

Incurred Cost Submission Requirement

Government contractors that are awarded cost-reimbursable and time-and-materials contracts will need to submit to their cognizant federal agency official (government representative) and auditor an adequate final indirect cost rate proposal. This proposal is typically called an Incurred Cost Submission (“ICS”), and its purpose is to calculate actual indirect cost rates, enabling review and approval of the rates by the government. Once the indirect cost rates are approved, the contractor is required to update its contract billings with the newly approved rates to the government within 60 days. In cases where contracts are physically complete, the contractor is required to submit a completion invoice to reflect the settled amounts and rates within 120 days.

Under the Allowable and Payment Clause of the Federal Acquisition Regulation (“FAR”), contractors must submit an adequate final ICS, with supporting data, within six months after the end of the contractor’s fiscal year. Extensions to this time period may be requested in writing by the contractor; however, the reason for the extension must be reasonable and result from exceptional circumstances. If a contractor fails to submit its ICS within the six-month period, the government representative may unilaterally determine the indirect cost rates. In determining unilateral rates, the government typically sets the rates at a lower percentage to protect against the inclusion of unallowable cost.

Allowable vs. Unallowable Costs

The FAR includes cost principles that provide both general and specific criteria for determining whether costs are allowable or unallowable. Contractors must understand and properly apply these criteria when accumulating costs and preparing their ICS, as errors in determining cost allowability may result in monetary penalties assessed by the government. This is especially relevant in the current environment, as the government faces immense budget pressures and is interpreting the FAR cost principles more stringently than it has in the past.

When the criteria provided in the FAR lists specific items and types of cost as unallowable, the costs are said to be expressly unallowable. Some of the FAR’s other criteria and principles do not list specific costs or types of costs, and they require

some judgement to determine allowability. For example, cost “reasonableness” is a requirement for allowability. The importance of determining whether a cost is expressly unallowable centers around the penalties that the government will assess when these costs are claimed in an ICS. The penalty for claiming an expressly unallowable cost is equal to the amount of the unallowable cost plus interest on the paid portion, if any, of the disallowance. If the cost was determined unallowable for that contractor before submission, the penalty is twice the amount of the unallowable cost.

In early 2015, the Defense Contract Audit Agency (“DCAA”) clarified in a Memorandum for Regional Directors (MRD 14-PAC-021 (R)) a list of cost principles that it believes meets the definition of expressly unallowable costs. Contractors should consider this MRD, the principles and criteria under FAR Part 31, applicable contract requirements, and other relevant authoritative guidance. While using this MRD, contractors should keep in mind that it is not a comprehensive list of expressly unallowable costs, and it does not represent the legal position of the government.

Differences of opinions between contractors and the government with regard to cost allowability continue to lead to allegations of criminal and civil false claims. It is critical for a contractor to properly interpret and apply the cost principles based on its specific business requirements.

ICS Completion and Supporting Efforts

Chess Consulting provides its clients with a range of services to support completion of their ICSs. Depending on their needs, our services range from providing guidance on specific technical areas and schedules to completing the entire submission. In addition to assisting clients with ICS completion, we also assist clients with reviewing and revising their estimating and accounting systems that support adequate ICS completion. We typically provide the following services when supporting ICS requirements:

- Review indirect cost rate methodology and provide recommendations for improvement; this involves comparing the indirect cost rate method used in estimating practice to the method used in the ICS to ensure consistency;

- Review contract and other relevant regulatory restrictions to identify:
 - Types of cost deemed unallowable, and
 - Funding and other limitations;
- Review cost detail to identify and remove unallowable costs;
- Confirm supporting documentation is readily available and adequately substantiates the claim for reimbursement of direct costs by contract;
- Prepare the documentation necessary to substantiate the claim for indirect costs by pool;
- Prepare the requisite ICS schedules and review the ICS, in part using the DCAA's ICS Adequacy Checklist;
- Facilitate discussions between the DCAA auditors and the client during the audit of the ICS;
- Review accounting practices for more efficient means to capture and report on costs supporting the ICS;
- Assess and compare provisional billing rates to actual indirect cost rates throughout the year;
- Review or implement the process to adjust billings based on the revisions to final indirect cost rates; and
- Review or implement the process to facilitate contracts closeouts.

The Chess Consulting Advantage

Our professionals work closely with each of our clients to establish an understanding of its indirect cost structure. Each client has a different cost structure and we use our experience to help ensure that the ICS is prepared consistent with the company's structure. We also ensure the submission is deemed adequate by the government, using our extensive knowledge of the DCAA's ICS Adequacy Checklist and ICE model, an electronic spreadsheet developed by the DCAA for contractors to use when submitting the ICS. Some examples of our client engagements include:

- *A mid-size privately owned government contractor.* To remain competitive in the government space, a mid-size privately owned government contractor needed to reduce administrative expenses, thereby reducing its general and administrative indirect cost rates. It was considering cost reduction options in the internal audit and compliance functions but wanted to ensure continued compliance with government contract requirements. We provided management of the internal audit and government contract compliance functions and, as part of this effort, also completed the company's ICS. In performing the internal audit and compliance function, our professionals were able to add more value, at a reduced cost, to the

client as compared to previous years under its own internal audit and compliance group.

- *A not-for-profit government contractor.* We were asked to revise seven years of past ICSs for a not-for-profit government contractor that identified potential fraud perpetrated by a company official. Our work initially focused on review of the general ledger and source documentation to verify costs were supported and properly recorded. We then worked with the accounting department to have necessary adjustments recorded in the general ledger, and used the revised general ledger data to complete the ICSs. The DCAA has since reviewed several of the ICSs submitted, and it issued approval letters for both with minimal adjustment.

Chess Consulting Differentiators

Deep industry knowledge and technical expertise which helps each client deal effectively with the complexities of the processes and issues facing its business.

Profitability focus concentrating on actions and solutions that create a competitive business advantage while fully complying with regulatory requirements.

Practical and creative solutions that effectively address difficult compliance and business issues.

Supportable positions that have been proven to withstand scrutiny from regulatory agencies such as the SEC, DCAA, DOJ, and GAO.