

GovCon 101 - The Incurred Cost Submission

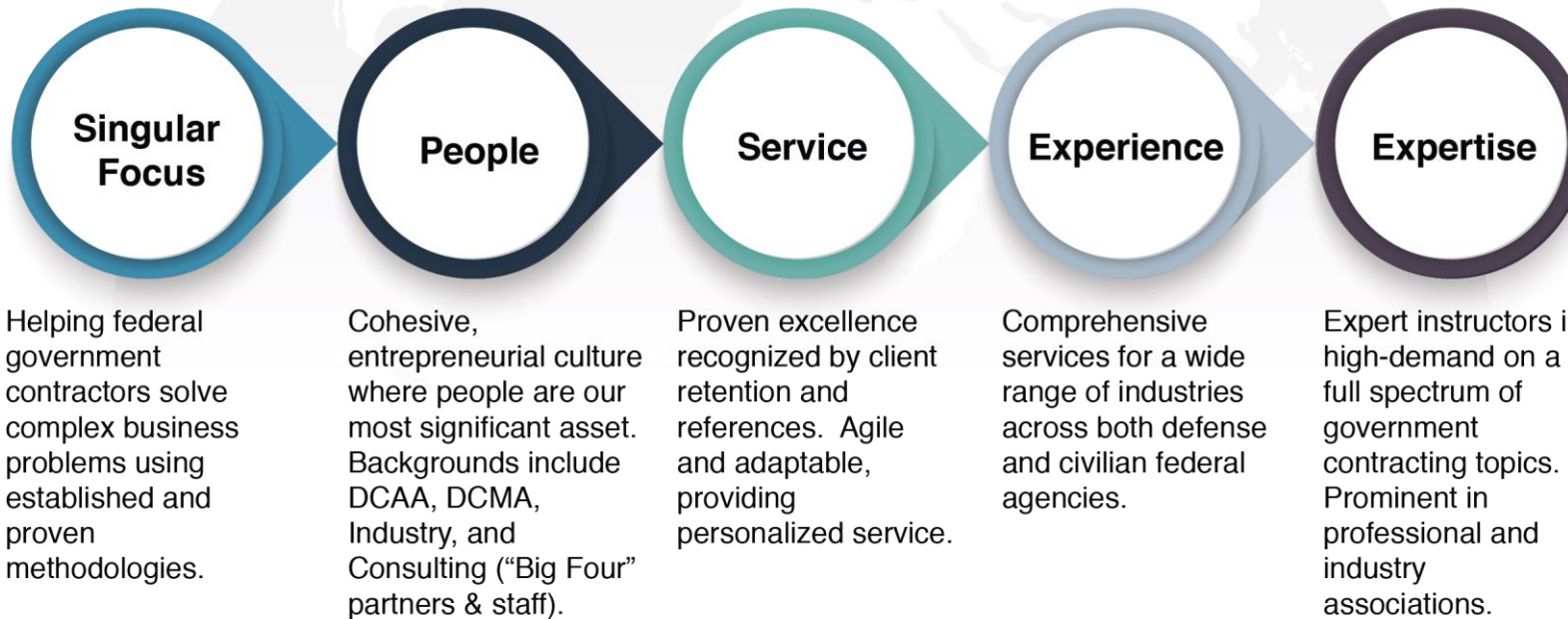


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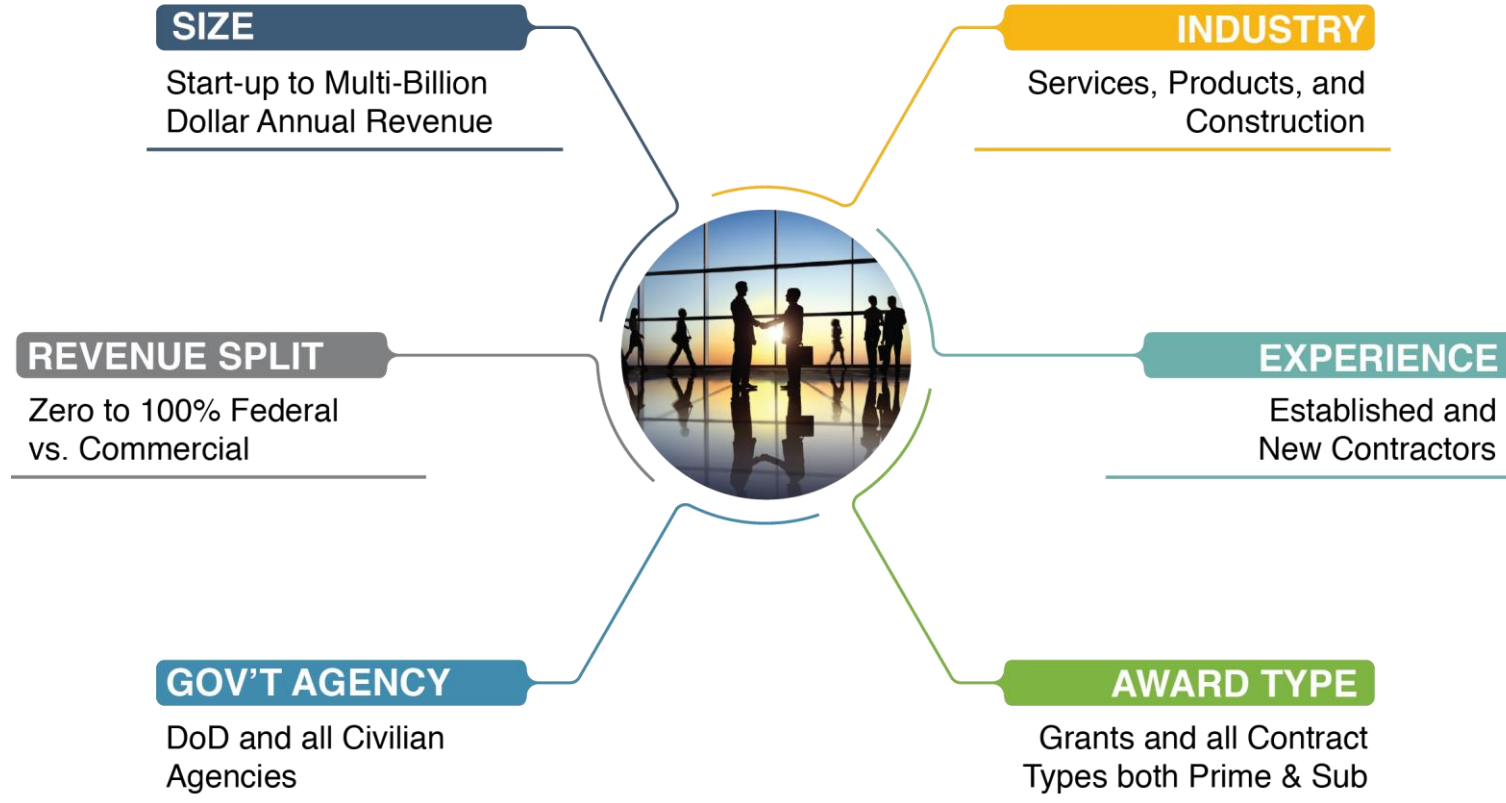


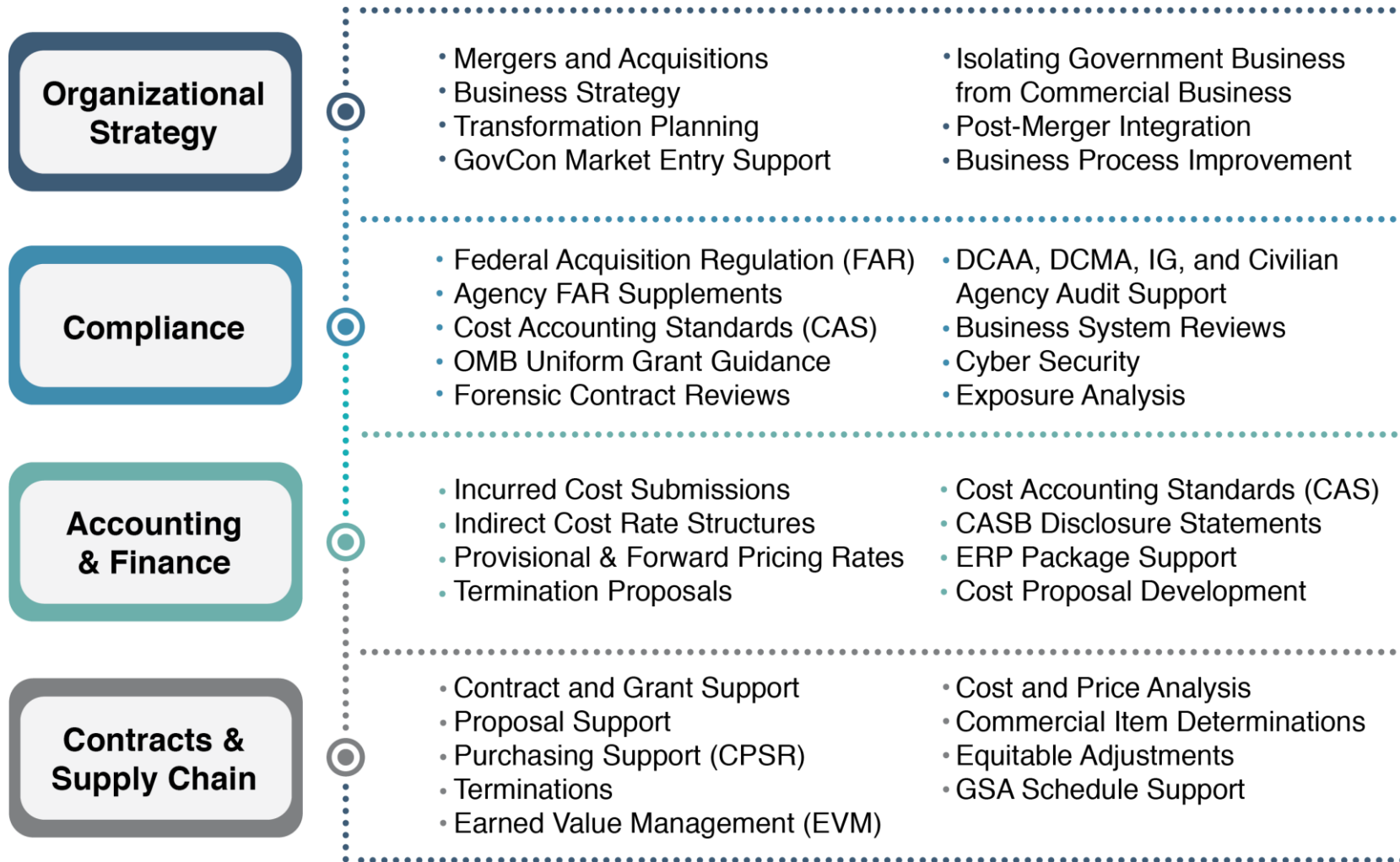
Capital Edge Consulting Overview

Capital Edge is the country's largest independent consulting firm focusing solely on the U.S. Government contracting market.



All entities receiving Federal funding







Marie Salamone, CCP, MBA, Partner

Marie has more than 30 years of government contract cost accounting and compliance consulting as well as cost engineering, construction claims analysis and litigation experience in an array of industries that include pharmaceutical, defense, manufacturing, service, energy, and waste management. Utilizing her expertise in the construction industry, Marie serves clients of all size by providing accounting, contracts, compliance, and claims support. She has developed numerous incurred cost proposals for a wide variety of clients, ranging from very simple to very complex rate structures with mix of contract types. Marie has also developed termination proposals, forward pricing proposals and policies and procedures for both large and small contractors across a number of industries.

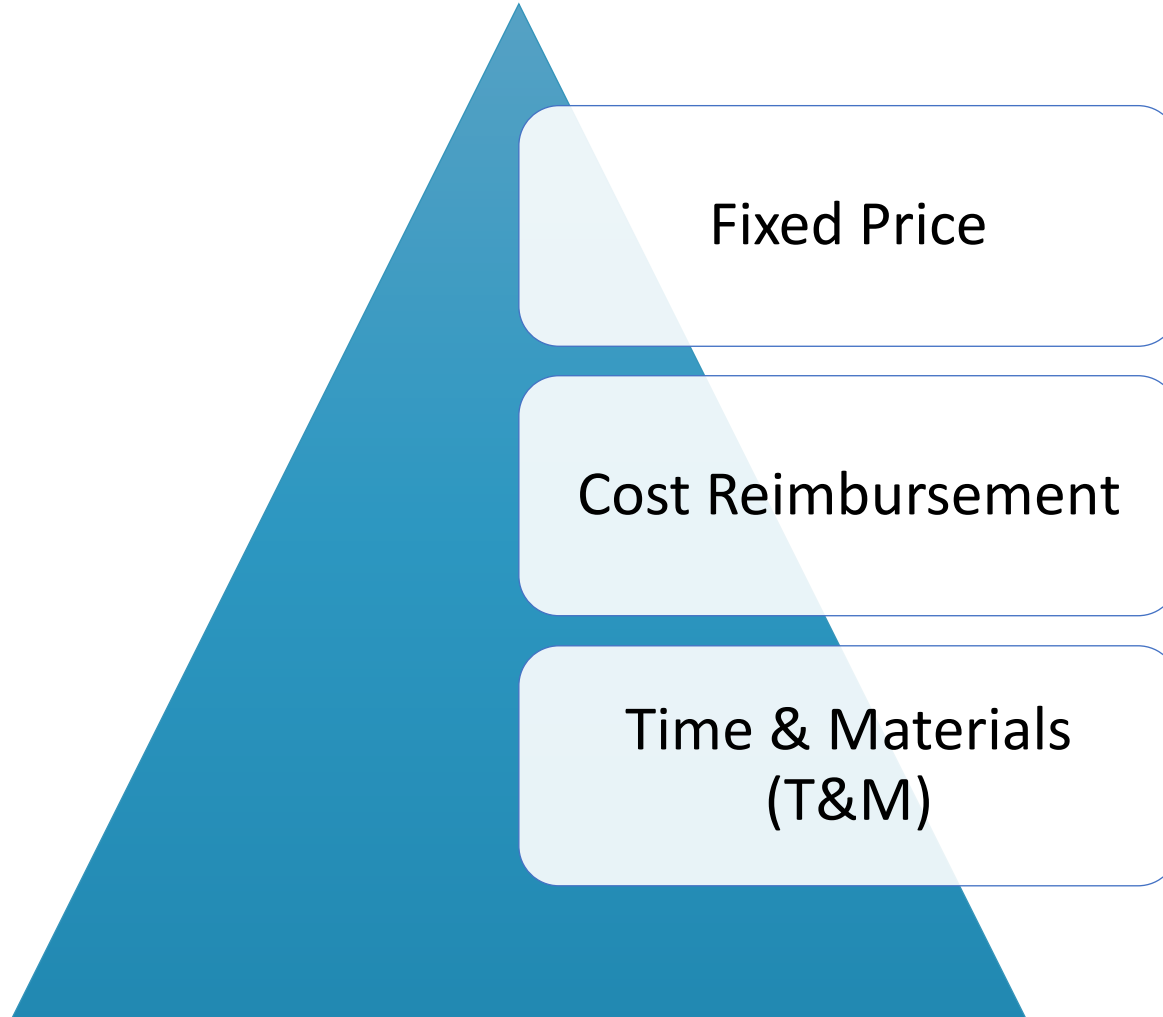


Sammie Warnecki, Senior Consultant

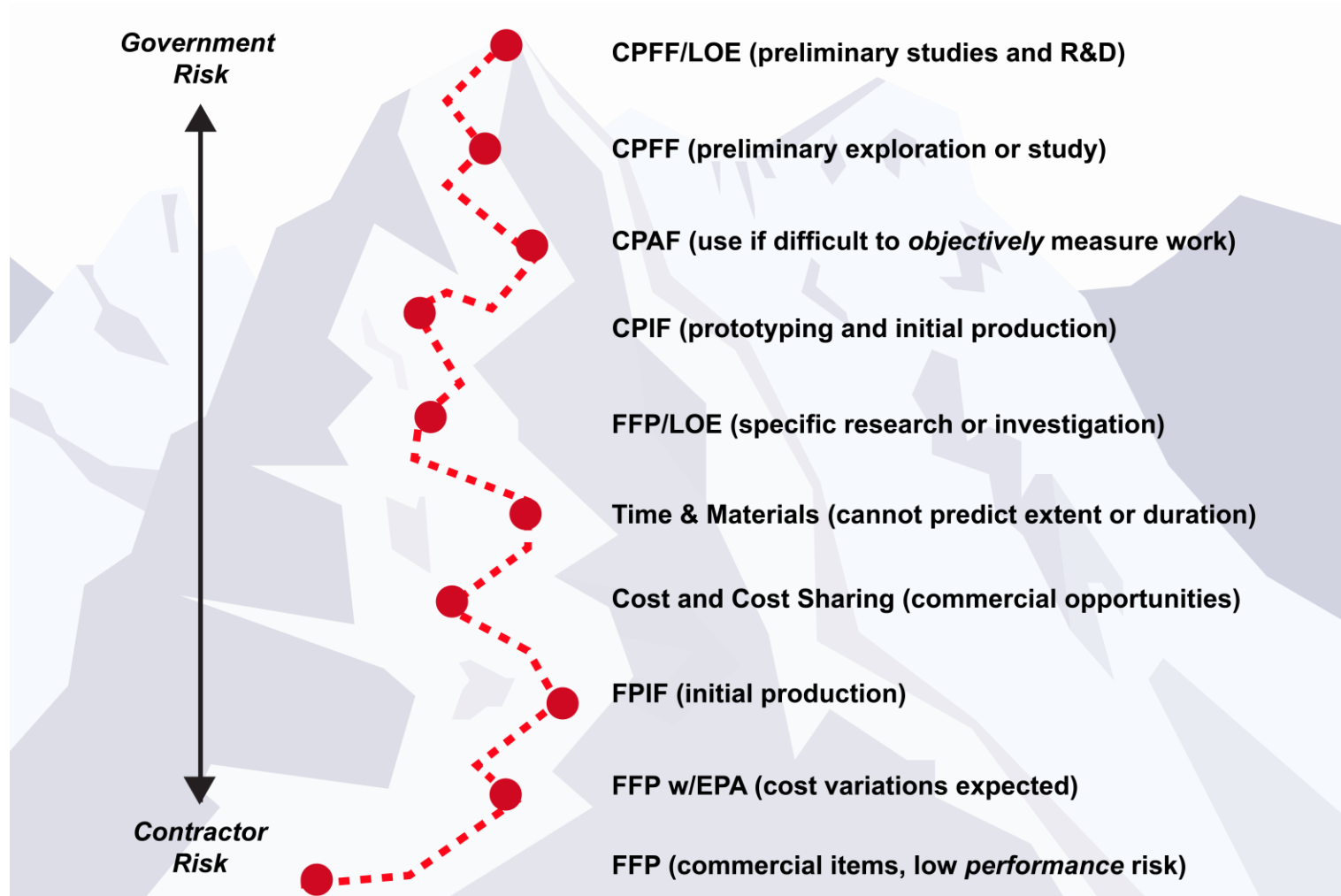
Sammie has significant experience in providing professional support to government contractors in the areas of government contract cost accounting, regulatory compliance, estimating, procurement, and training. Sammie is skilled in the areas of the Federal Acquisition Regulations (FAR), Defense Federal Acquisition Regulation Supplement (DFARS), Department of Energy Acquisition Regulation Supplement (DEARS), Cost Accounting Standards (CAS), Davis-Bacon Act, Service Contract Labor Standards (formerly SCA), and Contractor Purchasing System Reviews (CPSR). She has also supported clients with the preparation of Incurred Cost Submissions (ICS), Forward Pricing Rate Budget estimates, and Provisional Rate Models. Sammie has also developed training curricula pertaining to property management, cybersecurity, contract types, incurred cost submissions, billing, and provisional rates.

- ✧ Incurred Cost Proposal Overview
- ✧ What is the Purpose and Origin of the ICS?
- ✧ When is the ICS Required?
- ✧ Data Requirements
- ✧ Overview of Key Schedules
- ✧ Allowability of Cost
- ✧ Common Pitfalls
- ✧ Final Preparation Tips
- ✧ Submitting the ICS

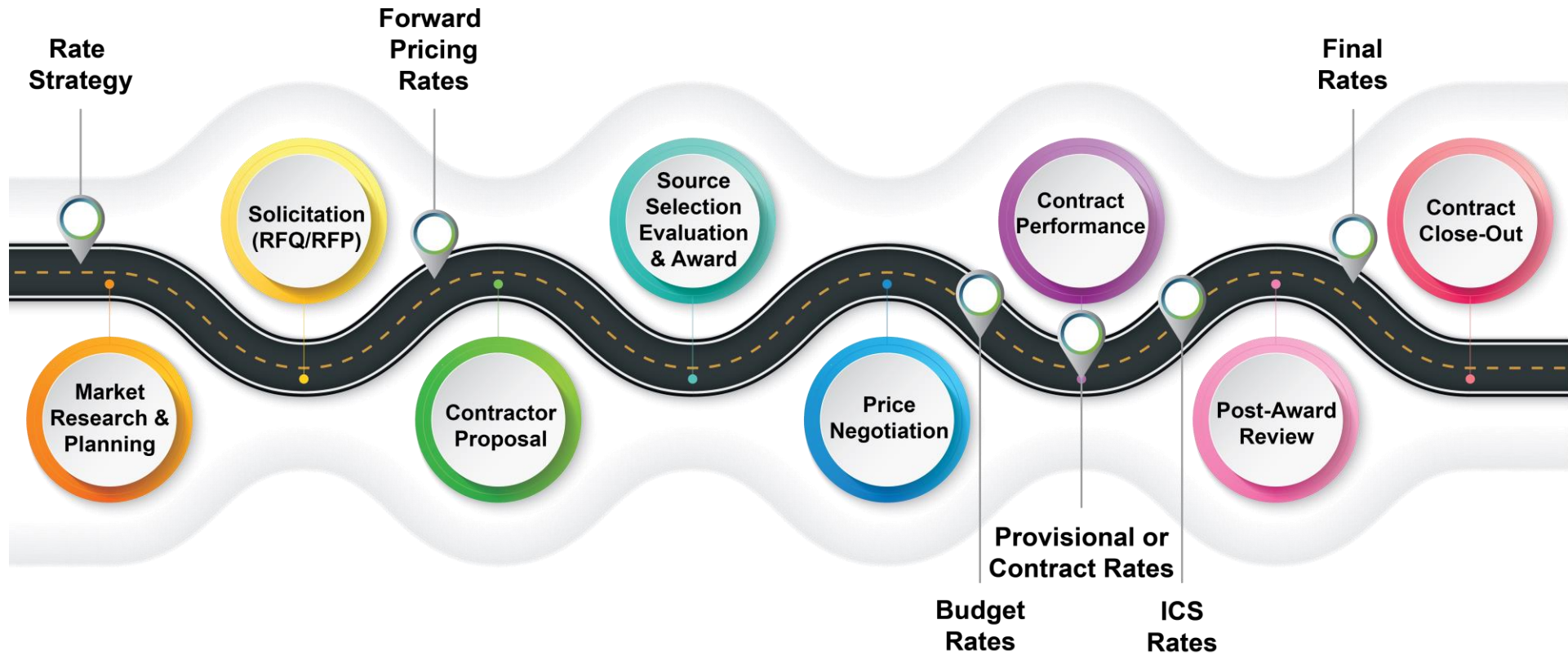
Incurred Cost Proposal Overview

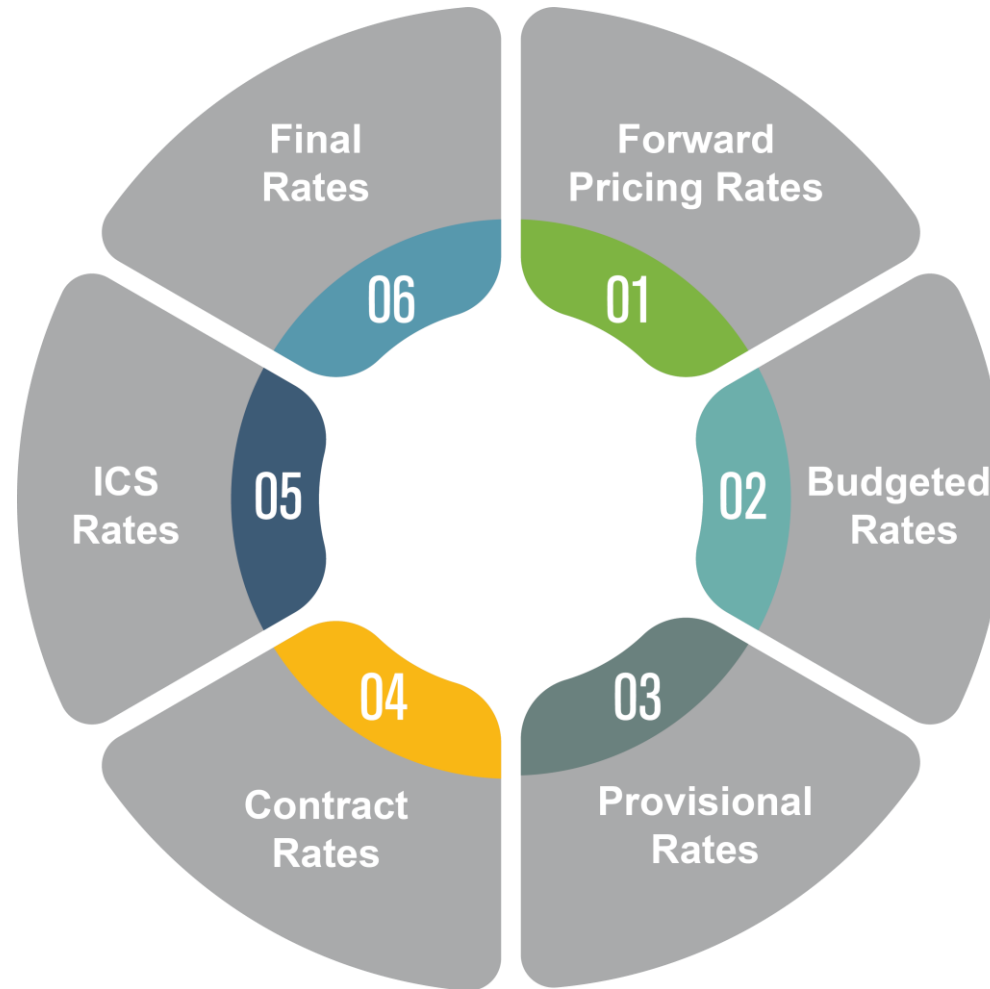


Contract / Subcontract Types



Acquisition Cycle - Indirect Rates





✧ **Forward Pricing Rates** - FAR 42.17 allows for the establishment of mutually agreed to Forward Pricing Rates between the Contracting Officer and Contractor

- Established long-term rates for use in contractor pricing efforts
- Based on the Contractor's long-range plans and budgets
- May be continuously negotiated/updated based on availability of most current, accurate, and complete data
- Adequacy Check List available at DCAA.mil

✧ **Budgeted Rates**

- Approved internally for management purposes and as a basis for pricing products and services
- DCAA expects rates are prepared annually

Provisional or Contract Rates (FAR 42.704)

- Approval by the contracting officer or CFAO
- Rates established based on information from recent review, previous rate audits or experience
- Auditor assurance that rates are as close as possible to final indirect cost rates anticipated
- Revision by mutual agreement (AT ANY TIME), to prevent substantial over/underpayment
- Typically based on a contractor's budget rates

ICS Rates (Final Indirect Cost Rate Proposal)

- Unaudited year end rates based on actual costs incurred
- Subject to audit by DCAA or Contracting Officer's designee
- Required within six months of Contractor's fiscal year end
 - FAR 52.216-7 (d)(2)(i) - Allowable Cost and Payment
 - FAR 52.232-7(b)(4) & (b)(5) - Payments under T&M and Labor-Hour Contracts
- FAR 42.704 allows for ICS rates to become provisional rates for the fiscal period until the Contractor's ICS can be audit and rates finalized

- ✧ **Final Rates** - FAR 42.705 requires final determination of rates by either the Contracting officer or his assigned representative (auditor)
 - Adjusted for questioned/unallowable costs identified by the auditor and Subject to Negotiation

What is the Purpose and Origin of the ICS?

To finalize claimed costs on flexibly priced contracts

- The ICS accomplishes this by compiling both the indirect cost pools and the applicable bases for each pool
- Using these, the submission calculates and justifies the contractor's indirect rates including overhead and G&A costs
- The rates calculated are final, and are used to “true-up” billings between the contractor's provisional rates and those in the ICS to ensure costs are billed correctly



FAR 52.216-7 (d)(2)(i) - Allowable Cost and Payment

- **“The Contractor shall submit an adequate final indirect cost rate proposal to the Contracting Officer (or cognizant Federal agency official) and auditor within the 6-month period following the expiration of each of its fiscal years.”**
 - Final proposed rates should be based on actual costs incurred during that fiscal year
 - 52.216-7 (d)(2)(iii) now includes a list of data items required for an adequate ICS
 - While DCAA’s ICE Model is not specified, the data items listed directly correlate to the schedules in DCAA’s ICE Model
 - DCAA’s ICE Model Supplemental Schedules are also listed



Uses a number of schedules to compile the information necessary to calculate indirect rates



While each schedule has its own purpose, most are interrelated



Several are summary schedules of inputs on other worksheets



Some schedules are optional and not required by 52.216-7, although the Contracting Officer may request them and DCAA is likely to request certain ones.

When is the ICS Required?

When is an Incurred Cost Proposal Required?

One must be submitted by every Contractor with a contract subject to:

- Allowable Cost and Payment Clause (52.216-7)
- Payments under T&M and Labor-Hour Contracts (52.232-7 (b)(4) & b(5))

If the Contractor does not submit their final indirect rates, the Contracting Officer may:

- Determine the amount due to the contractor under the contract
- Input the amount in the contract as a unilateral modification to it
- Consider this amount as the final determination of the Contracting Officer

Within six (6) months of the end of the CONTRACTOR'S fiscal year

- Ex: If fiscal year is same as the calendar year, then the ICS is due by June 30 of each year

Reasonable extensions may be obtained from the Contracting Officer or ACO

- For exceptional circumstances only
- Must be requested **IN WRITING** by the Contractor, and accepted **IN WRITING** by the Contracting Officer
- Support for extension request should be provided

Data Requirements



- ✧ Current Disclosure Statement, if applicable
- ✧ Fiscal Year Ending Trial Balance
 - Contains all the costs incurred by the company by individual chart of accounts
 - Good to use as a check against other accounting system reports
 - System reports can often be misleading due to improper setup
 - Auditors will expect reconciliation to the trial balance and the financial statements

Statement/Report of Indirect Expense Pools

- Critical piece of data in completing the ICS efficiently and accurately
- The main document used to complete Schedules B, C, and D
- Contains indirect costs broken down by each respective intermediate and final pool
- Ideally, costs should appear in these reports just as they would appear in the ICS schedules
- The ability to produce this report will depend on your system or your Excel knowledge (isn't that your official system anyway 😊)
- This data must tie to the trial balance

Project Revenue/Program Summaries

- Basis for contract costs entered into Schedule H
- The total of direct costs by project should match the total direct contract costs claimed in Schedule H of the incurred cost submission
- Ability to extract direct costs by contract, including labor, material, and ODCs
- Identify, by contract type, all contracts with revenue in the appropriate fiscal year
- Will provide visibility into contracts that must be identified on Schedule H and I
- Remember not to use revenue as total billed, because if it includes profit then it is not cost to cost
- Ensure all project reports include all project tasks

Project Labor Summaries

- Lists total labor hours incurred on a contract, separated out by labor category
- Need a labor summary for each T&M contract, because all T&M contracts must list hours incurred by labor category on Schedule K

Billing Register

- Lists all invoices, by contract, sent out during the fiscal year and the amount of each invoice
- Use the Billing Register to find the final invoice for each contract in that fiscal year
- Make sure to segregate costs from profit when calculating your cumulative billed – The ICS does not include profit/fee

Invoices

- The final fiscal year invoice is necessary in determining the amount of any cumulative over or (under) billings
- For each contract, find the final fiscal year invoice according to the billing register
 - The invoice amount should match the amount in the billing register, less any fee
- The most important information on the invoice is:
 - The invoice number,
 - the time period of the invoice, and
 - the cumulative billed amount (inception to date) from the invoice
- In addition, the invoice should also contain labor rates for T&M contracts, which are needed to complete Schedule K

Contract Briefs

- All contract briefs should be included at the end of the ICS
- Subcontract information should also be provided by the contracts department

Prior Year ICS

- The prior year ICS is necessary to roll forward the prior years' billed amount to the current ICS and determine cumulative differences in billing vs. incurred costs
- Also can be used to complete optional Supplemental Form A-x's, which compare changes in the expense pools
- Remember, it's all cumulative

Overview of Key Schedules

Indirect Cost Pools and Bases

- Schedule B – G&A Expenses (Final Pool)
- Schedule C – Overhead Expenses (Final Pools)
- Schedule D – Other Indirect Expenses (Intermediate Pools)
- Schedule E – Claimed Allocation Bases

Contract Costs

- Schedule H – Direct Costs by Contract with Applied Indirect Costs
- Schedule I – Cumulative Direct and Indirect Costs Claimed and Billed
- Schedule J – Subcontract Information
- Schedule K – Summary of Hours and Amounts on T&M Contracts

- ✍ Schedule A – Summary of Claimed Indirect Expense Rates
- ✍ Schedule F – Facilities Capital Cost of Money Factors Computation
- ✍ Schedule G – Reconciliation of Books of Account and Claimed Direct Costs
- ✍ Schedule H-1 – Government Participation in Indirect Expense Pools
- ✍ Schedule L – Reconciliation of Total Payroll to Total Labor Distribution
- ✍ Schedule M – Listing of Decisions/Agreements/Approvals and – Description of Accounting/Organizational changes
- ✍ Schedule N – Certificate of Final Indirect Costs
- ✍ Schedule O – Contract Closing Information for Contracts Completed in this Fiscal Year
- ✍ Supplemental Schedule As – Year Over Year Comparative Analysis of Indirect Expense Pools Detailed by Account
- ✍ Supplemental Schedule B – Executive Compensation
- ✍ Supplemental Schedule C – Identification of Prime Contracts Where Contractor Performs as a Subcontractor
- ✍ Supplemental Schedule O – Contract Briefs

- Calculates total G&A cost pool
- G&A costs are those associated with the general management and administration of business unit as whole (CAS 410-30(a)(6))

Costs

- Salaries, benefits, & other costs for HR, accounting, and similar departments
- Home Office Expenses for executive labor and travel, business development
- Legal & Professional Fees
- State Taxes
- IR&D and B&P Expenses

Schedule Items

- G&A costs broken down by account name and number
- Any allocation amounts from Service Center, Home Office, fringe, etc.
- B&P costs broken out separately into labor, fringe, overhead, and ODC's
- Total expense pool amount
- All unallowable costs should be deducted out in the adjustments column in the schedule

- ✧ Calculates overhead expenses, those costs that are closely associated with contract performance
 - Support functions such as direct labor, subcontractors, etc.
- ✧ Schedule includes details of costs by account name and number
 - One schedule per O/H Pool and includes Fringe if Fringe is final cost pool
- ✧ Unallowable costs should also be segregated and removed if they exist at the overhead level
- ✧ Examples of Overhead Costs include:
 - Supplies and facilities supporting personnel working on contracts
 - Depreciation on factory equipment
 - Warehousing of materials
 - Allocations from intermediate service centers

- ✧ Intermediate pools, containing costs not specifically associated with any one pool
- ✧ Schedule includes detail of costs by account name and number
- ✧ Unallowable costs are segregated out and removed if they exist at the overhead level
- ✧ These pools are allocated to one of the final cost pools in Schedules B or C
- ✧ Types of intermediate pools include:
 - Home Office expenses
 - Facilities expense
 - Fringe benefits
 - Overhead and IT Service Centers

- ✧ Calculates the allocation bases for all final indirect pools
 - Costs in each base should be broken down by line item and entered as link to other inputs in the ICS, on Schedules H or otherwise
 - No information should be hard-coded in Schedule E
- ✧ Example allocations bases include:
 - G&A – total cost input or value added
 - Overhead – total direct labor and fringe, plus total B&P labor and B&P fringe
- ✧ Allocation bases for intermediate pools are included here too
 - i.e. square footage calculation for facilities allocation or the labor distribution for fringe benefits

- ✧ Schedule H is the most important schedule and the basis for most of the submission
- ✧ Calculates actual incurred costs by contract, broken out by contract type
 - First, uses project status reports to compile direct costs for each contract
 - Next, uses the indirect rates calculated in Schedule A to determine the total indirect expenses for each contract

- ✧ Determines the costs claimed versus those billed for all cost reimbursement and T&M contracts
- ✧ All cost reimbursement and T&M contracts are broken out by contract at the billing level
- ✧ Cumulative claimed costs are pulled from Schedule H (cost reimbursement) and Schedule K (time and materials) and added to prior year claimed costs
- ✧ Billed costs are determined from the final invoice of the Contractor's fiscal year
- ✧ Goal is to calculate the total over or (under) billing on these contracts

Schedule J – Subcontractor Information

- All subcontracts under any T&M or cost reimbursement prime contract must be listed in Schedule J (according to DCAA Information for Contractors)
- Reality is that DCAA wants ALL subcontracts here and that the total listed will tie to Sch. H Direct Subcontracts
- Information that must be included:
 - Subcontract number
 - Prime contract number & total contract value
 - Subcontractor name, address, and DUNS
 - Subcontractor point of contact and phone number
 - Total value of subcontract
 - Period of Performance
 - Costs incurred in that fiscal year
 - Award type

- ✧ Breaks out all T&M contracts to calculate labor hours and costs incurred
- ✧ Hours incurred by labor category are summarized
- ✧ Ensure that T&M rates are current and be aware of potential mid-year rate changes (due to escalation or an exercised option year)
- ✧ Material and travel costs then added, and loaded with the claimed G&A rate, if applicable
- ✧ For each contract the total costs and task ceilings should be calculated

- ✧ Supplemental Schedule B provides the company information related to risk and executive earnings.
- ✧ The following types of compensation are subject to the threshold:
 - Salary
 - Bonus
 - Deferred Compensation
 - Pensions, retirement plans and employee stock options
 - Employer contribution to defined contribution pension plans



DEFENSE CONTRACT AUDIT AGENCY
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FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PSP 730.5.04

November 15, 2021
21-PSP-008(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
CORPORATE AUDIT DIRECTORS, DCAA
ASSISTANT DIRECTORS, HQ, DCAA

SUBJECT: Audit Alert on Contractor Compensation Cap – Statutory Fiscal Year (FY) 2022

What You Need to Know

As prescribed in Section 702 of the Bipartisan Budget Act of 2013 (BBA; Pub. L. 113-67, December 26, 2013), the Office of Federal Procurement Policy (OFPP) published the compensation cap amount for FY 2022. CAM 6-414.7 was updated to include the BBA compensation cap amount for FY 2022.

What Auditors Need to Do

Auditors should use the following cap amount in evaluating all contractor employee compensation costs proposed during FY 2022 applicable to contracts awarded on or after June 24, 2014:

BBA Contractor Compensation Cap for Contracts Awarded after June 24, 2014 (FAR 31.205-6(p)(4))	
For Costs Incurred	Cap Amount
1/1/2022 – 12/31/2022	\$589,000

Questions and Further Information

FAO personnel with questions regarding this audit alert should contact their regional or CAD offices. Regional/CAD personnel with questions regarding this audit alert should contact Policy Pricing and Special Projects (PSP) Division via e-mail at DCAA-PSP@deaa.mil.

/Signed/
Martha E. McKune
Assistant Director, Policy and Quality

DISTRIBUTION: E

BBA Contractor Compensation Cap for Contracts Awarded after June 24, 2014 (FAR 31.205-6(p)(4))	
For Costs Incurred	Cap Amount
1/1/2022 – 12/31/2022	\$589,000

BBA Contractor Compensation Caps for Contracts Awarded after June 24, 2014 (FAR 31.205-6(p)(4))	
For Costs Incurred	Cap Amount
1/1/2021 – 12/31/2021	\$568,000
1/1/2020 – 12/31/2020	\$555,000
1/1/2019 – 12/31/2019	\$540,000

DCAA's review of compensation reasonableness has become more aggressive during audits:

- DCAA is taking exception to executive compensation well below the benchmark cap for the year audited
- Paradoxical DCAA - what was previously acceptable, is now completely unacceptable
- DCAA is often using national blended salaries and failing to adjust for location based cost of living areas
- It is imperative for contractors to maintain a basis for their compensation and to share all available information with the auditor when they request “your executive compensation”

Allowability of Cost

Allowable Cost and Payment

- Contractor shall bill costs in compliance with FAR 52.216-7
 - (a) invoicing
 - (b) reimbursable costs, and
 - (d) final indirect cost rates
- Contractor shall be current on its submission of incurred cost proposals

Key Philosophies Embedded in Cost Principles

- Government does not want to share in costs that it does not cause nor derive a benefit (“causal and beneficial”)
- Equitable allocation or identification of costs to government contracts
- Non-government programs should absorb their share of costs
- “Encourage” businesses to exercise prudence in incurring expenses, and make good business decisions
- Selected costs in FAR 31.205-XX identified as unallowable are theoretically not created by doing business with government, nor required to sustain contract performance
- Congressional involvement (e.g. statutory “cap” on compensation)

Criteria for determining allowability — must comply with all of the following:

- Reasonableness
- Allocability
- Cost Accounting Standards (CAS), if applicable
- GAAP if CAS does not apply
- Contract terms and conditions (beware of the “Christian Doctrine”)
- FAR 31.205 selected cost restrictions (“allowable”)
- Company policies to the extent more restrictive than FAR Part 31

- ✧ Simply incurring a cost does not justify allowability
- ✧ The Contractor has responsibility to properly support proposed or billed costs to demonstrate:
 - Costs were incurred
 - Are allocable
 - Comply with cost principles (i.e. allowable)
- ✧ The contracting officer may disallow all or part of a claimed cost that is inadequately supported--failure to have adequate documentation to substantiate allowability may result in disallowance of costs
- ✧ **DCAA Form 1 - Notice of Contract Costs Suspended and/or Disapproved**

- ✧ Does not exceed cost a prudent person would incur in conduct of competitive business
- ✧ Ordinary and necessary
- ✧ Sound business practices
- ✧ Arm's-length bargaining
- ✧ Business responsibilities to customer and employees
- ✧ Consistent with company's business policies & practices

Common Pitfalls

- ✧ When changing G&A allocation bases, you must consider the impact of rate changes on existing contracts
- ✧ When creating a customer site O/H, be aware of the impact to your contractor site work
- ✧ Creating new O/H pools for new contracts or new work sites can be very dangerous
 - The administrative and systemic burdens often outweigh the benefits
 - This process can also create numerous small pools and bases that may fluctuate significantly
- ✧ Be wary of your contract type mix when making changes
 - How will this effect the entire contract population?

- ✧ Recognizing contract types and those which require the preparation of an ICS
- ✧ Segregating direct and indirect costs, particularly direct vs. indirect labor
- ✧ Reconciling accounting system reports to the trial balance
- ✧ Identifying and removing unallowable costs

Final Preparation Tips

Document, Document, Document!

- Be sure to document as much as possible in a way that someone unfamiliar with your organization will understand since you may be long gone by the time an auditor shows up.
- While preparing the current ICS or in the course of performing your regular duties, you may receive information which impacts future incurred cost submissions
 - We recommend keeping a list of these items so that the preparer of the next incurred cost submission has a head start.

Understand ICS Audit Expectations

- An auditor is likely to expect a turnaround time of three days or less for documentation and answers to questions.
 - Set a clear understanding with DCAA when you will be able to provide data and set yourself up for success by under-promising and over-delivering.
 - Be sure to take a look at the supporting data that DCAA typically reviews and be sure it can be available upon audit initiation.

- **Prepare all the Supplemental Schedules**

- Although supplemental schedules are not required to be included with the ICS for adequacy determination purposes, they will likely be some of the first items requested at the beginning of an audit.
- Some of the supplemental schedules have other valuable uses to the company and to the ICS preparation process.
 - For example, the set of Supplement Schedule A's can be used to evaluate the year after year change in costs by account.
 - Large fluctuations in costs identified in these schedules can indicate a preparation error in the ICS or simply changes in company spending.
 - These schedules can be used by management to see what is driving the change in rates for a deeper understanding of their business.

Keep a “Working Copy” and a “Final Submission” version of the ICS

- The “Working Copy” includes all links to supporting schedules and workpapers so that each value on every schedule is easily traceable.
 - The details in the working copy will significantly reduce the time spent answering questions during an audit and will also help those new to preparing an ICS understand the source of the amounts claimed and how the rates are calculated.
- The “Final Submission” version contains only the schedules required for submission and contains no supporting schedules or links to supporting schedules or source data.
 - This is the file which is submitted to the government.
- These two files should be marked as FINAL and WORKING COPY in the file name and stored in a properly labeled folder.

Submitting the ICS

- ✧ Recommend using DCAA's ICS Adequacy Checklist prior to submitting ICS
 - Controversy with Adequacy Checklist and CUI
 - No proprietary information and available to the general public
- ✧ Section B of the Checklist – Proposal Adequacy reviews the following items:
 - Verify that Contractor is prime on at least 1 Flexibly Priced Government Contract
 - Determine if Contracts are DOD, Non-DOD or both
 - Verify Math Calculations
 - Reviews Schedules A, B, Cs, Ds, E, F, G, H, I, J, K L, M, N, & O
- ✧ DCAA ICS Adequacy Checklist is available as a hand-out
- ✧ Recommend submitting both electronically and physically
 - Setup email for read receipts
 - Delivery with signature required (Fed-Ex, UPS, etc.)

Review of Important Components of an ICS

- ✧ Direct costs of the company or organization, with government flexibly-priced and T&M contracts broken out separately by contract (Schedule H)
- ✧ Calculation of Indirect cost rates using defined pools and bases
- ✧ Allocation of indirect costs to flexibly-priced and T&M contracts through the application of calculated indirect rates
- ✧ Reconciliation of billed costs to incurred costs on flexibly-priced and T&M contracts to determine any over or under billing (Schedule I)

- ✧ The rates calculated in the ICS are used to “true-up” billings between contractor’s provisional rates and those calculated by the ICS.**
- A. True
 - B. False

-  **How many months after the Contractor's fiscal year is the ICS due?**
- A. 3 months
 - B. 6 months
 - C. 9 months

 **Reasonable extensions may be obtained from who?**

- A. Contracting Officer
- B. ACO
- C. Both the Contracting Officer OR ACO





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May 9-10, 2023; 12:00 PM -2:00 PM ET

✍ This course is intended to provide an overview of Incurred Cost Proposals, including the purpose, recommended format, requirements, rate structure considerations, allowability and allocability of cost, and current DCAA audit considerations. All sessions include the ability to ask questions regarding specific concerns or challenges participants are experiencing.

✍ **Outline & Topics:**

• **Introduction**

- Incurred Cost Proposal Overview
- What is the Purpose and Origin?
- When is it Required?
- Understanding the Requirements of Different Contract Types
- Data Requirements
- Allowability of Cost

• **Indirect Rate Structure and ICS Overview**

- Direct vs. Indirect Costs
- Indirect Cost Pools & Allocation Bases
- Causal / Beneficial Relationships
- Intermediate Cost Pools & Service Centers
- Allocability of Cost

• **ICS Review**

- Overview of Required and Optional Schedules
- Examples of Required Schedules
- DCAA Adequacy Checklist
- DCAA Hot Topics