

**INFORMATION ON THE LOCAL OVERHEAD
RATE OF DILLINGHAM CONSTRUCTION INC.
UNDER ITS CONTRACT WITH
USAID/PHILIPPINES**

Audit Report No. 5-492-95-002
January 13, 1995



FINANCIAL INFORMATION IN THIS REPORT MAY BE PRIVILEGED. THE RESTRICTIONS OF 18 USC 1905 SHOULD BE CONSIDERED BEFORE ANY INFORMATION IS RELEASED TO THE PUBLIC.





U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

February 22, 1995

MEMORANDUM

TO: See below

FROM: Richard C. Thabet, RIG/A/Singapore

A handwritten signature in black ink, appearing to read "Richard C. Thabet".

SUBJECT: Information on the Local Overhead Rate of Dillingham Construction Inc. under its Contract with USAID/Philippines

Please amend the report number of the subject memorandum information report from 5-492-95-002 to 5-492-95-003.

We made a mistake in the sequence during issuance.

We apologize for any inconvenience caused.

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U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

January 13, 1995

MEMORANDUM

TO: Kenneth G. Schofield, Mission Director, USAID/Philippines
FROM: Richard C. Thabet, RIG/A/Singapore *Richard C. Thabet*
SUBJECT: Information on the local overhead rate of Dillingham Construction Inc. under its contract with USAID/Philippines

Enclosed is a copy of the subject report. This report includes comments that your staff provided during the course of the review and at the exit conference in response to our discussion paper. In summary, our work showed that the appropriate overhead rate which should be used for any change orders under the subject contract is 23.52%.

As this is a Memorandum Information Report, no recommendation has been written and therefore, no official response from you is required.

If you have any problems or concerns with this report, please give me a call so that we can discuss them and reach an acceptable resolution.

I appreciate the cooperation and courtesies extended to my staff during the review.

Background

On May 12, 1994, USAID/Philippines signed a \$35 million fixed-price contract (with Bill of Quantities) with Dillingham Construction Inc. (Dillingham) for the construction of a new airport in General Santos City, Mindanao.

Over the course of the construction, situations arose whereby change orders were necessary to ensure proper completion of the airport. However, these items were not envisaged at the planning stages of the contract and Dillingham had to perform tasks which were initially not contracted for.

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To address with this problem, the contracting officer agreed to reimburse Dillingham for actual costs incurred for any additional approved item of change. The costs incurred for each change order would also include Dillingham's overheads, as these would be costs associated with implementing these changes. To determine the overhead rate, USAID/Philippines' contracting officer requested Dillingham to prepare a proposal on the overhead rate it intended to charge. On November 9, 1994, the mission requested RIG/A/Singapore to review Dillingham's overhead computation to determine if the proposed rate had been appropriately calculated. The review was performed in Dillingham's site office at General Santos City and discussions were later held with all parties involved.

Information Objective

The Office of the Regional Inspector General for Audit, Singapore (RIG/A/Singapore) reviewed the overhead rate computation of Dillingham Construction Inc. under contract no. 492-0456-C-00-4044 with USAID/Philippines to answer the following objective:

What is the appropriate local overhead rate which should be used for change orders effected under contract no. 492-0456-C-00-4044?

Appendix I describes the review's scope and methodology.

Information on Local Overheads of Dillingham Construction Inc.

What is the appropriate local overhead rate which should be used for change orders effected under contract no. 492-0456-C-00-4044?

The appropriate rate which should be used for change orders effected under contract no. 492-0456-C-00-4044 is 23.52% for each item of change.

Our computation is based on the following assumptions:

The local overhead costs are computed on Dillingham's **projected** total indirect costs over the **projected** total direct costs for this contract. These are the best figures available as the contract has only been in progress for about half a year.

Time sensitive costs such as security, rent, utilities etc. are considered variable indirect costs that would be impacted by the change orders. It is expected that there could be an extension of time to complete the original scope of works and additional time for future change orders.

We believe that contract revisions should incorporate this rate as a pre-determined fixed rate. Using this rate as a provisional rate would necessitate a financial audit at the end of the contract to finalize the amount. Assuming that total change orders would amount to a 5% increase in the value of the contract sum, and that half of this amount would be items already included in the Bill for Quantities, the overhead costs claimed would be \$167,000. In order to audit these overheads, the mission would have to spend about \$20,000 for audit fees and utilize a substantial amount of U.S. Government employee resources. It is therefore not cost-effective to set a provisional rate for this agreement.

The initial overhead rate proposal submitted by Dillingham showed a rate of 25.88%. During the review, we made the following adjustments to the overhead pool resulting in a 2.36% decrease to 23.52%:

Computation of the local overhead rate
for Dillingham's Construction Inc.
General Santos City Airport Contract

Total variable overheads based on Dilingham's projection (A) \$5,384,857

Less: Adjustments for items which are not
considered variable overheads:

<u>A/C No.</u>	<u>US dollars</u>	<u>Reason for disallowance</u>
01-650-01 Operation & maintenance manuals	\$60,000	fixed amount
80-802-03 Two way radio	79,200	fixed amount
80-803-02 Temporary living allowance	25,775	one-time expense item
80-803-03 Expense account	12,000	ineligible cost
80-803-05 Special travel per diem	10,000	one-time expense item
80-803-10 Living allowance	58,250	one-time expense item
80-803-13 Expatriate household shipments	8,750	one-time expense item
80-803-22 Household furniture	18,000	one-time expense item
80-803-25 Storage of personal effects	12,500	one-time expense item
80-804-09 Medical exams	4,800	one-time expense item

80-804-21	Safety awards	500	fixed amount
80-809-01	Temporary signs	1,400	fixed amount
80-813-19	Donations, Dues, Subscriptions	3,400	ineligible cost
80-816-01	Home Office charge	165,000	ineligible cost
90-941-01	Computer stations	30,000	fixed amount
Total adjustments (B)			<u>\$489,575</u>
Total adjusted variable overhead (A)-(B)			\$4,895,282
Total DCI projected direct costs (C)			\$20,805,291
DCI original overhead rate (A)/(C)			25.88%
Adjusted overhead rate (A)-(B)/(C)			23.52%
Reduction in overhead rate recommended			2.36%

The estimated cost savings for this 2.36% reduction is \$16,000. This amount is based on a 5% increase in contract sum of which 2.5% of these items are subject to the above overhead rates.

Management Comments and Our Evaluation

In our discussion after the review, the parties involved responded as follows:

The management of Dillingham indicated that 23.52% is a fair amount. They added that they were glad that this issue concerning the overhead rates could be resolved in a relative short period of time.

The contracting officer and project officer generally agreed with the methodology we employed and the result of our work. They stated that if we were to add another 12.7% to the local overhead rate (for profit and home office overheads), the total mark up would amount to 36.2%. Another internationally reputed construction firm's rate is 42%. Based upon this comparison, the contracting officer and the project officer said that 23.52% appears to be a reasonable amount.

While we did not attempt to solicit official management comments due to time constraints, we held thorough discussions with all parties involved.

**SCOPE AND
METHODOLOGY**

We reviewed Dillingham Construction Inc.'s (Dillingham) computation of the appropriate overhead rate to be used for its change orders under its contract with USAID/Philippines (Contract No. 492-0456-C-00-4044).

We conducted the review in General Santos City on November 29, 1994 at the contractor's work site. We held discussions with the official who was assigned the responsibility to compute and establish the overhead rates for the contractor.

We reviewed the documents which outlined Dillingham's projected cost for the construction activity and examined the nature of such costs, including their classification as direct and indirect costs. We then examined the indirect cost pool and disallowed costs which we deemed to be ineligible, one-time or fixed in nature. These items could not be considered variable overheads. Based on these adjusted amounts, we recomputed the overhead rate and discussed the adjustments with the responsible official of Dillingham.

We did not attempt to verify the overall reliability of the computer-generated data in the given reports as they were projected costs, not incurred costs already spent.

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