CALIFORNIA DEPARTMENT OF TRANSPORTATION

Prevailing Wage Interpretive Guidance

External Contracts – Architectural and Engineering (A&E) Contracts

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Prevailing Wage Interpretive Guidance

Architectural and engineering (A&E) firms working on public works projects in California are required to pay prevailing wages to certain categories of employees working on specific types of work. The requirements for payment of prevailing wages, and the required prevailing wage amounts to be paid, are established by the California Department of Industrial Relations (DIR). Payment of prevailing wages often results in A&E firms paying additional amounts to covered employees in the form of additional wages, additional benefits, or both. These additional payments in excess of the employee's standard wages and benefits are commonly referred to as "prevailing wage deltas". Because prevailing wages are established as two components – a base wage component and a fringe benefits component – the prevailing wage deltas are also established separately, as "prevailing wage delta base" and "prevailing wage delta fringe". The treatment of prevailing wage deltas may have a significant effect on the calculation of an A&E firm's indirect cost rate, as well as amounts used in preparing cost proposals and invoices. The purpose of this guidance document is to describe the requirements for treatment of prevailing wage deltas for accounting, contract negotiation, and invoicing, for A&E firms contracting with Caltrans or local government agencies.

Definitions

The following definitions apply to the calculation of prevailing wage deltas:

Prevailing wage delta base – the difference between the employee's standard hourly wage and the base wage identified in the Prevailing Wage determination (established by DIR) specified for the covered service the employee is performing.

Prevailing wage delta fringe – the difference between the fringe benefits normally provided to the employee (as calculated by the A&E firm), calculated on an hourly basis, and the prevailing wage fringe amount required to be paid for the employee's role established by the DIR, also calculated on an hourly basis.

An example of prevailing wage delta base and delta fringe would be as follows:

An A&E firm has an employee working on a project requiring payment of prevailing wage; relevant information is as follows:

Actual base hourly wage	$40.00
Base hourly wage per prevailing wage determination	$50.00
Prevailing wage delta base	$10.00
Actual fringe benefits, calculated on an hourly basis	$ 8.00
Fringe benefits per prevailing wage determination	$12.00
Prevailing wage delta fringe	$ 4.00

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Importance of Consistency

This document discusses the possible accounting treatments A&E firms may use in accounting for prevailing wage deltas, establishing their indirect cost (overhead) rate, and contracting with Caltrans and local government agencies. It is critically important for each firm to establish a method of accounting and apply it consistently to ALL prevailing wage delta costs, regardless of the client, contract, or reimbursement method. Firms may not change their method of accounting based on whether the costs are billable or non-billable, or based on the method that provides the best result for a specific contract. The decision of the accounting method for prevailing wage deltas must be applied to the entire A&E firm, every time that such costs are incurred. Firms must be able to prove that their accounting treatment for prevailing wage deltas is consistent, in order to be reimbursed for prevailing wage delta costs on Caltrans and local government agency and local government agency contracts. Firms may provide evidence of their accounting treatment for prevailing wage through an overhead audit or through other documentation.

Possible Accounting Methods

Generally, there are three methods that firms may use to account for prevailing wage delta costs:

1) Account for the delta as direct labor cost
2) Account for the delta as other direct cost
3) Account for the delta as overhead cost

It is important to note that because A&E firms sometimes pay their affected employees the prevailing wage deltas in different ways for delta base versus delta fringe, it is possible that a firm might use one accounting method for delta base and another method for delta fringe. This approach is allowable, provided the firm uses the same methods consistently for all contracts. For the following examples, we will assume for illustration purposes that the firm uses the same method for treatment of both the delta base and delta fringe; however, it is noted that firms at times use different methods for treatment of the deltas.

Effect on Indirect Cost Rate (Overhead) Calculation

The accounting method chosen by an A&E firm for treatment of prevailing wage deltas has a significant effect on the indirect cost rate calculation. The proper calculation of A&E firm indirect cost rates is established by Federal Acquisition Regulation 48 CFR 31 (FAR Part 31) and the AASHTO Uniform Audit and Accounting Guide (AASHTO Audit Guide). The indirect cost rate calculation can be summarized as follows:

Indirect cost rate = Total FAR allowable indirect costs / Total direct labor costs

As an example, assume an A&E firm has the following costs:

Total direct labor costs = $1,000,000
Total indirect costs = $1,600,000
FAR unallowable costs = $100,000
Total FAR allowable costs = $1,500,000

Indirect cost rate = 1,500,000 / 1,000,000 = 150.00%

Accounting Method 1 – Treat Prevailing Wage Deltas as Direct Labor Cost

The first method which A&E firms may use to account for prevailing wage deltas is to treat them as direct labor costs. Using the previous example, we will assume that the firm has an additional $20,000 of prevailing wage delta costs, which they account for as direct labor costs. The result would be as follows:

	Previous Example	Add Prevailing Wage Deltas	Adjusted
Total direct labor costs	$1,000,000	$ 20,000	$1,020,000
Total indirect costs	$1,600,000		$1,600,000
FAR unallowable costs	$ 100,000		$ 100,000
Total FAR allowable indirect costs	$1,500,000		$1,500,000
Indirect cost rate	150.00%		147.06%

Accounting Method 2 – Treat Prevailing Wage Deltas as Other Direct Cost

The second method which A&E firms may use to account for prevailing wage deltas is to treat them as other direct costs. Using the same example, we will assume that the firm accounts for the additional $20,000 of prevailing wage delta costs as other direct costs. The result would be as follows:

	Previous Example	Add Prevailing Wage Deltas	Adjusted
Total direct labor costs	$1,000,000		$1,000,000
Total indirect costs	$1,600,000		$1,600,000
FAR unallowable costs	$ 100,000		$ 100,000
Total FAR allowable indirect costs	$1,500,000		$1,500,000
Indirect cost rate	150.00%		150.00%
Prevailing wage other direct costs	$ 0	$ 20,000	$ 20,000

Accounting Method 3 – Treat Prevailing Wage Deltas as Indirect / Overhead Cost

The third method which A&E firms may use to account for prevailing wage deltas is to treat them as overhead / indirect costs. Using the same example, we will assume that the firm accounts for the additional $20,000 of prevailing wage delta costs as indirect costs. The result would be as follows:

	Previous Example	Add Prevailing Wage Deltas	Adjusted
Total direct labor costs	$1,000,000		$1,000,000
Total indirect costs	$1,600,000	$ 20,000	$1,620,000
FAR unallowable costs	$ 100,000		$ 100,000
Total FAR allowable indirect costs	$1,500,000	$ 20,000	$1,520,000
Indirect cost rate	150.00%		152.00%

As the examples illustrate, there can be a significant effect on an A&E firm's FAR allowable overhead rate depending on the accounting method chosen for the treatment of prevailing wage deltas. Again, any of these methods is acceptable, but the costs MUST be accounted for consistently for ALL contracts. Reimbursement of the costs must not determine the accounting treatment; instead, firms must account for the prevailing wage delta costs in the same manner in all cases, regardless of reimbursement.

Documentation Requirements

A&E firms must document their accounting treatment for prevailing wage deltas. Firms should prepare a written policy outlining the following information:

- Description of types of work they perform which require payment of prevailing wage rates
- Explanation of how the firm pays prevailing wage deltas to affected employees (e.g. pay directly to employee as single amount to cover delta base and delta fringe, pay delta base to employee and pay delta fringe amount to a third party plan, etc.)
- Accounting method used for prevailing wage delta base costs
- Accounting method used for prevailing wage delta fringe costs
- Effect on firm's most recently completed indirect cost rate

In addition, if the A&E firm has a CPA firm perform an audit of its indirect cost rate, the audit report should include a footnote describing the A&E firm's treatment of prevailing wage deltas for both base and fringe. The CPA firm is expected to perform testing to verify the information disclosed in that footnote, including testing to support that the A&E firm accounts for prevailing wage deltas consistently. A&E firms with CPA-audited overhead rates will be allowed to provide other supporting documentation while transitioning to inclusion of this information in the indirect cost rate audit. A&E firms which do not have CPA-audited overhead rates will be required to submit their Prevailing Wage Policy prior to contract execution. A&I reserves the right to perform additional procedures at any time, as deemed necessary, to verify the firm's accounting treatment is consistent and properly supported.

Effect on Contract Negotiation and Invoicing

The three methods described above to account for prevailing wage deltas result in different indirect cost rates, and should be reimbursed differently. It is Caltrans' intent that A&E firms which can provide evidence that they account for prevailing wage deltas properly and consistently, using one of the three approved methods, shall be reimbursed for the prevailing wage delta costs consistent with the firm's accounting treatment. A summary of the three methods and related reimbursement is as follows:

Prevailing Wage Delta Cost Accounting Treatment	**Prevailing Wage Delta Multiplier Value**
Classified as Direct Labor	(1+OH)*(1+Fee) Full Multiplier
Classified as Other Direct Cost	1.00 Multiplier
Classified as Overhead / Indirect Cost	0.00 Multiplier

As noted earlier, it is important for A&E firms to account for prevailing wage deltas consistently, regardless of the method or amount of reimbursement, and to provide documentation of their accounting method, in order to be eligible for reimbursement of these costs. Caltrans will review the firm's Prevailing Wage Policy's accounting treatment to ensure it is consistent and properly supported. Once accepted, reimbursement of prevailing wage delta costs will be allowed based on the table above, consistent with the firm's accepted accounting treatment. The burden of proof is on the A&E firm to provide evidence that the prevailing wage delta costs are accounted for properly and consistently. If an A&E firm cannot support that their accounting treatment for prevailing wage deltas is proper and consistent, the contracting agency will not reimburse the prevailing wage deltas.

Reimbursement for Firms Using Safe Harbor Indirect Cost Rate

A&E firms using the Safe Harbor Indirect Cost Rate on a contract will be reimbursed for prevailing wage deltas as an Other Direct Cost.

Implementation Period

Caltrans implemented this policy on March 1, 2017, and all A&E firms must comply to be eligible for prevailing wage delta payment reimbursements. A&E firms should begin working now to document their policies and procedures in this area. Firms who have a CPA audit of their indirect cost rate should notify their CPA firm of the expectations for footnote disclosures and testing of prevailing wage delta accounting treatment immediately, so those items can be addressed in upcoming audits.