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¶ 13 The New Uncompensated Overtime Rule

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A final rule published January 29 and effective March 2 threatens to change the rules for uncompensated overtime dramatically.[1] Uncompensated overtime refers to the hours worked in excess of the standard 40-hour work week by employees who are exempt from the Fair Labor Standards Act (FLSA) and therefore not entitled to additional compensation for overtime work.

The FAR before the New Rule

Before this new rule took effect, there was no requirement in the Federal Acquisition Regulation for contractors to record or account for uncompensated overtime for their FLSA-exempt employees. Indeed, Government regulators have repeatedly rejected recommendations by the Defense Contract Audit Agency and the Department of Defense inspector general to require contractors to record uncompensated overtime.

For example, in promulgating Cost Accounting Standard 418, the CAS Board expressly considered and rejected a proposed CAS 420, which would have required that ''A direct labor hour base shall include all hours actually worked directly on cost objectives (whether compensated or uncompensated).''[2] The CAS Board subsequently withdrew the uncompensated overtime provision with the following explanation:

> Under the previously proposed CAS 420, uncompensated overtime hours directly worked on cost objectives would be included in a direct labor base. A number of commentators said that controlling and recording such overtime hours would be difficult. The cost that would result from requiring the uncompensated overtime hours to be controlled and recorded appears to outweigh the benefits to be derived. Accordingly, this requirement is being omitted from the standard being proposed today.[3]

Consistently, Director of Defense Procurement Eleanor Spector rejected a DOD IG recommendation to add a provision to the Defense FAR Supplement requiring contractors and subcontractors to record all hours worked by FLSA-exempt employees. In a Jan. 26, 1996 letter responding to a DOD IG draft audit report, Spector disagreed with the recommendation to impose full-time accounting, stating,

> I nonconcur with the recommendation. The issue of full-time accounting was addressed in detail by the DoD Advisory Committee on Uncompensated Overtime which I chaired and the DoDIG participated as a member. The committee concluded in its December 1989 report that contractors should be allowed to maintain different accounting systems provided they comply with current government accounting rules and regulations. Clearly, if uncompensated overtime hours are material, they must be properly recorded and allocated. I am unaware of any current significant or widespread problems concerning uncompensated overtime that would suggest that the committee's conclusion is no longer valid.[4]

The DOD IG persisted, and in its final report stated,

> Most contractors do not require their direct charge FLSA-exempt employees to record all hours worked in

> excess of 8 hours a day or 40 hours a week. They generally do not allocate salary costs paid exempt employees to all hours worked, and most contractors usually fail to allocate indirect costs to direct charge uncompensated over-time worked. Such practices are highly manipulative and contribute to inequities in the costing and pricing of Government contracts.[5]

The DOD IG also reiterated its recommendation to add a DFARS provision requiring full-time accounting, and stated that ''this lack of a basic internal accounting control requirement presents a glaring weakness that can render an entire accounting system unreliable."

Spector once again rejected the DOD IG recommendation. In an Aug. 13, 1996 letter, she stated that she had reviewed the report, and her position was unchanged:

> I believe the report fails to provide convincing evidence that contractors' accounting practices for uncompensated overtime actually result in significant or widespread mischarging of labor costs on Government contracts. I recognize that full-time accounting would facilitate the DCAA field review of contractor labor costs and promote more judicious utilization of DCAA scarce resources. However, it would place an additional administrative burden on contractors without any proven tangible or monetary benefit to the Government. The mandatory imposition of additional labor record-keeping requirements (full-time accounting) on all defense contractors to reduce an unknown level of risk to the Government is unnecessary, burdensome, and counter to and inconsistent with current initiatives to streamline and simplify the procurement process.[6]

Spector's letter also criticized the DOD IG for suggesting that it would direct DCAA to question a contractor's accounting system if the contractor refused to implement full-time accounting. Spector stated,

> Based on the statistical data presented in your report, while contractors frequently do not record uncompensated overtime, DCAA has determined the practice does not result in a material difference in the allocation of costs to contracts. Therefore, it would be arbitrarily punitive for you to direct DCAA to recommend disapproval of the labor recording portion of a contractor's accounting system when all labor hours are not recorded, as you state in your report you will do unless I change my position on your recommendation. The proper procedure for handling a disputed OIG recommendation is outlined in DoD Directive 7650.3. Threatening to require DCAA to provide inappropriate audit advice to its customers is not part of that procedure.[7]

The FAR mentions uncompensated overtime only in FAR 37.115 and FAR 52.237-10, Identification of Uncompensated Overtime, both of which were originally published in the DFARS and subsequently moved to the FAR. These provisions were added to implement § 834 of the National Defense Authorization Act for Fiscal Year 1991.[8]

Section 834 required the secretary of defense to prescribe regulations to ensure, to the maximum extent practicable, that professional services are acquired based on the task to be performed rather than on the number of hours of service provided.[9] Among other things, the regulations must require offerors to identify any uncompensated overtime included in a proposal.[10] In addition, the regulations must establish criteria to ensure that proposals for contracts for technical and professional services are evaluated on a basis that does not encourage offerors to propose uncompensated overtime.[11]

FAR 52.237-10 is a mandatory clause for contracts for professional or technical services that are acquired based on the number of hours to be provided.[12] The clause requires offerors to identify any proposed labor rates that are based on a regular work week exceeding 40 hours, including uncompensated overtime in indirect cost rates. It also requires that the cost accounting practices used to estimate uncompensated overtime be consistent with the practices used to accumulate and report such hours.

Accordingly, before the new final rule took effect, even when FAR 52.237-10 was included in a contract, it did not *require* the contractor to record uncompensated overtime. To the contrary, as long as the contractor's proposed labor rates did not include uncompensated overtime, the clause (in effect before the new final rule) required the contractor to *exclude* uncompensated overtime in accumulating and reporting its labor costs.

Indeed, the Armed Services Board of Contract Ap-

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peals has held that even if a contractor records uncompensated overtime under a time-and-materials contract, if its proposed labor rates do not include an uncompensated overtime adjustment, the contractor is entitled to bill at the fixed hourly (unadjusted) rates specified in the contract for all hours worked, including uncompensated overtime hours.[13]

Although acknowledging that neither the FAR nor CAS expressly *requires* contractors to record uncompensated overtime, DCAA has long taken the position that contractors *should* account for all hours worked, whether compensated or uncompensated. DCAA's Contract Audit Manual (DCAM) states in this regard:

> Many contractors' accounting systems do not assign costs to those hours worked by exempt employees in excess of 8 hours per day or 40 hours per week. In some cases, labor costs are distributed only to cost objectives worked on during the first 8 hours of the day. In other cases, employees are permitted to select the cost objectives to be charged when more than 8 hours per day are worked or the contractor has an informal policy as to how employees should select the objectives to charge. For example, when a contract and B&P project are worked on the same day, the actual hours incurred on the contract might be charged first and the balance up to 8 hours might be charged to the B&P project. Obviously, there is serious risk of mischarging costs to Government contracts under such circumstances.[14]

The DCAM instructs auditors to cite the contractor as noncompliant with FAR 31.201-4 and CAS 418 if DCAA determines that Government contracts are being overcharged by a material amount due to an inequitable allocation of costs because the contractor does not record all time worked.[15]

Both FAR 31.201-4 and CAS 418 require the proportionate allocation of costs to benefiting cost objectives. FAR 31.201-4 provides that a ''cost is allocable if it is chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship."[16] Similarly, CAS 418 requires that indirect costs ''shall be allocated to cost objectives in reasonable proportion to the beneficial or causal relationship of the pooled costs to cost objectives."[17]

The failure to record uncompensated overtime could potentially result in a disproportionate allocation of an employee's compensation costs because the cost objectives to which the uncompensated hours are allocated do not bear their proportionate share of the employee's compensation. Additionally, failing to include all of an employee's labor hours in an indirect allocation base could potentially result in a disproportionate allocation of indirect costs because the uncompensated labor hours do not bear any indirect costs, even though tasks performed during the uncompensated hours may benefit from the functions included in the indirect cost pool.

Importantly, however, the DCAM emphasizes that ''[m]ateriality is the governing factor when determining whether noncompliances should be cited and whether a contractor should be required to implement a total-hour accounting system."[18] The DCAM instructs auditors to pursue the issue only if a preliminary evaluation determines that *both* (1) uncompensated overtime could materially impact labor cost allocations *and* (2) a significant amount of uncompensated overtime exists.[19]

The New Rule

The final rule was issued without public comment, ostensibly ''because it only clarifies policy that is already stated in the FAR."[20] However, this assertion is dubious at best if the rule means what it appears to say. The rule starts innocuously enough by adding the existing definitions from FAR 52.237-10, Identification of Uncompensated Overtime, to FAR 37.101, and changing the defined ''uncompensated overtime rate" to ''adjusted hourly rate (including uncompensated overtime)."[21] The definitions themselves remain unchanged:

> *Uncompensated overtime* means the hours worked without additional compensation in excess of an average of 40 hours per week by direct charge employees who are exempt from the Fair Labor Standards Act. Compensated personal absences such as holidays, vacations, and sick leave shall be included in the normal work week for purposes of computing uncompensated overtime hours.
>
> *Adjusted hourly rate (including uncompensated overtime)* [formerly known as *uncompensated overtime*

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> *rate*] is 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).[22]

The final rule also leaves unchanged paragraph (c) of the clause, which states, ''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."[23]

However, it adds a new paragraph (d) to FAR 37.115-2 and revises paragraph (b) of FAR 52.237-10 to *require* contractors to apply the adjusted hourly rate (including uncompensated overtime), rather than the hourly rate, to all proposed hours, whether regular or overtime, ''whenever there is uncompensated overtime."[24] The significance of this new requirement is best illustrated by comparing paragraph (b) of the former version of FAR 52.237-10 to paragraph (b) in the revised clause:

FAR 52.237-10, Identification of Uncompensated Overtime (Aug 2012)	**FAR 52.237-10, Identification of Uncompensated Overtime (Mar 2015)**
(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.	(b)(1) Whenever there is uncompensated overtime, the adjusted hourly rate (including uncompensated overtime), rather than the hourly rate, shall be applied to all proposed hours, whether regular or overtime hours.
	(2) All proposed labor hours subject to the adjusted hourly rate (including uncompensated overtime) shall be identified as either regular or overtime hours, by labor categories, and described at the same level of detail. This is applicable to all proposals whether the labor hours are 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.

The former clause required the offeror to identify only those ''proposed hours against which an uncompensated overtime rate is applied," i.e., those hours for which the contractor was *proposing* to use adjusted hourly rates (including uncompensated overtime). Offerors that did not propose to apply adjusted hourly rates were not required to identify uncompensated overtime, let alone adjust their hourly rates.

By contrast, the revised clause requires the contractor to *apply* the adjusted hourly rate to all proposed hours ''whenever there is uncompensated overtime," i.e., whenever the contractor's direct-charge, FLSA-exempt employees work more than 40 hours per week. Moreover, the revised FAR 52.237-10(b)(2) states that this requirement applies to all proposals, whether the labor hours are at the prime or subcontract level. It also applies to uncompensated overtime hours that are in indirect cost pools for personnel whose regular hours are normally charged as direct.[25] And because paragraph (c) requires that an offeror's accounting practices used to estimate uncompensated overtime must be consistent with the cost accounting practices used to accumulate and report uncompensated overtime hours, the revised clause appears to require contractors to record all hours worked and apply adjusted hourly rates (including uncompensated overtime).

Conclusion

One can only hope that the revised clause does not mean what it appears to say. It would be ironic indeed if, after many years of DCAA and the DOD IG fighting without success to require contractors to adopt total time accounting, the FAR Councils adopted the DCAA and DOD IG position in a final rule published without public comment. If the rule means what it appears to mean, it plainly violates the 41 U.S.C.A. § 1707 requirement that procurement regulations be published for public comment if they relate to the expenditure of public funds and have either (1) a significant effect be-

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yond the internal operating procedures of the agency, or (2) a significant cost or administrative impact on contractors or offerors.

ENDNOTES:

[1]See 80 Fed. Reg. 4992 (Jan. 29, 2015).

[2]See 43 Fed. Reg. 1126 (Mar. 16, 1978).

[3]44 Fed. Reg. 42991 (Jul. 23, 1979).

[4]Memorandum from Eleanor R. Spector, Director, Defense Procurement, to Director of Audit Policy and Oversight, DOD Inspector General, ''DoDIG Draft Audit Report on Oversight Review of the Defense Contract Audit Agency Audit Coverage of Uncompensated Overtime at Major Contractors" (Jan. 26, 1996).

[5]DOD IG Report No. PO-96-0101, ''The Followup Oversight Review of the Defense Contract Audit Agency Audit Coverage of Uncompensated Overtime at Major Contractors" (June 14, 1996).

[6]Memorandum from Eleanor R. Spector, Director, Defense Procurement, to Director of Audit Policy and Oversight, DOD Inspector General, ''DoDIG Final Report on Followup Oversight Review of the Defense Contract Audit Agency Audit Coverage of Uncompensated Overtime at Major Contractors (Report No. PO-96-010)" (Aug. 11, 1996).

[7]Id. at 2.

[8]National Defense Authorization Act for Fiscal Year 1991, Pub. L. No. 101-510, § 834, 104 Stat. 1485, 1613–14 (Nov. 5, 1990), codified at 10 U.S.C.A. § 2331.

[9]10 U.S.C.A. § 2331(a).

[10]10 U.S.C.A. § 2331(b).

[11]Id.

[12]See FAR 32.115-3.

[13]See *GaN Corp.*, ASBCA No. 57834, 12-2 BCA ¶ 35,103; 7 CP&A Rep. ¶ 55.

[14]DCAM ¶ 6-410.1 (Jan. 15, 2015).

[15]DCAM ¶ 6-410.3.d.

[16]FAR 31.201-4.

[17]48 C.F.R. § 9904.418-40(c).

[18]DCAM ¶ 6-410.3.d.

[19]DCAM ¶ 6-410.6b.

[20]80 Fed. Reg. at 4993.

[21]Id.

[22]FAR 52.237-10(a).

[23]FAR 52.237-10(c).

[24]Id.

[25]Id.

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