Appendix G
Methods of Compensation

ALLOWABLE METHODS

Method No. 1: Cost Plus Fixed-Fee

This is the most common method used by the Department and reimburses the firm for direct and indirect costs attributable to the project plus a negotiated predetermined amount for profit (fixed-fee). During the negotiating phase, limits are agreed to on all four cost elements which when totaled are referred to as the contract upset limit or compensation. The four cost elements are direct labor, overhead, profit and direct non-salary expenses.

This method is appropriate when the extent, scope, complexity, character, or duration of the work cannot be reasonably determined at the time of negotiation.

This method is, also, particularly well suited for many projects that are divided into phases where work conducted under one phase defines the scope of services for the next phase. This method has the most flexibility for increasing the amounts payable through the supplemental agreement process for extra work beyond the original defined scope of services.

The major disadvantage is in project management and administration. The Consultant must submit a complete package of backup information with each monthly invoice, including verified payroll records and verification of all direct expenses billed. All of this information must be reviewed, copied and approved by the Project Manager, the Section's fiscal officer, and the Finance Office. Upon project completion, the accumulated records must be audited.

As stated, this method of payment has four basic components, which determine the total compensation to be paid: direct salary costs(labor), overhead, profit and direct non-salary expenses.

Direct labor is the cost of salaries for those personnel such as principals, engineers, technicians, drafters, CADD operators, stenographers, survey personnel, and clerks, that are directly chargeable to the project.

A second reimbursable cost is the firm's overhead. This cost represents those allowable costs that are not directly attributable to the project. These costs are quite extensive, and the Project Manager should be aware of exactly which of them are currently eligible for reimbursement. In addition to this manual, a review of recent project pre-award audits or contacting the Audit Section will provide additional information.

Overhead costs generally include some or most of the following:

- Provisions for office, light, heat, and related items associated with the working space, depreciation allowances or rental for furniture, drafting equipment, and CADD equipment, automobile expenses, and office and drafting supplies not directly chargeable to the project;

- Taxes and insurance other than those included as salary cost, but excluding state and federal income taxes;

- Library and periodical expense, and other means of keeping current in the profession, such as attendance at technical and professional meetings;
- Those services and expenses essential to the conduct of the business, including prelimi-

nary arrangements for new projects and interest on borrowed money; executive, administrative, accounting, legal, stenographic, and clerical salaries and expenses, other than identifiable salaries included in salary costs and expenses included in reimbursable non-salary expenses, plus salaries of partners and principals, to the extent that they perform general executive and administrative services as distinguished from technical or advisory services directly applicable to the project;

- Business development expenses, including salaries of principals and salary costs of employees so engaged; and

- Provision for loss of productive time of technical employees between assignments and for time of principals and employees on public- interest assignments.

In addition to the above items, included in the overhead are those costs which are related to salaries. These are called payroll burden and fringe benefits. Items usually associated with this part of the overhead include paid sick leave, vacation, holidays, payroll taxes, unemployment taxes, social security taxes, retirement and insurance benefits.

The third component of this payment method is the profit or fixed fee. This fee is negotiable but becomes fixed once agreed upon. This fee is intended to compensate the Consultant for contingencies, interest on invested capital, readiness to serve, disallowed overhead items, and profit. The fixed fee varies with the scope, complexity and duration of the project.

The fee is essentially fixed for completion of the services described in the parent agreement for contracts which are within the original scope of service, budget and on schedule. However, the agreement should provide for a means to make appropriate adjustments in the event that there are changes in:

- the costs of the work above those established in the current agreement,
- the character of the work,
- the complexity of the work,
- the duration of the work, or
- the conditions under which the work is required to be performed.

Costs incurred by a firm for unauthorized work, work required to meet schedules due to a firm's inadequate assignment of personnel or planning, work deemed unacceptable, and work required to correct a firm's errors or omissions, may not be eligible for an adjustment in the fixed fee. In fact depending upon the circumstances, all costs incurred may not be reimbursable. This is a Project Manager's decision based upon the firm's presentation of such a request.

The fourth component is direct non-salary expenses. These costs include:

- Living and traveling expenses of employees, partners and principals when away from the home office on project-related business;

- Directly related communication expenses, such as long-distance telephone, FAX, telegraph, cable, express charges and postage, other than general correspondence;

- Services directly related to the project, such as special legal and accounting fees, subconsultants, boring contracts, laboratory costs, commercial printing, and other similar charges;

- Cost of materials and supplies directly assignable to the project; and

- Reproduction costs directly chargeable, such as blueprinting, photostating, and printing.

Method No. 2: Lump Sum

This method is used only when the extent, scope, complexity, character and duration of work can be clearly defined and just compensation can be determined.

The Consultant agrees to perform the work for a single total price. This price includes all labor, overhead, profit and direct non-salary costs. The project manager should ensure that the lump sum amount is arrived at through the development and evaluation of estimates of each of these cost elements for the work anticipated. Such agreements need to contain provisions for the adjustment of the lump sum amount in the event of a scope change, which should be rare.

The advantage of this method is the ease of administration; progress payments may be made through estimates of percentage of work completed without reviewing payrolls or expenditures and auditing procedures are simplified. The disadvantage of this method is that the contract payment is generally fixed. Because documentation is not as extensive on lump-sum contracts, when this amount is exceeded or work believed to be beyond the original scope is ordered, this method becomes very cumbersome and is usually an unpleasant experience for both parties to resolve.

Payment No. 3: Cost per Unit of Work

This method is used when the cost of the work per unit can be determined in advance with reasonable accuracy but the extent of work is indefinite.

The Consultant is paid on the basis of a preset price for each unit of work performed. The prices must be supported by cost analyses similar to those required for the lump-sum method. One of the most common areas in which this method is used is in soil investigations, where costs can be based on such items as linear feet of drilling, the installation of observation wells, cost per boring, cost per sample, and cost per type of soils test.

Another type of project for which this method may be applicable is materials testing, where the types of tests required, the test procedures, and the number of tests are very well defined by standard specifications.

The advantages and disadvantages of this method are similar to those for the lump-sum method. Administration of the contract is easier, but the potential problem of possible differences in unit costs because of changed conditions still exists.

Method No. 4: Specific Rates of Compensation

This method is considered only for relatively minor items of work of indeterminable extent and only where the Department retains control of the class of employee being used and the extent of such use.

The Consultant is paid at an agreed to and supported hourly or daily rate for each class of employee directly engaged in the work. Such rates are all- inclusive and cover the Consultant's direct costs, indirect costs and profit.

This method is most appropriate for services of short duration or intermittent duration with a well-defined scope of limited complexity. Possible uses would include expert witness testimony, other related legal work, construction inspection, construction site visits, materials inspection, value engineering or peer review by an independent firm, or supplementing in-house staff to meet unusual project needs.

NON-ALLOWABLE METHOD OF PAYMENT

The consultant industry uses a fifth method of paying for services that involves developing a fee based on a percentage of the cost to the owner for implementing the work product being prepared.

Any method of payment where the amount a firm is paid is based on a percentage of the cost to implement is not allowed. In the past, the most common use of this method was to pay a firm an agreed percentage of the low bid received to perform the work. This practice is not accepted by the Department and is absolutely forbidden on federally sponsored contracts.

The major disadvantage of this method is that it provides no incentive for the Consultant to prepare the most cost-effective project. Improvements in the design may increase the Consultant’s costs but reduce the potential fee.

Because of the many inherent problems with this method of payment, most public agencies no longer consider this a viable pay alternative.