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**ABA**  
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Section of  
Public Contract Law



# Contractor Incurred Cost Proposals

Current Issues and Trends

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# Agenda

- Introduction
- Regulatory Requirements
- Recent Developments: Statute of Limitations Issues
- Best Practices for Incurred Cost Documentation, Collection, and Submission
- Best Practices for Facilitating the Audit Process
- Audit Scrutiny
  - Hot Topics
  - Managing Government Auditor Requests for Specific Types of Information
- Appendix: Areas of Special Government Audit Focus



# Introduction

- Incurred Cost Proposals
  - What they are
  - When they are submitted
  - ICPs matter because they
    - Determine final payments to the contractor
    - May delay contract closeout and affect cash flow timing for final bills
    - Will face substantial audit scrutiny
    - May result in penalties for inclusion of expressly unallowable costs

# Regulatory Requirements

- FAR § 52.216-7, “Allowable Cost and Payment”
  - Permits billings of indirect costs based on provisional rates
  - Requires submission of final indirect cost pools and allocation bases in accordance with FAR Subpart 42.7
- Prior to 6/30/2011, only required:
  - “Adequate final indirect cost rate proposal”
  - “Support . . . with adequate supporting data”
- After 6/30/2011:
 

<ul style="list-style-type: none"> <li>➤ Summary of all claimed indirect expense rates, including pool, base, and calculated indirect rate.</li> <li>➤ General and Administrative expenses</li> <li>➤ Overhead expenses</li> <li>➤ Occupancy expenses</li> <li>➤ Claimed allocation bases, by element of cost, used to distribute indirect costs</li> <li>➤ Facilities capital cost of money factors computation</li> <li>➤ Reconciliation of books of account and claimed direct costs by major cost element</li> <li>➤ Schedule of direct costs by contract and subcontract</li> </ul>	<ul style="list-style-type: none"> <li>➤ Schedule of cumulative direct and indirect costs claimed and billed by contract and subcontract.</li> <li>➤ Subcontract information</li> <li>➤ Summary of each time-and-materials and labor-hour contract</li> <li>➤ Reconciliation of total payroll</li> <li>➤ Listing of decisions/agreements/approvals and description of accounting/organizational changes</li> <li>➤ Certificate of final indirect costs</li> <li>➤ Contract closing information for contracts physically completed in this fiscal year</li> </ul>
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- FAR Subpart 42.7
  - Sets forth procedures for audit of ICP and negotiation of final rates
  - Provides penalties for inclusion of expressly unallowable cost



# Regulatory Requirements

- FAR § 52.215-2, “Audits and Records—Negotiations”
  - Contractors must maintain records “sufficient to reflect properly all costs claimed to have been incurred or anticipated to be incurred directly or indirectly in performance of this contract”
  - Records must be available for audit until 3 years after final payment under the contract or for any shorter period specified in Subpart 4.7
- FAR Subpart 4.7:
  - Provides additional record retention requirements
  - Requirements measured from fiscal year to which records relate
- *BearingPoint, Inc.*, ASBCA No. 55354, 09-2 BCA ¶ 34,289
  - Contractor records need not be maintained in “nice neat little files”
  - The FAR does not prescribe a particular form for records or other evidence supporting costs



# Regulatory Requirements

- DCAA's Interpretation of Regulatory Requirements
  - ICP checklist
    - Generally tracks the new FAR requirements
    - Provides detail concerning DCAA's expectations for categories of information identified in FAR § 52.216-7
    - [DCAA's Guide for Determining Adequacy of Contractor Incurred Cost Proposals](#)
  - ICE (Incurred Cost Electronically) Models
    - Spreadsheets designed by DCAA to provide contractors with a standard ICP format
    - **There is no legal requirement to use ICE models**
      - Failure to use ICE model may result in deemed inadequacy
      - When not using ICE model, contractors must demonstrate that format is responsive and complete

# Recent Developments: Statute of Limitations Issues

Relevant today because of significant backlog of unaudited ICPs.

- CO must assert claim through final decision within six years of claim accrual (41 U.S.C. § 7103)
- Claim accrual is the date when the government knew or should have known of a claim (FAR § 33.201)
- Government knowledge (actual or **constructive**)
  - Contracting officer knowledge not required (*Raytheon Missile Sys.*, ASBCA No. 58011, 2013 WL 685219 (Jan. 28, 2013))
  - DCAA knowledge is government knowledge (*id.*)
  - Submission of ICP to DCAA (**not DCAA audit**) triggers CDA statute of limitations (*Raytheon Co.*, ASBCA No. 57576, 13-1 BCA ¶ 25,209)

# Best Practices for Incurred Cost Documentation, Collection, and Submission

- Use Advanced Agreements where possible
- Document and archive the source of your foundational G/L data
- Development and Submission of ICPs
  - Start with a clean model
  - Use the ICP adequacy checklist as a guide
  - Follow your disclosed or established cost accounting practices
  - Integrate your model schedules through linking
  - Strategically plan your analysis to scrub unallowable costs and use auditable methods of cost segregation
  - **Use explanatory notes**
  - Create a support binder
  - Establish your use of electronic documents carefully
  - Keep an **exact** copy of what is provided to the government
  - Protect your proprietary data





# Best Practices for Facilitating the Audit Process

- During an Audit
  - If an entrance conference is not scheduled, request one prior to providing data
  - Establish a single point of contact to ensure consistency in communication with the auditors
  - Establish regular meetings with auditors to keep them apprised of your progress and discuss issues
  - Ensure that all requests are received in writing and appropriately justified
  - Establish the timeline needed to satisfy requests
  - **Keep track of everything provided to the government in support of an audit**
- After an Audit
  - If an exit conference is not scheduled, request one
  - Determine whether or not to reply to auditor findings communicated in the exit conference
  - Request a copy of the audit report from your CO/ACO



# Audit Scrutiny: Hot Topics

- Government Demands for Resubmission of ICPs
  - Not a new phenomena
    - Increasing in frequency
    - Reflect concerns ranging from actual inadequacies to desires for additional information
    - Recently DCAA has demanded resubmissions because older, unaudited ICPs are not formatted in most recent ICE model
  - Of great importance because of SOL issues
    - Key question: When will SOL begin to run?
    - Government may argue it only knew of potential claims upon resubmission
  - **If resubmission is necessary**, specify areas that will remain unchanged
  - If supplementing an existing ICP, state that underlying ICP is auditable and adequate



# Audit Scrutiny: Hot Topics

- Availability and Type of Documentation
  - Government backlog in reviewing ICPs is causing delayed requests for additional documentation
  - Requirements (discussed above)
    - FAR § 31.201-2(d) requires maintenance of “adequate” support and permits disallowance
    - FAR § 52.215-2 requires records be made available for audit until 3 years after final payment or for shorter period specified in FAR Subpart 4.7
    - DCAA position appears to be that all cost documentation must remain available for three years after contract closeout
    - Closeout will usually not occur until after indirect rate finalization
  - Having a compliant and functional document retention system is **essential**
    - Compliance with FAR § 52.215-2 and FAR Subpart 4.7 document unavailability impact CDA SOL and cost allowability considerations



# Audit Scrutiny: Hot Topics

- Expressly Unallowable Costs
  - Contractors may be subject to penalties for including expressly unallowable costs in ICPs (see FAR § 42.709)
    - Expressly unallowable costs are “specifically named and stated to be unallowable” under the “express provisions of an applicable law, regulation, or contract” (48 C.F.R. § 9904.405-30)
    - “[T]he Government must show that it was unreasonable under all the circumstances for a person in the contractor’s position to conclude that the costs were allowable.” *Fiber Materials Inc.*, ASBCA No. 53616, 07-1 BCA ¶ 33,563
  - DCAA, however, appears to view expressly unallowable costs more broadly
    - Includes costs allegedly not fully documented/supported



# Audit Scrutiny: Managing Auditor Requests

- Auditor Requests for Attorney-Client Privileged Materials
  - Arises frequently in the context of legal costs
    - DCAA expects to see work product or invoices to confirm that work was actually performed
    - Disclosure to DCAA may waive privilege
  - DCAA MRD 12-PPS-018(R) / DCAAM § 1-504
    - Elevates assertions of privilege to “high level” company executives and regional DCAA office
    - Suggests that if unprivileged information is not available, contractor must disclose information or face disallowance
  - Common alternatives
    - Provide redacted invoices
    - Provide summary of billing
    - Provide invoices (disfavored)

# Audit Scrutiny: Managing Auditor Requests

- Government Requests for Internal Audits
  - Government's ability to access contractor records is defined by statute (see, e.g., 10 USC §§ 2306a, 2313)
  - This ability does **not** extend to subjective contractor assessments, such as internal audits (see, e.g., *U.S. v. Newport News Shipbldg. & Dry Dock Co.*, 837 F.2d 162 (4th Cir. 1988))
  - In 2011, the GAO issued a report criticizing DCAA for not seeking access to internal audits (GAO-12-88)
    - Resulted in a sharp increase in DCAA requests
    - DCAA issued guidance concerning access to internal audits (12-PPS-19(R))
  - 2013 NDAA (P.L. 112-239)
    - Broad DCAA access provisions considered (S. 3254 § 843)
    - Narrow access provisions adopted (P.L. 112-239 § 832)
    - Focus on internal audits relied on to demonstrate business system adequacy
  - **Government's statutory authority to access internal audit material has not changed**



Questions?

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## Additional Information

# Appendix





# Audit Scrutiny: Areas of Special Focus

- Travel costs
  - Includes travel costs of employees **and consultants/subcontractors**
    - Contractors must be able to obtain from consultants sufficient documentation if travel costs are reimbursed
  - Expectation is extensive documentation
    - Documentation that airfare is lowest available
    - Screening and removal of unallowable costs
    - Justification for premium airfare
- Restructuring costs
  - Typically unallowable (FAR § 31.205-27)
  - Auditors closely reviews costs that may be related to restructuring, such as legal costs
  - If a restructuring has occurred, prepare to explain nature of legal costs and why certain costs were found to be allowable



# Audit Scrutiny: Areas of Special Focus

- Consultant Costs / Legal Fees
  - FAR § 31.205-33: fees allowable only when supported by evidence of the nature and scope of the service furnished, including:
    - Details of all agreements, including rates and work requirements
    - Invoices submitted by consultants, including time and nature of services
    - Consultants' work product and related documents
  - DCAAM on obtaining consultant work product (DCAAM § 7-2105.2):
    - Purpose is to determine the nature and scope of the work performed
    - “The auditor should not insist on a work product if other evidence provided is sufficient to determine the nature and scope of the actual work performed”
  - DCAA position is that costs are unallowable if:
    - No written agreement exists
    - Work product does not exist or is not provided



# Audit Scrutiny: Areas of Special Focus

- Subcontract Costs
  - Documentation
    - Auditors often take the position that if an action is not documented, it did not occur
    - Most common documentation issues involve
      - Commercial item determinations
      - Cost/price analysis and reasonableness determinations
      - Sole source determinations and related market research
  - T&M Issues
    - Subcontractors must supply personnel that meet the prime contract's qualification requirements
    - Materials costs and ODCs must be documented and reasonable