

Incurring Cost Submissions and Audits

Moderator - Mike Mardesich, FORVIS

Panelists -

DCAA – Angie Dawson, Quality Auditor

DCAA – David Kim – Program Manager

Incurring Cost Submissions

FAR 52.216-7 Allowable Cost and Payment (d) Final indirect cost rates

- Final annual indirect cost rates and the appropriate bases to be established in accordance with FAR 42.7, Indirect Rates
- Contractor to submit an adequate final indirect cost rate proposal within 6 months of fiscal year end

Incurred Cost Submissions

FAR 52.216-7 Allowable Cost and Payment

- An adequate indirect cost rate proposal shall include the data listed in the clause unless otherwise specified by the cognizant Federal agency official

FAR 42.705-1 and FAR 42.705-2

- Once a proposal has been determined to be adequate for audit in support of negotiating final indirect cost rates, the auditor will audit the proposal and prepare an advisory audit report to the CO

Incurred Cost Submissions

FAR 52.216-7 Allowable Cost and Payment

- Summary of Claimed Indirect Expense Rates
- General and Administrative (G&A) Expenses (Final Indirect Cost Pool)
- Overhead Expenses (Final Indirect Cost Pool)
- Occupancy Expenses (Intermediate Indirect Cost Pool)
- Claimed Allocation Bases
- Facilities Capital Cost of Money Factors Computation
- Reconciliation of Books of Account and Claimed Direct Costs
- Schedule of Direct Costs by Contract/Subcontract and Indirect Expense Applied At Claimed Rates

Incurring Cost Submissions

FAR 52.216-7 Allowable Cost and Payment

- Government Participation in Indirect Expense Pools
- Schedule of Cumulative Direct and Indirect Costs Claimed and Billed
- Subcontract Information
- Summary of Hours and Amounts on T&M/Labor Hour Contracts
- Reconciliation of Total Payroll to Total Labor Distribution
- Listing of Decisions/Agreements/Approvals and Description of Accounting/Organizational Changes
- Contract Closing Information for Contracts Completed in this Fiscal Year

Incurring Cost Submissions

FAR 52.216-7 Allowable Cost and Payment

- Comparative analysis of indirect expense pools detailed by account with prior fiscal year and budgetary data
- Executive compensation information
- List work sites and number of employees assigned to each site
- Description of accounting system
- Procedures for identifying and handling unallowables
- Certified financial statements or other financial data (e.g., trial balance, compilation, review, etc.)
- Management letter from outside CPAs concerning any internal control weaknesses

Incurring Cost Submissions

FAR 52.216-7 Allowable Cost and Payment

- Actions that have been and/or will be implemented to correct internal control weaknesses described in above
- List of internal audit reports issued in this fiscal year
- Annual internal audit plan of scheduled audits to be performed in this fiscal year
- Federal and state income tax returns
- Securities and Exchange Commission 10-K Annual Report
- Minutes from Board of Directors meetings
- Listing of delay and disruptions and termination claims submitted which contain costs relating to the subject FY
- Contract briefings

Risk Based Sampling

<u>Risk Category</u>	<u>Sampling ADV</u>	<u>Sampling Percentage</u>	<u>Notes</u>
Low	<\$5M	0.5%	
	\$5M - <\$50M	5%	
	\$50M - <\$100M	10%	
Medium	\$100M - \$250M	20%	Mandatory audit every 5 th year.
	>\$250M - \$500M	25%	Mandatory audit every 4 th year.
High	>\$500M - <\$1B	25%	Mandatory audit every other year.
	\$1B or more	N/A	Audit must be performed each year.

Qualitative Factors

- History of significant questioned costs.
- Contracting officer / DCAA concerns.
- Status of accounting system survey or audit.
- Presence of relevant business system deficiencies.
- Significant accounting practice changes.
- Significant organizational changes.

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

- Preliminary audit steps
 - Adequacy of ICP
 - Identification of costs excluded from total subject matter of audit
 - Closed contract and subcontracts
 - Termination costs
 - Subcontract cost audit not required per prime auditor
 - Classified work
 - Corporate allocations
 - Non-DoD and non-reimbursable

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Preliminary audit steps - Materiality considerations

- Government participation in allocation bases
- Calculate quantified materiality
 - If the total subject matter of audit is from \$1 to \$1,000,000,000 use the formula:
 - Materiality Threshold = $\$5,000 * ((\text{Total Audit Subject Matter} / \$100,000) ^ .75)$
 - If the total subject matter of audit is greater than \$1,000,000,000, the materiality threshold will be 0.50 percent of the total subject matter of audit.
- Identify significant cost elements less than quantified threshold

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Materiality considerations

Calculate adjusted materiality – direct costs

- Reduce based on auditor's judgment
- Usually 20 % unless objective case for further reduction

Calculate adjusted materiality – significant indirect cost elements

- Divide the quantified materiality amount by the Gov't participation rate to calculate the revised quantified materiality amount.
- Reduce the revised quantified materiality at least 20 percent based on auditor judgment to calculate the adjusted materiality amount.

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Materiality considerations

The accounts/cost amounts subject to further audit procedures to support the audit opinion.

- Significant accounts/cost amounts proposed in each indirect cost element exceeding the adjusted materiality amount
- Significant accounts/cost amounts based on risk factors, qualitative characteristics, variability, and/or stated concerns of the contracting officer

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Preliminary audit steps - Communicating the engagement/planning meetings

Entrance conference inquiries

- Actual, suspected, or alleged irregular conduct
- Use of specialists to prepare subject matter
- Investigations or legal proceedings
- Other audits or studies related to subject matter

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Preliminary audit steps - Contract briefs and permanent files

- Reliability of briefs
- Contract ready to close
 - Verify PoP
 - Verify LOE achievement
 - Verify costs and fee within contractual limits
- Permanent files
 - Identify changes to org structure
 - Follow-up on prior audit findings/recommendations
 - Other studies or audits
 - Results of real-time testing

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Preliminary audit steps - Analytical procedures

- Indirect Cost Comparison with Prior Years and Budgets
- Comparative Analysis – Sensitive Labor Accounts
- Changes in Charging Direct/Indirect Costs
- Executive compensation changes from prior FY
- Profit margin test on T&M/labor hour contracts
- Schedule I Billing Variances

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Preliminary audit steps - Internal controls

- Contractor walk-through of controls
- Other audits e.g., labor and material real-time testing, accounting system, CPSR
- Obtain understanding of
 - Subcontract award and management process
 - Inter-organizational transfer policies and procedures
 - Application of budgetary controls e.g., bonuses and incentives dependent on meeting a predetermined budget
 - Compensation package establishment process
 - Handling of classified contract costs
- Scanning controls
- Testing to payment for non-labor costs

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Preliminary audit steps - Other procedures that may be required

- Excessive pass-through
- Review of Board of Director minutes
- Tax Returns and Financial Statements
- Defined benefit pension plan considerations
- List of facilities identifying those
 - With no or few employees, or
 - Owned by a related company
- Determine significance and reporting of IR&D

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Reconciliations

- Contract Cost Analysis and Reconciliation to Books
- Pools/Bases Reconciliation to books
- Payroll/Labor Distribution Reconciliation.
- Voluntary deleted items
 - Reconcile voluntary deleted items to the books and records
 - Ensure all voluntary deleted account balances are identified and accounted for as unreimbursable, including directly associated unallowable costs

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Direct and indirect labor

- Contractor Labor Audit
- Comparative Analysis-Sensitive Labor Accounts.
- Payroll/Labor Distribution Testing
- Adjusting Entries and Exception Reports
- T&M or Labor Hour contracts
 - Trace claimed labor hours to books
 - Verify compliance of labor hours and rates with contract
 - Verify compliance of employee qualifications with contract
- Executive compensation - verify
 - Within caps
 - Otherwise reasonable

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Direct Material

- Adjusting Entries and Exception Reports
- Purchases Existence and Consumption
 - Required for the contract,
 - Purchased in reasonable quantity and at a reasonable price
 - Used on the contract, in compliance with contract terms and CAS if applicable (i.e., CAS 402 and 411), and
 - Accounted for properly
- Determine if testing to payment is necessary

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Subcontracts

- Adjusting Entries and Exception Reports.
- For selected subcontracts assess allowability (FAR 31.201-2)
 - Verify allocability
 - Verify the existence, accuracy and proper recording of the subcontract cost
 - Billings match subcontract
 - Subcontract costs were paid

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Subcontracts

- Adjusting Entries and Exception Reports
- For selected subcontracts assess allowability (FAR 31.201-2)
 - Determine reasonableness
 - Costs should not be questioned if reasonableness cannot be established.
 - If significant, a reservation on the engagement should be reported as well as the non-compliance with FAR 31.201-2(d)
- Ensure the lower-tier subcontractor billings submitted to the prime / upper-tier contractor comply with contract terms
- Assist Audits – Incorporate results of assist audit

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Indirect Expenses

- General Ledger, Trial Balance, Income and/or Credit Adjustments
- Adjusting Entries and Exception Reports
- Indirect Account Analysis
 - Perform transaction testing on accounts to obtain sufficient evidence for allowability, allocability, and reasonableness of these costs
- Indirect Allocation Bases
- Determine if the same accounting period is used for accumulating costs in an indirect costs pool as for establishing its allocation base CAS 406/FAR 31.203(g)

Audit Program Activity Code 10100 Post Year End Incurred Cost Audit

Other Direct Costs (ODCs)

- Adjusting Entries and Exception Reports
- Perform adequate testing of significant ODC transactions for allowability, allocability, and reasonableness

FCCOM

- Verify compliance with the provisions of CAS 414 and FAR 31.205-10

Inter-organizational transfers

- Adjusting Entries and Exception Reports
- Compliance with FAR 31.205-26(e)
 - Transfers at costs
 - Transfers at price

FAR 52.216-7 Allowable Cost and Payment

Incurred Cost Proposals

- Government and contractor to execute a written understanding setting forth the final indirect cost rates specifying
 - Agreed-upon final annual indirect cost rates
 - The allocation bases to which the rates apply
 - The periods for which the rates apply
 - Any specific indirect cost items treated as direct costs in the settlement and the affected contract and/or subcontract
 - Any contracts/subcontracts with advance agreements or special terms and the applicable rates