



5 Ways to Prep for the Audit While Preparing the Incurred Cost Proposal By Jennifer Rettelle, Director of Operations

The requirement to submit a final indirect cost rate proposal, more commonly referred to as the Incurred Cost Proposal or Incurred Cost Submission (ICS) is contained in FAR clause 52.216-7(d)(2)(i) – Allowable Cost and Payment which states: “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.”

Are you ready for your incurred cost audit? One of the major historical audit challenges is the delay, sometimes many years, between timely submission under FAR 52.216-7 and the actual audit. DCAA is now required to audit adequate final indirect cost rate proposals within one year, but only time will tell if they can meet that lofty goal. To help eliminate the future audit risk, Capital Edge has identified five ways to start preparing for the audit, while preparing the current annual incurred cost submission.

Document, Document, Document!

This point cannot be stressed enough. The backlog in incurred cost audits only further solidifies the likelihood that the people preparing the incurred cost submission may not be available to support an audit or the data needed to support the audit is difficult to find. The likelihood of an ICS audit occurring years after submission has historically been high. 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.

For example:

- Do you have new intermediate cost pools this year (i.e. new fringe, IT, facilities, etc.)?
- Did the basis for the allocation of any of your cost pools change?
- Are you aware of potential changes to home office allocations which could impact the current fiscal year or future years?
- Is your company still able to track all data metrics needed for allocation (i.e. number of user licenses, headcount, square footage, etc.)?

We recommend keeping a list of these items so that the preparer of the next incurred cost submission has a head start. Maintaining such a record can also expedite the timeline for incorporating these changes into current or future submissions and provide some, if not all, of the information needed to document the change(s) in preparation for an audit. In addition, these changes may likely be considered a change in cost accounting practice, which has other compliance implications for CAS covered contracts that we won't delve into here.

- Did the purpose of a specific account change from the prior year? Are the costs previously accumulated in one account now captured in multiple accounts? Did the purpose of a particular cost center or department change? Be sure to keep clear notes on these changes year after year, as they may prove invaluable during an audit.
- Save yourself the headache of scrambling to answer an auditor's questions and be sure to keep all files used in the preparation of the ICS in a storage repository that is shared with multiple people and is routinely backed up. Keep the file structure simple and organized so that someone who is less familiar with the process can find documentation needed to support an audit.
- Keep the original source data, including the trial balance, project ledgers, 941s, Statement of Indirect Expenses, contract list, invoices, and all other information used to populate and calculate the final rates in the ICS. Having a single and organized place to find this data will save time, effort, and sanity when the auditor is asking questions.
- Were any assumptions, adjustments, or other information used to prepare the ICS? Be sure to document all of these including any applicable rationale that was used. This information can go a long way to support costs that are questioned by an auditor.

Spread the Knowledge Wealth

We recommend that contractors are careful to spread the wealth of knowledge of the inner workings of their incurred cost submission and preparation methodology with others in the finance or accounting department. Such steps will reduce the risk of substantial knowledge loss in the event employees with major roles in the ICS preparation process move on to other positions before the audit occurs.

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. The process to complete these schedules is more efficient when completed as part of the original ICS preparation and can help identify items which may be questioned by an auditor. In addition, 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 and they can also be used to identify areas where DCAA may focus their audits, especially if certain high risk accounts such as travel, executive compensation, legal, consulting, etc. have increased significantly year after year.

Keep a "Working Copy" and a "Final Submission" version of the ICS

We recommend maintaining two copies of the ICS when it is completed:

- 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.

Understand Audit Expectations

Understanding the expectations of your auditor will help facilitate a working relationship during the course of the audit. An auditor is likely to expect a turnaround time of three days or less for documentation and answers to questions. It is critical to set a clear understanding with DCAA of when you will be able to provide data and set yourself up for success by under-promising and over-delivering. Additionally, be sure to take a look at the supporting data that DCAA typically reviews and be sure it can be available upon audit initiation.

For many contractors, the deadline for the next Incurred Cost Proposal is June 30th. We recommend getting started soon to be sure that you have adequate time to prepare the submission. Capital Edge has a wealth of resources available to support contractors with preparation and review of their ICS. Whether your organization is large, small, or somewhere in between, we can help take the stress out of this requirement.

About Capital Edge Consulting, Inc.

Capital Edge consultants combine their unique backgrounds and experience in consulting, public accounting, industry, DCAA and DCMA to provide clients with unmatched government contracting expertise. This breadth and depth of specialized experience enables Capital Edge to provide the exact services and level of expertise federal government contractors need to succeed. Capital Edge has worked with government contractors ranging in size from startup to Fortune 100 companies in industries such as manufacturing, nuclear energy, professional services, biotech/pharmaceuticals, defense, and software.

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