Indirect Cost Rate (ICR) Training

Process to Create Your Indirect Cost Rate (ICR) Schedule

(Module 2)
**Process to Create Your Indirect Cost Rate (ICR) Schedule**

**Getting from A to B Overview**

- **First** – Finalize your Labor Distribution Report (LDR). Further details to follow.
- **Second** – Perform adjusting entries to the General Ledger (GL) accounts.
- **Third** – Finalize your Financial Statements (Income Statement, Balance Sheet, etc.).
- **Fourth** – Build the Financial Statement (Income Statement) column on your Indirect Cost Rate (ICR) Schedule.
- **Fifth** – List unallowable items in the firm’s adjustment column.
- **Last** – Add the totals in the accepted amount column and divide by the direct labor to calculate the indirect cost rate.
Labor Distribution Report (LDR)

Process to Create Your Indirect Cost Rate (ICR) Schedule

- Labor Distribution Report (LDR) Definition – A report showing the distribution of labor hours and dollars by designated labor categories (direct, indirect, paid time off, etc.) in which an employee worked.
- The firm should finish the LDR prior to starting the Indirect Cost Rate (ICR) Schedule.
- The LDR is created by combining the firm’s payroll register and employees’ timesheets.
- If the firm performs monthly reconciliations, then those reconciliations can be rolled up to create the firm’s annual LDR - See Module 5.

Examples of LDR’s on the following slides

a) Single member firm with draws working less than 2,080 hours per year.

b) Single member firm with draws working more than 2,080 hours per year, which results in uncompensated overtime.

c) Ten person firm with staff payroll and uncompensated overtime (This example is helpful to keep in mind as your firm grows from draws to payroll)
Single Person Firm With Draws Working Less Than 2,080 Hours Per Year

- The owner drew $6,250 per month.
- The owner worked 1,800 hours during the year.

**Hourly Rate Computation**

1) Add total draws during the year ($6,250 x 12 months = $75,000 yearly compensation).
2) Divide total draws by the total number of hours worked during the year to compute the hourly rate ($75,000 / 1,800 hours = $41.67 hourly rate).

**Labor Distribution (LDR) Computation**

1) Fill in each labor category with the hours from the owner’s timesheets.
2) Multiply each set of hours by the hourly rate previously calculated.
3) Add each category dollar amount together to arrive at the total dollar amount ($75,000).
4) The total dollar amount column ($75,000) should equal the owner draws total ($75,000), therefore no uncompensated overtime will be recorded.
**Labor Distribution Report (LDR)**

**Example 2**

**Single Person Firm With Draws Working More Than 2,080 Hours Per Year, Which Results In Uncompensated Overtime**

- The owner drew $12,500 per month.
- The owner worked 2,124 hours during the year.

**Hourly Rate Computation**

1. Add total draws during the year ($12,500 x 12 months = $150,000 yearly compensation).
2. Divide total draws by the standard 2,080 hours per the year ($150,000 / 2,080 hours = $72.12 hourly rate).

**Labor Distribution (LDR) Computation**

1. Fill in each labor category with the hours from the owner’s timesheets.
2. Multiply each set of hours by the hourly rate previously calculated.
3. Add each category dollar amount together to arrive at the total dollar amount ($153,173.08).
4. Since the owner worked more than the standard, the total dollar amount ($153,173.08) calculated will be more than the owner draws ($150,000). The variance is the uncompensated overtime ($3,173.08) worked during the year.

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### Table: Single Person Firm Standard LDR

<table>
<thead>
<tr>
<th>Employee</th>
<th>Total Draws Taken For</th>
<th>Hourly Rate</th>
<th>Total Hrs.</th>
<th>Direct Hrs</th>
<th>Direct $</th>
<th>Direct OT Hours</th>
<th>OT $ at 1.5</th>
<th>Indirect Office Hrs</th>
<th>Office $</th>
<th>B&amp;P Labor</th>
<th>B&amp;P $</th>
<th>Holiday Hrs</th>
<th>Holiday $</th>
<th>Vacation Hrs</th>
<th>Vacation $</th>
<th>Sick Hrs</th>
<th>Sick $</th>
<th>Total $ Column</th>
<th>Uncomp. O/T</th>
<th>Owner Paid Draws</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner 1</td>
<td>$150,000</td>
<td>$72.12</td>
<td>2,124</td>
<td>1,600</td>
<td>$115,384.62</td>
<td>0</td>
<td>$0.00</td>
<td>390</td>
<td>$28,125.00</td>
<td>62</td>
<td>$4,471.15</td>
<td>72</td>
<td>$5,192.31</td>
<td>0</td>
<td>$0.00</td>
<td>0</td>
<td>$0.00</td>
<td>$153,173.08</td>
<td>$3,173.08</td>
<td>$150,000</td>
</tr>
<tr>
<td>Total</td>
<td>2,124</td>
<td>1,600</td>
<td>$115,384.62</td>
<td>0</td>
<td>$0.00</td>
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<td>0</td>
<td>$0.00</td>
<td>0</td>
<td>$0.00</td>
<td>0</td>
<td>$0.00</td>
<td>$153,173.08</td>
<td>$3,173.08</td>
<td>$150,000</td>
</tr>
</tbody>
</table>

*Owner draws $12,500 per month*

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There will be uncompensated overtime due to the fact the owner worked over the standard 2,080 hours!
Ten Person Firm With Staff Payroll And Uncompensated Overtime

- The firm has a mix of hourly and salary employees.
- The firm has a mix of employees working over/under the standard 2,080 hours per year.

**Hourly Rate Computation**

1) For salary employees, divide total salary by the standard 2,080 hours per year. For example, A. Adams hourly rate is $95,834 / 2,080 hours = $46.07 hourly rate.

2) For hourly employees, the hourly rate from payroll will be added in the hourly rate column.

**Labor Distribution (LDR) Computation**

1) Fill in each labor category with the hours from the employees’ timesheets.

2) Multiply each set of hours by the hourly rate previously calculated or added from payroll.

3) Add each category dollar amount together to arrive at total dollar amount for both hourly and salary employees ($739,654.74).

4) For hourly employees, the total dollar amount should match the total paid to the employee through payroll. No uncompensated overtime should be reported for hourly employees.

5) For salary employees, if the employee worked more than the standard, the total dollar amount will be more than the total paid to the employee through payroll. The variance is the uncompensated overtime worked during the year.

Uncompensated Overtime should only be recorded and reported for salaried employees and/or owners!
Process to Create Your Indirect Cost Rate (ICR) Schedule

After the Labor Distribution Report (LDR) has been finalized, the firm will need to perform adjusting entries to the General Ledger (GL) (The GL is built from your “Chart of Accounts” – See Module 4) accounts for:

- Accruals
- Deferrals
- Reimbursements
- Recording error corrections
- May not apply to cash basis firms

Once the adjusting entries have been performed, then the firm can finalize the Income Statement.

- The Income Statement is the basis for the Indirect Cost Rate (ICR) Schedule.
- Once the Income Statement is finalized, you can create the schedule
Indirect Cost Rate (ICR) Schedule

Process to Create Your Indirect Cost Rate (ICR) Schedule

- The creation of the Indirect Cost Rate (ICR) Schedule commences with the addition of the Income Statement figures to the first column of the ICR Schedule - See Module 4.

- First, add the direct/indirect labor expenses from the finalized Income Statement.
Process to Create Your Indirect Cost Rate (ICR) Schedule

• The creation of the Indirect Cost Rate (ICR) Schedule commences with the addition of the Income Statement figures to the first column of the ICR Schedule - See Module 4.

• Second, verify the labor totals equal the labor totals on
Process to Create Your Indirect Cost Rate (ICR) Schedule

- The creation of the Indirect Cost Rate (ICR) Schedule commences with the addition of the Income Statement figures to the first column of the ICR Schedule - See Module 4.

- Third, add the fringe benefits and non-labor indirect expenses from the Income Statement.
Process to Create Your Indirect Cost Rate (ICR) Schedule

- Once the financial statement column is completed, the firm can now make the necessary adjustments, See Module 6 for unallowable expenses.

- First, add the firm’s adjustments for unallowable expenses under the firm’s adjustments column.

- Second, in the reference column, add the reference letters pertaining to each adjustment.
Indirect Cost Rate (ICR) Schedule

Process to Create Your Indirect Cost Rate (ICR) Schedule

• Once the financial statement column is completed, the firm can now make the necessary adjustments, See Module 6 for unallowable expenses.

• Third, add explanation and FAR references for each adjustment in the reference section at the bottom of the schedule.

References
ABC Adjustments:
A Unallowable costs of $24,612 idle capacity per 48 CFR 31.205-17(c).
B Lodging ($1,600), Meal ($42,000), and Mileage ($3,200) rates in excess of federal travel regulation unallowable per 48 CFR 31.205-46(a)(2).
C Inadequate supporting documentation unallowable per 48 CFR 31.201-2(d).
D Key person life insurance for $6,000 unallowable per 48 CFR 31.205-19(c)(2)(v).
E Unallowable taxes and licenses per 48 CFR 31.205-41.
F Amortization of goodwill for $7,000 unallowable per 48 CFR 31.205-49.
H Public relations ($1,957) and advertising ($11,615) unallowable per 48 CFR 31.205-1.
L Contributions unallowable per 48 CFR 31.205-8l.
N Unsupported direct selling costs of $18,800, no documentation available to demonstrate and support "person to person" selling unallowable per 48 CFR 31.205-38(b)(5).
O Fringe Benefit adjustment; directly associated cost to unallowable Advertising ($17,360), Public Relations ($8,120) and Direct Selling Labor ($2,920) unallowable per 48 CFR 31.201-6(a).
P Auto Allowance payments of $12,000 unallowable per 48 CFR 31.205-6(m)(2) and 31.201-2(d), documentation of mileage log not available and unable to support and show segregation of business and personal use. Associated costs for vehicle unallowable per 48 CFR 31.205-46(d) and 31.205-6(m)(2). Associated costs include Insurance ($1,000), Maintenance ($997), and Depreciation ($664).
Q Bonus payments of $65,000 unsupported and not performance based unallowable per 48 CFR 31.205-6 and 2010 AASHTO Audit Guide, Chapter 7, Section 7.12-C
R Labor Variance Account to show the uncompensated overtime labor adjustment. Labor Variance account is an offset account to balance to payroll. - $48,708.88
S Severance payment does not follow company's established severance policy, $5,400 is unallowable per 48 CFR 31.205-6(g).
General Tips to Assist with The Process:

- **WHAT NOT TO DO**

  - We see some firms who create the Indirect Cost Rate (ICR) Schedule before reconciling labor, creating the Labor Distribution Report (LDR), and/or finalizing the financial statements. This process is backwards and creates more work for the firm. The figures must be correct prior to building the ICR Schedule.

  - Your LDR form can be used for monthly labor reconciliations and at year end, the monthly reconciliations can be rolled up into an annual worksheet – See Module 5.

  - If your firm’s payroll cycle is different from your firm’s fiscal year, you will need to complete a reconciliation and an adjusting entry. See Example.
Payroll Adjusting Entries to Align the Payroll Cycle with the Firm’s Fiscal Year

- The firm in this example has the following periods:
  - Payroll Cycle (Bi-Weekly, 26 paychecks) runs from 12/23/12 to 12/21/13.
  - Fiscal Year runs from 1/1/13 to 12/31/13.

Payroll Adjusting Entries

- The firm will need to adjust out the wages paid from 12/23/12 to 12/31/12, as the labor was performed in the previous fiscal year.
- The firm will also need to adjust in the wages earned from 12/22/13 to 12/31/13, as the labor was performed in the current fiscal year.
- After the two adjusting entries are calculated, the firm will show the adjustments to arrive at the adjusted payroll total.
- The adjusting entries will align payroll with the labor reported on the firm’s Indirect Cost Rate (ICR) Schedule.
- **Disclaimer:** This is only one type of method to reconcile labor. The adjusting entries are for your reconciliation **ONLY**!
Online Guidance

Be Sure to Visit Us Online

Our website is filled with educational material and guidance for all firms. We have published several interpretive guidance documents to further assist firms. The website below provides guidance on the following topics and we are in the process of adding further topics:

• Labor
• Uncompensated Overtime
• Direct Selling, Public Relations, Advertising and Bid & Proposal
• Allowable Bonus
• Auto Expense
• Meals
• Airfare

Please check our website on a regular basis for updates.

URL – http://www.wsdot.wa.gov/Audit/default.htm

WSDOT Safe Harbor Program:

http://www.wsdot.wa.gov/Audit/SafeHarborICR.htm
For Additional Guidance and Contact Information – Please refer to the end of Module 6!
Questions? Comments?
We are happy to help you!