

Master Document – Audit Program

Activity Code 17500		Progress Payment, Cost
Version 7.8, dated November 2012		
B-1	Planning Considerations	
<p>1. This program is intended to provide a logical sequence to the audit effort and to reflect a mutual understanding between the auditor and the supervisor as to the scope required to meet auditing standards and DCAA objectives for the current assignment. The audit steps in the program are intended as general guidance and should be modified as considered necessary to fit the current audit objectives. Portions of the audit which are covered in other assignments (e.g., billing systems, Earned Value Management System Criteria, Material Management and Accounting Systems) should be referenced at the appropriate place in this program.</p>		
<p>2. Progress payments are a form of Government financing for fixed-price contracts that are provided in recognition of the need for working capital, for long lead items, and work in-process expenditures. The basic authority for progress payments based on cost is included in FAR 32.503, which prescribes policies, procedures, forms, solicitation provisions, and contract clauses for providing contract financing through progress payments based on costs.</p>		
<p>3. The purpose of the progress payment audit is to verify the amounts claimed on SF 1443 (Contractor's Request for Progress Payment) to the contractor's accounting books and records and to evaluate the propriety of the progress payment request in accordance with the provisions of the contract.</p>		
<p>4. While the contracting officer is responsible for assessing the contractor's financial condition, auditors should immediately alert the contracting officer if they become aware of information that may indicate unfavorable or adverse financial conditions that could impede a contractor's ability to perform on Government contracts (e.g. audit leads, significant events, current economic conditions, etc.) and adjust the audit scope and associated audit procedures accordingly.</p>		
<p>5. The scope of audit depends on how much reliance can be placed on the contractor's accounting and billing system's internal controls, cost representations, and billing procedures. This decision must reflect a mutual understanding between the auditor and the supervisory auditor as to the work required to meet auditing standards and DCAA objectives. As with any audit, the audit scope must also consider any specific concerns raised by the contracting officer.</p>		
<p>6. This program does not replace individual auditor judgment and may be supplemented or revised to satisfy the needs of a particular assignment.</p>		
<p>7. The objective of progress payments is to provide the contractor with interim financing for a percentage (stated in contract) of allowable costs incurred for undelivered and uninvoiced items. The amount of financing is also subject to other limitations specified in the progress</p>		

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<p>payment contract clause. As contract items are delivered and accepted, progress payment amounts are reduced (liquidated) against payments due for completed items using the liquidation method stated in the contract.</p>
<p>8. The inherent risks to the Government of interim financing are (i) the time value of money if the contractor receives premature payments or is overpaid; and (ii) the loss of goods and services if the contractor does not deliver or does not meet contractual specifications. Auditors should monitor and minimize these risks by being alert for high risk situations such as poor financial conditions, low cash balances, losses on contract work, etc. During performance of risk assessments, auditors are reminded to contact the contracting officer to obtain the contractor’s financial condition information for risk assessment purposes. Considerations for the instant progress payment request (SF 1443) that could impact the Government's risk of premature/overpayment include:</p>
<p>a. Overstating the contract price (Item 5).</p>
<p>b. Overstating total costs incurred to date (Items 9, 10, and 11).</p>
<p>c. Understating the incurred costs to date and estimate to complete (Items 12.a and 12.b).</p>
<p>d. Overstating subcontractor claims (Item 14.e).</p>
<p>e. Understating the costs attributable to items delivered and invoiced.</p>
<p>f. Using an inappropriate progress payment rate.</p>
<p>g. Using an inappropriate liquidation rate.</p>
<p>h. Misapplying the loss ratio factor for subcontracts.</p>
<p>References</p>
<p>1. Course No. 1142, Progress Payments</p>
<p>2. "The Progress Payment clause in the contract. (See FAR 52.232-16, DoD Supplement 252.232-7003 through -7007)</p>
<p>3. FAR 32.5 and DoD Far Supplement 232.5</p>
<p>4. Price Revision Clauses, FAR 52.216-5, 216-6, 216-16 or 216-17.</p>
<p>5. CAM 14-200 "Audit of Progress Payments Based on Cost"</p>
<p>6. CAM 14-300 "Assessing a Contractor Financial Capability"</p>
<p>7. CAM 6-1005 "Determination of Allowable Costs"</p>

B-1	Preliminary Steps	
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<p>1. Review the open MRD’s for guidance which may impact the audit and adjust the scope and procedures appropriately. Open MRDs can be identified using the link provided on the DCAA Intranet home page for “MRDs, AGMs, & AMGMs”</p>	
<p>2. Review permanent files and/or current audit assignments to ensure that related findings from earlier audits are considered in the scope of follow-up reviews. (Note: Such information may not be separately maintained in a permanent file, but may be contained in individual current audit assignments.)</p>	
<p>3. Using the framework and the guidelines in WP B-2, obtain and document an understanding of the contractor's internal controls that are relevant to the audit. With the proper planning auditors should be able to obtain and document a major portion of this understanding during a walk-through of the contractor's assertion.</p>	
<p>4. Review the contract for terms and conditions affecting progress payment requests and cost or performance reporting requirements.</p>	
<p>a. Determine the contract price (Item 5) is in accordance with FAR 32.501-3 and based on the most current modification. (i.e., under firm fixed price contracts, the contract price is the current amount fixed by the contract plus the not-to-exceed amount for any unpriced modifications.) Determine if portions of the contract are being reimbursed/financed by means other than progress payments. (See CAM 14-205a)</p>	
<p>b. Determine the contractual progress payment and liquidation rates. (FAR 52.232-16 or DFARS 252.232-7004)</p>	
<p>c. For contracts requiring first article approval before performance continuation, ensure that the progress payment request does not exceed the amount authorized by FAR clause 52.209-3g or alternate II, if applicable.</p>	
<p>5. Review the contractor's progress payment request and determine whether:</p>	
<p>a. The SF 1443 is mathematically correct. Also, test the logical relationships inherent to the form, for example:</p>	
<p>(1) Total Costs Eligible for Progress Payments (Item 11) should not exceed Total Costs Incurred to Date (Item 12.a). If so determine why.</p>	
<p>(2) Total Dollar Amount (Item 15) cannot exceed Item 16.</p>	
<p>(3) Payment Requested (Item 26) cannot exceed the Cost Limitations (Item 20.e) or Price Limitation (Item 21.e).</p>	
<p>(4) The sum of Item 21.a and 21.b must agree with the Contract</p>	

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Price on Item 5.	
If significant errors are found in the request, coordinate with the contracting officer and return the SF 1443 to the contractor and suspend further audit effort.	
b. The contract price agrees with the contract as amended (see CAM 14-202.3 and 14-205a). Contract price should be adjusted for portions of the contract being reimbursed/financed by means other than progress payments.	
c. The progress payment and liquidation rates are in agreement with the progress payment clause in the contract.	
d. The contract is in a loss position, i.e. Item 12.a plus 12.b exceed the contract price. If so, include application of the loss ratio factor in the audit scope.	
e. The SF 1443 includes significant progress payments to subcontractors (Items 14.a through 14.e). If so, at the entrance conference, determine the prime contractor's procedures for reviewing subcontractor progress payment requests including application of the loss ratio. If the required analyses are not performed or are considered inadequate, consider if assist audits should be requested (see CAM 14-205g.).	
6. Coordinate the audit with Government contract administration and program officials:	
a. Discuss the results of Preliminary Audit Steps and identify any areas of concern that can be addressed during the audit.	
b. Coordinate Government technical assistance in evaluating incurred cost and a technical evaluation of estimate to complete and estimate at completion (ETC/EAC), if appropriate (see CAM 14-205f, D-100 and D-200).	
c. Determine whether the contract under audit is subject to earned value management system (EVMS) criteria. If so, obtain a copy of the EVMS estimate at completion (EAC) / estimate to complete (ETC) for this audit.	
d. Make arrangements to obtain data on prior technical evaluations, delivery schedules, cost analyses, or other management reports when available, for example, CPRs, milestone charts, PERT charts or similar systems which assess contractor performance on the contract.	
e. Determine if the Government evaluations of the ETC/EAC considered any cost or schedule problems identified in CPRs, PERT charts, financial statements, tax reports, or similar data. If prior evaluations present a range of EACs, determine which is	

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<p>most likely.</p>	
<p>f. Contact the contracting officer to ascertain any known concerns (including risk related to the contractor’s financial condition) that will impact the audit and adjust the audit scope and procedures accordingly. If information regarding the contractor’s financial condition is not available from the contracting officer, the auditor should perform the procedures addressed in CAM 2-302.1h. If during the course of the audit the auditor becomes aware of unfavorable or adverse financial conditions, they should immediately communicate their concerns to the contracting officer, and appropriately adjust the scope of audit.</p>	
<p>g. Electronically transmit an acknowledgement/notification to the ACO/Buying Command notifying them of the commencement of the risk assessment and that the expected completion date will be provided in the formal acknowledgement/notification once the risk assessment is complete. (CAM 2-303). The acknowledgement/notification process should be within the timeframe and in accordance with the procedures in CAM 4-104.</p>	
<p>7. Issue a notification letter to the contractor regarding the audit in accordance with CAM 4-302.3.</p>	
<p>8. Hold a planning meeting with the audit team (e.g., RAM, Manager, Supervisor, Auditors) to discuss the risk of fraud and other noncompliances with applicable laws and regulations that could have a material effect on the assertion. The discussion should include relevant prior audit experience (e.g., questioned cost, relevant reported estimating or accounting system deficiencies), relevant aspects of the contractor’s environment (e.g., the extent of incentives, pressures and opportunities to commit fraud and the propensity to rationalize misstatements), other known risk factors, and the audit team’s understanding of relevant internal controls (see W/P B-2). The team should also review and discuss the general and other relevant sections of the IG Handbook on Fraud Indicators for Contractors as well as the relevant fraud indicators in CAM Figure 4-7-3. See “Principal Sources of Fraud Indicators” below.</p> <p>Based on the team discussion and other risk assessment procedures the team should document on W/P B, Section 4 the risk factors/indicators identified and design audit procedures to meet the audit objectives and provide reasonable assurance of detecting fraud and other noncompliances with applicable laws and regulations that could have a material effect on the proposal (i.e., tailor (add/delete/modify) the audit steps). GAGAS 6.13(a)</p>	

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<p>Communication among audit team members about the risk of material misstatement due to fraud should continue as needed throughout the audit.</p> <p>Principle Sources of Fraud Indicators:</p> <ul style="list-style-type: none"> • Handbook on Fraud Indicators for Contract Auditors, Sections I and III, (IGDH 7600.3, APO March 31, 1993) located at: http://www.dodig.mil/PUBS/igdh7600.doc. • CAM Figure 4-7-3. <p>(To access the fraud handbook, copy and paste the web address shown above into the address block in Internet Explorer.)</p>	
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C-1	Contractors Claimed Costs	
	Version 7.8, dated November 2012	W/P Reference
	<p>Review the contractor's claimed costs eligible for progress payments (SF 1443, Item 11) and trace the costs through the contractor's billing system (both manual and automated portions) to the contractor's accounting books and records. The auditor's verification of the contractor's reconciliations of the billing system data to the accounting books and records should satisfy this objective.</p>	
	<p>a. Ensure that the costs have been incurred or paid in accordance with FAR 52.232-16 (CAM 14-202.4)</p>	
	<p>b. Verify that all direct costs billed reconcile to the contractor's accounting books and records. Direct material costs should be evaluated to ensure that the Government has clear title in accordance with FAR 52.232-16. (CAM 14-205c(1))</p>	
	<p>c. Verify indirect costs are based on approved billing rates or available forward pricing rates, or consider the need to audit the billing rates in conjunction with the progress payment audit. (CAM 14-205c(2)). Note: Indirect costs allocable to ineligible direct costs are also ineligible until the direct costs become eligible.</p>	
	<p>d. Verify that subcontractor and vendor costs incurred but not paid are included in progress payment requests only when the contractor makes payment to subcontractors and vendors:</p> <ul style="list-style-type: none"> (1) in accordance with the terms and conditions of a subcontract or vendor invoice and, (2) ordinarily within 30 days of the submission of the contractor's 	

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progress payment request to the Government. (CAM 14-205c(4)).	

D-1	Estimate To Complete	
Version 7.8, dated November 2012		W/P Reference
Review the contractor's support for the estimate to complete (ETC) on Item 12.b. Ensure that it is no more than six months old (see SF 1443 instructions for Item 12b). The scope of reviewing the ETC should depend on the auditor's knowledge of the contractor, the results of prior audits, and the nature and age of the contractor's estimate. (see CAM 14-205e). If the contractor's ETC is more than six months old coordinate with the contracting officer.		
NOTE: A thorough evaluation of the ETC is critical, particularly on high risk contracts such as those for research and development effort or when the contractor has no experience producing the same or similar products. A technical evaluation is normally required on such contracts.		
a. Evaluate the reasonableness of the contractor's ETC/EAC using the guidance in CAM 9-300.		
(1) Verify that the contractor was consistent in its estimating practices (supported by the accounting system and records) for preparing its ETC/EAC. If the contract is subject to the EVMS criteria, any discrepancies between the ETC/EAC used for EVMS reporting purposes and the ETC/EAC for progress payment purposes should be discussed with the program office and the contractor. (CAM 14-205f).		
(2) Verify that the contractor has used appropriate rates and factors.		
(3) Review the quantitative and qualitative aspects of the EAC for reasonableness utilizing Government technical assistance and assist audits if considered necessary (see CAM D-300).		
b. Compare ETC/EAC projections for contract billing purposes with those used for financial reporting purposes (e.g. recent projections used to prepare financial statements and tax returns) for any material differences. (Contractors sometimes report different EACs because of different risk assumptions and profit expectations.). If any differences are identified, the contractor should reconcile the material differences. Also compare the EAC with other financial and management reports which may be		

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available that show total estimated costs to complete the contract. (CAM 14-205f(2)(b)).	
c. Review any Contract Performance Reports (CPRs), Cost/Schedule Status Reports (C/SSRs) - (see CAM 11-304), or similar reports or charts prepared by the contractor, and identify any cost, technical, or schedule problems which could affect the estimate at completion (EAC). Determine if the EAC considers these problems. Discrepancies between CPR and C/SSR data and the EAC should be discussed with the program office and the contractor. (CAM 14-205f(2)(a))	
d. When CPRs or C/SSRs are available, determine if the EAC appears reasonable when compared to projections using the contractor's recent Cost Performance Indices (CPI)s. Consider using the procedures discussed below:	
NOTE: Do not duplicate analyses available from the CAO or Program Office.	
(1) Graphically plot the cumulative to date Budgeted Cost of Work Scheduled (BCWS), Budgeted Cost of Work Performed (BCWP), and Actual Cost of Work Performed (ACWP), on a monthly basis. Identify unusual fluctuations (positive and negative) and trace to the cost account level to identify the underlying reasons.	
(2) Project the EAC using the contractor's recent Cost Performance Indices (CPI)s.	
NOTE: The CPI is an efficiency ratio computed from the data available on CPRs or C/SSRs.	
BCWP	
CPI = $\frac{\quad}{\quad}$	
ACWP	
One method for forecasting EAC considers the contractor's cumulative ACWP; the Budgeted Cost of Work Remaining (BCWR) which is Budget at Completion minus BCWP; and CPI ₃ which is the sum of BCWPs for the last three months divided by the sum of the ACWPs for the last three months.	
BCWR	
EAC = ACWP _C + $\frac{\quad}{\quad}$	
CPI ₃	

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(3) Coordinate with the CAO to discuss significant differences between the EAC projected using the CPI and the contractor's "bottom-up" ETC/EAC with the contractor. Differences may indicate serious problems in the contractor's estimates and/or system and must be thoroughly investigated.	
(4) If significant differences are not explained to the satisfaction of the auditor, request a technical evaluation on the items in question.	
e. Compare the EAC (the sum of Items 12a and 12b) with the contract price (Item 5) and note any variance from the negotiated profit rate. Assess the need to determine an alternate liquidation rate (see FAR 32.503-9(b) and 32.503-10)	

E-1	Loss Adjustment
Version 7.8, dated November 2012	
W/P Reference	
A loss at completion is indicated when the EAC exceeds the contract price. FAR 32.503-6(g)(1) requires that if the sum of the total costs incurred under a contract plus the estimated costs to complete the performance are likely to exceed the contract price, the contracting officer (or the auditor as the contracting officer's representative) shall compute a loss ratio factor and adjust future progress payments to exclude the element of loss. Follow the calculation procedures below to determine the required adjustment. (CAM 14-205f).	

Section I

Item 5: Contract Price (FAR 32.501-3) \$

Section II

Item 12a:	Total Costs Incurred to Date		\$
Item 12b:	Estimated Additional Cost to Complete (ETC)	+	\$
	Total Estimated Cost at Completion (EAC)	=	<hr/>
Loss Ratio Factor Calculation:			
	Contract Price	\$	(a)
	Total Estimated Cost at Completion	\$	(b)
	Loss Ratio Factor (a divided by b)	=	
Item 11:	Total Costs Eligible for Progress Payment		\$
	Loss Ratio Factor	x	<hr/> %
Adjusted Item 11:	Recognized Costs Eligible for Progress Payment	=	\$
Item 6a:	Progress Payment Rate	x	
Adjusted Item 13:	Alternate Amount to be Used	=	\$

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Section III

Adjusted Item 20a Factored Cost of Items Delivered
(Same as Item 21a)

\$ _____

Adjusted Item 20b Recognized Costs Applicable to Undelivered Items
(Adjusted Item 11 less Adjusted Item 20a)

\$ _____

F-1	Other Areas	
Version 7.8, dated November 2012		W/P Reference
	<p>1. Determine if the progress payment request is based on currently posted accounting records -- subsidiary and general ledgers. If not, advise the contracting officer in writing that progress payment requests should not be approved until the contractor's accounting records become current. Immediately issue a separate flash audit report on this deficiency (see CAM 14-205j(3)(b)). Coordinate with the ACO to determine if other audit services are needed when the accounting records become current.</p>	
	<p>2. Verify the price of delivered/invoiced items (Item 21a) to the contractor's DD Form 250 (DFARS 246.6), "Material Inspection and Receiving Report." and determine if the contractor reduces billed amounts on delivery invoices for previously received progress payments (Item 23). In case of multiple deliveries, the contractor should have records/schedules which the auditor should test verify to actual DD 250s.</p>	
	<p>3. When the cost of items delivered is based on projected unit costs (see SF 1443 instructions for Item 20a), compare it to the contract price of these items (Item 21a). This result should be consistent with the profit rate determined in W/P section D, step 1e.</p>	
	<p>4. For FPI and incrementally funded contracts containing a limitation on payment clause (CAM 11-100), OR those subject to other DoD reporting requirements such as CPR (see 11-300), reconcile the amounts on Items 12a, 12b, 20a and 21a with the amounts on the "limitation on payments statement" and/or other required reports. For reports with the same accounting cutoff date as the SF 1443, the amounts should be the same.</p>	
	<p>NOTE: The risk is that the contractor may use lower amounts for the ETC in preparation of the progress payment requests to avoid limitations and higher amounts on the quarterly statement to avoid refunds to the Government.</p>	
	<p>5. Trace Item 23 (Total Amount Applied and to be Applied to Reduce</p>	

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<p>Progress Payment) to contractor's accounting records (contra accounts or schedules). This amount should represent the amount of previous progress payments applied to reduce (recovered from) the contract price of contract items delivered and invoiced. Determine if the contractor compares amounts billed to receipts for each invoice and coordinates with the paying office if amounts differ, especially if receipts exceed billings. (See CAM 14-205k)</p>	
<p>6. Ensure that progress payment requests on costs related to undefinitized contract actions are separately identified and are limited to 80% of eligible costs as determined by the contract terms (see FAR 32.102(e)(2)). In addition, for DoD contracts, the contractor should not bill more than 50% of the not-to-exceed price until the contractor submits a qualifying proposal to definitize the action. Refer to DFARS 217.7503(b)(4). After 12/31/91, these limitations are covered by DFARS 217.7404-4 (1991 edition). See CAM 14-202.3.e for guidance.</p>	
<p>7. Perform the "Fair Value" test. If the unliquidated progress payments exceed the fair value of the work accomplished on the undelivered portion of the contract, FAR 52.232-16(c)(5) provides for the Contracting Officer to reduce or suspend payments or adjust the liquidation rate.</p>	
<p>a. Calculate the fair value of undelivered work on the contract as the lesser of SF 1443, Item 20e or 21e (or the maximum unliquidated progress payments, SF 1443, Item 22).</p>	
<p>b. Take the fair value calculation above and compare it with the sum of Item 24 (Unliquidated Progress Payments) plus Item 26 (Amount of Current Invoice for Progress Payment).</p>	
<p>c. If the result is a fair value test failure, determine the cause of the failure. The two most common causes of a fair value test failure are a loss on a contract or a liquidation rate problem. Coordinate with the contracting officer to determine the need to apply the appropriate loss ratio or to adjust the liquidation rate.</p>	
<p>d. On a loss contract, application of the loss ratio constitutes the adjustment that ensures progress payments do not exceed the value of work performed (Fair Value Test). See FAR 32.503-6(f).</p>	
<p>8. Test the contractor's billing system internal controls for reconciling amounts received on billings for this contract. If the test finds that the contractor has received overpayments, further test the contractor's controls for notifying the contracting officer and the paying office.</p>	
<p>9. If the liquidation rate is less than the progress payment rate, the auditor should:</p>	
<p>a. Coordinate with the ACO and determine the estimated profit used</p>	

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to establish the alternate liquidation rate.	
b. Verify that the current profit being realized on the contract (contract price less the estimated cost at completion (EAC)) is at least equal to or exceeds the estimated profit used to establish the alternate liquidation rate. See detailed audit procedures for the evaluation of the contractors EAC.	
c. If the current profit is less than the profit used to establish the alternate liquidation rate, recommend to the ACO that the alternate liquidation rate be changed to reflect the current profit estimate.	
d. If a modification changing the alternate liquidation rate is subsequently issued by the ACO, the auditor should verify that the contractor determines the impact of the revised alternate liquidation rate on prior contract deliveries and makes timely refund of prior contract invoice billings, if applicable.	
e. Verify that the contractor annually certifies its alternate liquidation rate in accordance with FAR 32.503-9(a)(9). The certificate should be accompanied by adequate supporting information.	
10. Add any additional audit steps considered necessary under the circumstances (see CAM 14-205).	

G-1	Subcontractors Progress Payments	
	Version 7.8, dated November 2012	W/P Reference
	Verify the amounts claimed for subcontractor progress payments (Items 14.a through 14.e) to the prime (higher-tier) contractor's accounting books and records. Determine if the prime (higher-tier) contractor's procedures for analyzing subcontractor progress payment requests and for liquidating progress payments on subcontractor deliveries protect the Governments interest (see CAM 14-205.g).	

A-1	Concluding Steps	
	Version 7.8, dated November 2012	W/P Reference
	1. Discuss audit findings with supervisor and hold an exit conference (follow the guidance in CAM 4-304.4).	
	2. Complete indexing and cross-reference working papers.	
	3. Prepare Audit Report (CAM 14-206 and 10-1200).	
	a. When an assist audit and/or a technical evaluation is necessary,	

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<p>and is not obtained, the Circumstances Affecting the Audit paragraph should be used to qualify the results of audit for the nonreceipt of such reports (CAM 10-1204.2).</p>	
<p>b. If the contractor's accounting system is considered inadequate for the administration of progress payments, describe the findings and fully explain why the conditions need to be corrected by the contractor. The report should include specific recommendations to the ACO as to whether the progress payment(s), in whole or in part, should be paid to the contractor under the circumstances.</p>	
<p>4. When a progress payment has already been paid and the audit identifies overpayments or premature progress payments, the auditor should consider the applicable interest. If interest is significant, or if the nature of overpayment/premature payment is considered systemic, the auditor should coordinate with the contracting officer to request a voluntary refund from the contractor for the interest. See CAM 14-207.</p>	
<p>5. Significant procedural or control deficiencies or CAS/FAR noncompliances should be cited in this report and also reported separately using the procedures in CAM 10-400 or 10-800. If significant billing system deficiencies are noted, issue a flash report and revise the ICAPS risk assessment.</p>	
<p>6. If the auditor has encountered information that constitutes evidence or raises suspicion that fraud or other illegal acts have occurred, refer such suspicion by completing a DCAA Form 2000 (see CAM 4-702.4).</p>	