrumental to development of policies and procedures that are compliant with 23 CFR 172.

- One commenter recommended strengthening the language in the notice to require adherence to the parameters of the work plan utilized in the pilot program. The commenter further recommended that the guidance be updated to require compliance with the policies and procedures outlined in the pilot program.

A Safe Harbor program developed by a contracting agency would be part of that agency's written policies and procedures compliant with 23 CFR 172.5(c) and subject to approval by FHWA. Participation in the Safe Harbor indirect cost

rate program is voluntary for the contracting agency and the consultant. If both entities do not agree on the parameters of the Safe Harbor indirect cost rate implementation, existing regulations provide guidance on how to proceed when the indirect cost rate has not been established by a cognizant agency. Actions that administratively limit or cause de facto ceilings on indirect cost rates are prohibited.

- One commenter suggested FHWA should include instructions to be sure that any State that implements a Safe Harbor indirect cost rate has a detailed plan in place for educating the firms of their true cost structure and moving the participating firms out of the program and into a cognizant agency approved indirect cost rate. The commenter theorized that, without the proper knowledge, setting a Safe Harbor indirect cost rate that is too low will have the effect of locking a firm into a money losing venture that will hamper the ability of the firm to mature to a formally recognized, properly formulated indirect cost rate.

The FHWA believes that a contracting agency should be able to determine their policy for educating and accepting eligible firms into their program, applying the Safe Harbor indirect cost rate, and graduating firms into a cognizant agency approved indirect cost rate. This would be consistent with current indirect cost rate procedures where contracting agencies develop their own policy pertaining to application of cognizant agency approved indirect cost rates. A rate that is set too low will not achieve the desired result of incentivizing new, small,

or disadvantaged business enterprises into the professional services market. A rate that is set too high is at risk for overpaying consultant actual costs.

Guidance on Safe Harbor Rate Streamlining for Engineering and Design Services

Consultant Contracts

Applicability and Purpose

This guidance applies to consulting firms providing engineering and design related services under a contract reimbursed with Federal-aid highway program (FAHP) funds and contracting agencies receiving FAHP funds. Consulting firms providing services under a contract reimbursed with FAHP funds are required to account for, and bill, costs in accordance with the Federal cost principles of the FAR of 48 CFR part 31. To do so, consulting firms develop indirect cost rates in accordance with the Federal cost principles. At the same time, contracting agencies shall provide reasonable assurance to FHWA that consulting firm costs claimed under FAHP-funded contracts, including indirect costs, are allowable in accordance with the Federal cost principles.

23 CFR 172.11(c)(1).

Adhering to these accounting requirements can place a significant burden on some consulting firms and may create a barrier for otherwise qualified firms to compete for FAHP-funded contracts. Many small firms, including Disadvantaged Business Enterprise firms, lack the financial expertise or financial resources to either develop an indirect cost rate themselves or hire a Certified Public Accountant firm to do it for them. New or start-up firms generally do not have a contract-related cost history to use as a

base for development of an indirect cost rate. These firms are typically prohibited from participating in FAHP-funded contracts without the development and application of a provisional indirect cost rate for each specific contract, which is adjusted based upon a labor intensive, contracting agency-conducted final audit at the completion of the contract.

Background and Pilot Program

To remove these barriers and to enhance contracting agency oversight of compliance with Federal cost principles, FHWA developed the Safe Harbor Indirect Cost Rate Test and Evaluation pilot. Ten contracting agencies participated in a test where new or small consulting firms were given the option of applying a Safe Harbor indirect cost rate to specific contracts. The selected Safe Harbor indirect cost rate was conservatively lower than the industry average rate, allowing the firms to participate in the engineering services market without an audit of their costs while providing an incentive for the firms to develop an actual rate when allowed by their cost history.

Test results showed a reduction in the financial management barriers that prevented new, small, or disadvantaged but qualified consulting firms from entering the federally funded engineering services market, and creation of a framework for these consulting firms to establish a cognizant agency approved indirect cost rate. Following a risk-based approach allowed contracting agency oversight and audit resources to prioritize their efforts on more complex, higher risk contracts.

The use of a Safe Harbor indirect cost rate is voluntary for both the contracting agency and the consulting firm. During the test and evaluation, a consulting firm was considered eligible to use a Safe Harbor indirect cost rate if it had not had an indirect cost rate previously accepted by a cognizant agency. Consulting firms with an audited, or otherwise accepted, actual indirect cost rate, developed in accordance with the Federal cost principles, were not considered eligible to participate in the Safe Harbor Indirect Cost Rate Program.

The FHWA's test and evaluation pilot used a nationwide Safe Harbor indirect cost rate of 110 percent of a firm's direct salary rate. This rate provided a minimal risk to contracting agencies for overpayment to those consulting firms participating in the program. Based on FHWA's experience with this pilot, FHWA will expand the use of the Safe Harbor indirect cost rate, beyond the 10 pilot States, to allow other interested contracting agencies receiving FAHP funds to develop and implement a self-administered Safe Harbor Indirect Cost Rate Program, under a risk-based approach compliant with 23 CFR 172.11(c).

Beyond the Pilot - Guidance on Use of the Safe Harbor Indirect Cost Rate

This guidance replaces the Safe Harbor Indirect Cost Rate Test and Evaluation pilot by expanding the scope of the program beyond the ten contracting agencies that participated in the pilot.

Contracting agencies are given discretion to determine the eligibility of consulting firms for a Safe Harbor indirect cost rate for use on a case-by-case basis and are required to document their decision.

While the original test of the Safe Harbor indirect cost rate only applied to an office-based indirect cost rate, FHWA sees the potential for benefit if a contracting agency elects to apply a field-based indirect cost rate as part of the agency's risk-based oversight process to provide reasonable assurance of consultant compliance with Federal cost principles.

If agreed to by both the contracting agency and the consulting firm, the Safe Harbor indirect cost rate is applied to new contracts executed with a contracting agency, or subrecipient.

Once applied to a contract, the Safe Harbor indirect cost rate should be used for the duration of the contract. A Safe Harbor indirect cost rate may be used in the determination of the fixed fee portion of the contract, which would not be subject to adjustment unless warranted by changes to the scope of work or duration of the contract.

Firms that use the Safe Harbor indirect cost rate, and do not have established salaries or wage rates for employees or classes of employees, use negotiated, fixed hourly labor rates for the direct labor portion of the contracted services. The negotiated direct labor rate should meet the reasonableness provisions as set forth in 2 CFR 200.404, considering the nature of the services to be provided. Where appropriate for the scope of services under contract, a "fully loaded" or "specific rate of compensation" hourly rate

could be established utilizing a reasonable hourly direct labor rate, a Safe Harbor indirect cost rate as the overhead rate component, and an appropriate amount of fixed fee that considers the complexity and risk involved.

The Safe Harbor indirect cost rate is intended to be a component of a contracting agency's risk-based oversight of the procurement, management, and administration of engineering and design-related services contract. Contracting agencies using the Safe Harbor indirect cost rate must first prepare and maintain written policies and procedures establishing the program in accordance with 23 CFR 172.5(c)(10), then develop written risk-based oversight procedures designed to provide reasonable assurance of consultant compliance with the Federal cost principles in accordance with 23 CFR 172.11(c)(2).

The use of the Safe Harbor indirect cost rate is voluntary for both the contracting agency and for eligible firms. In reviewing the eligibility of a consulting firm opting to use the Safe Harbor indirect cost rate, it may be necessary to contact the State DOT in the home State of the consulting firm to verify the audit history of the firm and ensure the firm does not have an audited or otherwise accepted indirect cost rate developed in accordance with the Federal cost principles. Some evaluation of the accounting system of the consulting firms choosing to use the Safe Harbor indirect cost rate may be necessary to verify the capability of accumulating and tracking direct labor for applying the Safe Harbor indirect cost rate, as well as for billing other direct costs by contract, segregating indirect costs, etc. The Internal Control Questionnaire provided in Appendix B of the *AASHTO Uniform Audit and Accounting Guide (2016 Edition)* may be used by contracting

agencies as a tool for assessing the accounting system capabilities of firms opting to use the Safe Harbor indirect cost rate. A contracting agency may wish to conduct post contract audits or other evaluations to verify accurate accumulation and billing of direct contract costs. However, an audit of indirect costs is not necessary for Safe Harbor indirect cost rate contracts, as the rate should be applied for the duration of the contract, and retroactive adjustments to indirect costs incurred on these contracts is not necessary.

The FHWA Division Office will serve as the primary point of contact and liaison for the contracting agency. The FHWA Division Offices also will monitor the respective contracting agency's use of the Safe Harbor indirect cost rate in accordance with the approved, written risk-based oversight procedures.

Contracting agencies using FAHP funds must comply with all Federal, State, and local laws and regulations to remain eligible for reimbursement.

This guidance is not legally binding in its own right and will not be relied upon by the Department as a separate basis for affirmative enforcement action or other administrative penalty. Conformity with this guidance document is voluntary only, and nonconformity will not affect rights and obligations under existing statutes and regulations.

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