Activity Code 17600	**DFAS Financial Capability Audit**
Version 7.1, dated June 2012	

B-1	**Planning Considerations**

Purpose and Scope

The purpose of the financial capability audit for DFAS Installment Agreements is to determine whether the contractor is capable of repaying the proposed installment amounts. The audit will not be stopped with a financial condition risk assessment, regardless of the results of the risk assessment. These audits are performed at the request of the DCMA Financial Capability Group (FCG) on behalf of Defense Finance and Accounting Services (DFAS). In accordance with DoD Financial Management Regulation, Volume 10, Chapter 18, when a debtor to the U.S. Government can establish sufficient justification, a series of installment payments may be approved by DFAS, which will ensure liquidation of debt within a reasonable time frame. Debts generally occur when the contractor has received an overpayment from DFAS. Contract overpayments can occur because of payment mistakes (e.g., duplicate payments) or because of contract administration adjustments. When contractors anticipate having financial difficulty repaying the debt, the contractor may approach DFAS for a repayment installment plan. Prior to approving the installment agreement, DFAS may request the contracting officer to perform a financial capability audit taking into consideration the proposed installment payments to ensure that the contractor has the financial capability to repay the installments. The contracting officer may request assistance from DCAA as discussed in CAM 14-302. In addition to determining the contractor's ability to repay the debt, the audit will also determine what the contractor did with the overpayment and why it is currently not available to return it to the Government.

References

1. FAR 9.104-1, General Standards
2. DFARS 232.072, Financial Responsibility of Contractors
3. SAS 59, The Entity's Ability to Continue as a Going Concern
4. CAM 14-300, Assessing A Contractor's Financial Capability
5. FASB 95, Statement of Cash Flows

B-1	**Preliminary Steps**	
Version 7.1, dated June 2012		**WP Reference**

1. **Research and Planning**	
a. 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”	
b. Financial capability audits are generally performed at the parent company. If this is a request for audit of a contractor segment, ensure that an exception for performing the audit at the segment level applies (CAM 14-302). Coordinate with the requestor.	
c. 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.	
d. 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.	
e. If the detailed risk assessment/audit is being performed at the parent company (as determined in Step 1a above):	
(1) Auditors at the parent location should identify all Government subsidiaries with significant Government contracts and cognizant DCAA offices.	
(2) If the parent “sweeps cash” through a cash management plan, request a copy of that plan to include any policies and procedures related to how transfers of cash surpluses or coverage of subsidiary cash deficits are accounted for (i.e., inter/intra accounts receivables established and related liabilities, bank accounts used, identified transactions between the parent and the Government subsidiary(ies)) detailing the net cash transferred to the parent or the net cash transferred to the subsidiary(ies) over the past three years.	
f. Review permanent files.	

(1) Review the results of prior accounting system surveys and results of related audits.	
(2) Obtain financial statements for the last three years. The audit request should include the contractor's financial statements for the past three years and the 12-month cash flow forecast reflecting the proposed installment amounts.	
(3) Review the most recent financial condition information obtained from the contracting officer.	
(4) Review any audit leads, including the results of any internal/external audit work in this area, and any audit leads of financial problems. Auditors at parent offices with multiple subsidiaries should survey auditors at all Government locations to identify any unfavorable or adverse events, if deemed necessary.	
(5) Obtain the mix of Government and commercial business.	
(6) Document a sufficient understanding of internal controls that is material to reporting the contractor's financial capability in order to plan the audit and design procedures to achieve the audit objectives.	
g. 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.	
h. 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. 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) Communication among audit team members about the risk of material misstatement due to fraud should continue as needed throughout the audit. Principle Sources of Fraud Indicators: • Handbook on Fraud Indicators for Contract Auditors, Sections I and III, (IGDH 7600.3, APO March 31, 1993) located at: h http://www.dodig.mil/PUBS/igdh7600.doc. • CAM Figure 4-7-3. (To access the fraud handbook, copy and paste the web address shown above into the address block in Internet Explorer.)	
i. If the company is not publicly held, request the contractor to provide written confirmation that the financial statements provided during the financial condition risk assessment disclose all off-balance sheet arrangements and related party transactions. A proforma letter requesting contractor confirmation on the financial statements is included in the Administrative section of the APPS entitled 31 - Confirmation Letter - Financial Statements.	
j. If the company is not publicly held, and the contractor states that all off-balance sheet arrangements and related party transactions are not reflected in the financial statements and/or cash flow forecast, request the contractor provide a schedule separately showing (1) the maximum liability included in the financial statements and cash flow forecast and (2) the maximum liability not reflected in the financial statements and cash flow forecast for off-balance sheet arrangements and related party transactions.	
k. Publicly held companies are required to disclose details regarding off-balance sheet arrangements under a separately captioned subsection of the “Management’s Discussion and Analysis” section of the quarterly and annual U.S. Securities and Exchange Commission (SEC) filings. Review the appropriate section of the SEC filings.	
l. The contractor should be requested to provide:	
(1) Any inquiries from their independent public accounting (IPA) firm related to off-balance sheet arrangements and related party transactions and their responses.	
(2) The results and reports of any internal audits, reviews or other	

analyses of off-balance sheet arrangements and related party transactions.	
m. Prepare a list of data required for the audit and provide to the contractor when establishing the entrance conference date. Conduct an entrance conference with the contractor in accordance with CAM 4-302. Key company executives should be invited to attend the conference.	
n. During the entrance conference, ask the contractor if there are any significant events that have occurred or may occur in the near future (sale of a division, loss of a contract, large layoff, new contract, buying larger plant, etc.).	
o. Issue a notification letter to the contractor regarding the audit in accordance with CAM 4-302.3.	
p. Document any significant or unfavorable events that would impact the contractor's financial status (loss of a contract, major layoff, sale of a division, etc.). The existence of this type of information may be contained within the permanent files, audit lead sheets, business system audits, local newspaper articles, or obtained through discussions with the contractor, supervisor, or auditor that normally works at the contractor location.	
2. **Risk Assessment**	
a. Obtain preliminary data and information.	
(1) Review the previous risk assessment.	
(2) Based on the circumstances, tailor the following audit to perform the assessment.	
(a) Gather the information needed to perform or update the risk assessment. If not already in the permanent files obtain:	
(i) annual financial statements and/or annual reports for the last three years, plus year-to-date financial information for the current year. The contractor's financial statements for the past three years should be provided by DFAS in its request for audit; [Note: Caution should be used when using current year data representing a period of less than six months. It may not be representative to use as a basis to assess the contractor's current financial condition. Additional analysis should be performed when less than six months of current year data is obtained.]	

(ii) current Form 10K and 10Q (required SEC annual and quarterly filings for publicly traded companies);	
(iii) tax returns for non-publicly traded companies to validate unaudited financial statements; and	
(iv) external credit ratings.	
(b) Request the contractor to provide any analyses it has performed to assess its current and future financial condition. Ask the contractor to provide details on prior, current, and forecasted events that have had or are forecasted to have a favorable or unfavorable impact on its financial condition.	
b. Internal Controls. The auditor should consider the contractor's internal control structure relating to financial planning and monitoring and its cash management plan. Review applicable business system audits (or the ICQ for non-majors) to determine if any internal control deficiencies have been identified that impact this audit. Some of the key controls are:	
(1) written policies and procedures that require evaluation of current financial conditions in order to anticipate and avoid unfavorable or adverse conditions;	
(2) periodic assessments of accounts payable and receivable, including analysis of accounts payable aging and the collectability of accounts receivable;	
(3) periodic assessments to ensure compliance with any loan covenants and debt payment schedules;	
(4) preparation of cash flow forecasts, including reasonable and supported assumptions;	
(5) monitoring, analyzing and managing its cash flow; and	
(6) periodic assessments of contract cost performance.	
c. Trend Analysis of Key Financial Ratios.	
(1) Use the contractor's financial statements obtained in step 2.a.(2)(a)(i) above to compute the ratios for the most recently completed fiscal year and the previous two fiscal years. An electronic workbook that calculates financial ratios is included in the OAG section of the APPS entitled Financial Capability Workbook. If compelling reasons exist to question the financial statements, or the statements are unaudited, then the auditor should perform additional steps to verify the financial information prior to computing the ratios (e.g., compare key	

financial statement amounts (total assets, total liabilities, etc.) to the general ledger or tax returns to validate data in the unaudited financial statements). The audit report should be qualified if the financial statements are unaudited.	
(2) Request from the contractor any additional ratios that the contractor believes may be a better indicator of its financial condition. Consider using such ratios.	
(3) Review the trends of the contractor's key ratios. If consistent unfavorable or adverse trends are noted for the most recent three year period, obtain from the contractor an explanation for the unfavorable or adverse trends and any actions being taken to improve the conditions. Sometimes a change in accounting practice or an unusual accounting method, such as an inventory valuation method, will explain the variance.	
d. Trend Analysis of Key Financial Statement Elements	
(1) Review the trends of the following financial statement elements for the most recently completed fiscal year and the previous two fiscal years. If consistent unfavorable or adverse trends are noted, obtain and verify any explanation from the contractor and any actions being taken to improve the conditions.	
• Profit/Loss • Sales • Cash Flow from: o Operating activities o Investing activities o Financing activities • Working Capital • Net Worth • Long-term Liabilities	
(2) The notes to the financial statements and/or the SEC filings (10K and 10Q) should be reviewed for any conditions or statements that may indicate financial risk requiring further inquiry/review. Determine if there is a going concern comment in the most recent financial statements. If so, this is a high risk indicator that requires further analysis.	
e. Off-Balance Sheet Arrangements and Related Party Transactions The auditor should review the information provided by the contractor, as well as information contained in the quarterly and	

annual SEC filings (if a publicly traded company) to determine if the financial statements disclose the maximum liability of off-balance sheet arrangements and related party transactions. A list of indicators that identifies the existence of related parties, entitled Potential Related Party Indicators, is included in the OAG section of the APPS and should be used to assist in identifying situations that would indicate related party arrangements.	
(1) Review for audit leads any inquiries from the contractor's IPA related to off-balance sheet arrangements and related party transactions and the contractor's response to these inquiries.	
(2) Compare for consistency the contractor's response to IPA inquiries concerning off-balance sheet arrangements and related party transactions to the contractor's disclosures in the confirmation letter. Follow-up any inconsistencies with the contractor.	
(3) Review for any audit leads the results and reports of any internal audits, reviews, or other analyses of off-balance sheet arrangements and related party transactions.	
(4) Verify that the contractor-prepared schedule (for nonpublicly held companies) identifying the maximum possible liability for each disclosure of off-balance sheet arrangements and related party transactions is based on sufficient, competent, evidential matter, which should be reconciled to the contractor's supporting documentation for each liability.	
f. Timely Payment of Payroll Taxes.	
Determine if the contractor is paying its payroll taxes on a timely basis (CAM 14-304h). [Note: Contractor delays or the nonpayment of payroll taxes may affect the allowability of claimed and billed costs and should be promptly discussed with the Supervisory Auditor.]	
g. Analysis of Parent Company's Management of Subsidiary's Cash.	
(1) Review and assess the parent's administration of its cash management plan. This includes reviewing the contractor's processes, controls, procedures and management reporting mechanisms used for ensuring that the cash needs of any subsidiary with Government contracts are being met. In situations where the parent has not guaranteed the performance of the subsidiaries, perform additional analysis of the corporation's cash management plan and assess the following:	
(a) whether a subsidiary with Government contracts is a consistent generator or user of cash to/from the parent;	
(b) how often subsidiary needs cash from the parent;	

(c) the significance of the funds being used by the subsidiary;	
(d) how such funds are being accounted for, e.g., liabilities, reduction of equity; and	
(e) parent actions taken or planned (based on its cash management plan) to support the financial needs of the subsidiary that is consistently using cash from the parent.	
(2) If analysis of the cash management plan and/or data discloses financial distress at a subsidiary with Government contracts, (and the contractor has not guaranteed or taken other actions to financially support the subsidiary's performance) determine whether assistance from the subsidiary is considered necessary. Consider requesting from the subsidiary auditors data which may not be available at the parent location, e.g., accounts payable aging, identification of loss contracts, local ACO inquiries, knowledge of other financial distress indicators.	
h. Analysis of Parent Data by Subsidiary Auditors.	
These risk assessment steps should be performed when the risk assessment/audit is being performed at a subsidiary.	
(1) If the parent is a public company, the auditor should use the financial data under Filings & Forms (EDGAR) presented on the SEC website (www.sec.gov). The auditor will rely upon this published contractor financial data to determine if there are indicators of financial distress at the parent location.	
(a) Note the type of audit opinion being rendered on the financial statements by the IPA;	
(b) other comments/notes contained in the published financial statements; and	
(c) any going concern comment (SAS 59) made by the IPA.	
(2) If the parent is a nonpublic company, the auditor should normally not pursue access to the financial records of the parent company unless (1) total Government dollars at the subsidiary location(s) are significant, (2) the parent sweeps cash or guarantees the subsidiary's performance, <u>and</u> (3) the auditor has indicators of potential financial distress of the parent. Unless all three of these key elements exist, auditors will only perform a risk assessment and/or audit at the subsidiary location.	
i. Other Indicators.	
(1) Low bond/debt ratings or declining trends may signal problems for the company in obtaining cash outside of normal operations. Where a conflict exists between external bond/debt ratings	

(especially high bond/debt ratings) and other risk assessments, the auditor should ascertain and evaluate the reason for the conflict. Bond/debt ratings may not be indicative of a company's ability to perform on contracts, and may not consider all information available to the auditor.	
(2) Discuss any plans the contractor may have to enter into significant leases, make significant capital expenditures, liquidate assets, borrow significant cash or restructure existing debt, reduce or delay expenditures, and increase ownership equity. Verify accuracy of decisions to supporting data.	
(3) Identify and analyze any unusual compensation packages used to retain employees or outstanding loans to other company operations or company officers that would drain financial resources from an operating unit with Government contracts.	
(4) Be alert to any other potential considerations that may warrant more analysis in the risk assessment or expansion to any audit. These items may be identified by the customer, company employees, other auditor or other sources. These may include: • Borrowing from or under-funding pension plans, • Non-payment of insurance premiums or under-insurance, or • Poorly maintained infrastructure (i.e., facilities, accounting software, etc.).	
j. Summarize the results of the detailed risk assessment. Proceed to the detailed audit steps in this audit program beginning with Cash Flow Forecasts (section C-1).	

C-1	**Cash Flow Forecasts**
Version 7.1, dated June 2012	**W/P Reference**
1. Obtain Data and Other Information	
This section of the audit program focuses on financial capability and includes an evaluation of the forecasted cash flows and related information. Obtain the following information from the contractor to proceed with the audit:	
a. A cash flow forecast with supporting rationale covering at a minimum a one year period. The cash flow forecast reflecting the proposed installment amounts should be provided by DFAS in its request for audit. [Note: the FAO's audit opinion must reflect a	

cash flow forecast of no less than six months from the date of the audit report.]	
b. The current fiscal year operating budget, including each contractor division.	
c. The capital acquisitions budget for the next three years.	
d. Accounts payable aging schedules for more than one period.	
e. Accounts receivable aging schedules for more than one period.	
f. Copies of any loan covenants/agreements.	
g. Status of any outstanding lines of credit.	
h. Debt/Bond payment schedules.	
i. Pending/potential claims and the status of any legal proceedings, investigations or any potential recoveries of losses.	
j. Current Board of Directors Minutes.	
k. Current sales backlog and new contract awards.	
l. Corporate guarantees, if applicable.	
m. Subordination agreement, if applicable.	
n. Any updates to status of any unfavorable or adverse conditions noted during the risk assessment.	
o. Written Confirmation Letter and Other Information. Request the contractor to provide written confirmation that the cash flow forecast provided during the financial capability audit includes liabilities associated with off-balance sheet arrangements and related party transactions. A proforma letter requesting contractor confirmation on the cash flow forecast is included in the Administrative section of the APPS entitled 31 - Confirmation Letter – Cash Flow Forecast. In addition to the written confirmation, the contractor should also be requested to provide:	
(1) A schedule separately showing (i) the maximum liability included in the financial statements and cash flow forecast and (ii) the maximum liability not reflected in the financial statements and cash flow forecast when the contractor states that the maximum liability for off-balance sheet arrangements and related party transactions is not reflected in the financial statements and/or cash flow forecast.	
(2) Any inquiries from their IPA related to off-balance sheet arrangements and related party transactions, associated with these statements, and their responses to these inquiries.	
(3) The results and reports of any internal audits, reviews or other	

analyses of off-balance sheet arrangements and related party transactions related to these statements.	
2. Review of Cash Flow Forecasts	
The cash flow forecast should be evaluated by the auditor for reasonableness and the contractor’s ability to make the installment payments. The evaluation of the cash flow forecast will form the basic framework for the auditor’s opinion on the contractor’s financial capability. The auditor needs to have a reasonable basis to assure that the contractor will have sufficient sources of cash to perform on Government contracts and to make the installment payments.	
a. Evaluate the contractor’s cash flow forecast.	
(1) If the forecast is presented in the form of a statement of cash flows, verify the key amounts to the forecasted income statement and balance sheet. Verify that the cash flow forecast reflects the proposed installment agreement amounts.	
(2) Compare significant cash flow line items to actual historical balances. Determine if sales or production forecasts and related operating costs are consistent with recent financial statement trends and evaluate supporting assumptions.	
(3) Verify that projected sales agree with the contractor's annual financial plan and indirect rate forecasts. A list of projected sales or sources of cash, by contract, should be reviewed by the auditor and verified to contract data on a sample basis. Any contracts in a loss position should be carefully reviewed to determine the extent to which any additional billings might be made. Assist audits may be required at organizations with multiple divisions or subsidiaries.	
(4) Other significant sources of cash should be identified by the contractor and verified by the auditor. Any projected collection of outstanding claims or unliquidated contract balances should be verified with the appropriate agency. If a significant projected source of cash is due to a planned liquidation of accounts receivable, confirmations may be required to the extent they were not audited by independent auditors. Contact the ACO prior to confirming accounts receivable balances outside the Government. If the ACO requests that receivables not be confirmed, qualify the report accordingly. Only the difference between the beginning and ending balance represents a source of cash.	
(5) Determine if the contractor's ability to achieve its cash flow	

forecast is dependent on the favorable outcome of one or a few key event(s). If so, the circumstances and chance of occurrence should be reviewed.	
(6) Verify projected uses of cash to the contractor's annual financial plan and forecasted indirect rate submission. Review the contractor's production schedule to determine if the variable uses of cash, such as material purchases and payroll (headcount), are adequate to support performance assumptions.	
(7) Verify that all interest and principal payments on any debt, loans, or lines of credit are considered in the forecast.	
(8) Determine if the cash flow forecast considers any unfavorable or adverse conditions that have already been identified in the auditor's review of existing financial conditions.	
(9) Compare previous cash flow forecasts with actual statements of cash flows to determine the reliability of past forecasts.	
(10) Determine whether the contractor has the financial means to meet ongoing costs of operations in the near term.	
(a) Routine borrowings against a line of credit that do not consume most of the line of credit are not a condition that should be considered financial distress. However, a projected shortfall in meeting short term obligations may require obtaining cash from outside the normal course of operations by means of extraordinary management actions (such as liquidation of assets, significant loans, or sale of stock) which is considered financial distress.	
(b) If a significant shortfall is not projected, but cash flows are dependent on significant conditions or events for which there is significant doubt (such as optimistic sales of a new product, anticipated contract awards, or a negative cash flow due to a pending contingent liability), the contractor would also be considered to be in a condition of financial distress.	
(11) Using the contractor-prepared schedule identifying the maximum possible liability for off-balance sheet arrangements and related party transactions, inquire of the contractor if any of the liabilities will become due in the near term (one year or less). If any are, verify that these cash outflows are reflected in the contractor's cash flow forecast.	
b. While examining the contractor's financial statements and cash flow forecast, if in the auditor's judgment the contractor has other financial means of making the total lump sum payment to DFAS, these financial means should be disclosed in the report. This	

would be valid only if the current financial condition is acceptable and the lump sum payment can be made without changing the financial condition to unfavorable.	

D-1	**Liquidation Of Accounts Payable**
Version 7.1, dated June 2012	**W/P Reference**
The auditor should determine if the contractor is liquidating accounts payable on a timely basis by reviewing the contractor's accounts payable aging schedule. Obtain a copy of the contractor's policy regarding liquidating accounts payable. For a multidivisional corporation with a decentralized accounts payable function, the auditor may need to request assist audits of segments/divisions with significant accounts payable balances.	
1. Verify the accounts payable aging schedule for more than one period to supporting accounting records (e.g., general ledger). Contractors may have the ability to manage accounts payable through various computer sort programs. When account balances are significant and the contractor does not prepare an aging schedule or similar analysis, the contractor should be asked to perform such analysis. If the contractor refuses, the auditor should report this absence of normal financial management and budgetary controls as a significant internal control weakness. The auditor will then consider evaluating liquidation of accounts payable by such audit procedures as statistical sampling and use of the IT retrieval software (e.g., SAS and FOCUS).	
2. Compare debt cancellation dates with cancelled checks on a sample basis to determine if any checks are being held.	
3. Evaluate the number of days outstanding. Any significant deviation from the contractor's policy should be explained. Significant payables over 90 days should also be explained by the contractor. Determine if the reason for slow liquidation of payables is due to inadequate available cash.	

E-1	**Loan Covenants**
Version 7.1, dated June 2012	**W/P Reference**
Review the contractor's loan agreements and covenants to determine if the contractor is complying with all of the conditions of the loan such as maintaining established ratios.	
1. Request the contractor to provide a historical analysis of the	

established ratios. Verify calculations. If the ratios are not being monitored by the contractor, the auditor should report this as a material internal control weakness.	
2. If the loan covenants or financial ratios are not being met, determine if they have been waived by the financial institution.	
3. Review the debt payments schedules. Verify that historical payments have been made on a timely basis. Note future payment requirements for verification during the contractor's cash flow forecast.	
4. Verify that the contractor properly classifies any lines of credit as short/long-term since the improper classification would affect the calculation of some financial ratios.	
5. Review the interest rate charged by the lending institution. An increase in the rate charged significantly above the prime rate could be attributable to perceived contractor financial distress.	
6. Review loan/line of credit to determine if they are secured by collateral. If the contractor receives progress payments, and collateral includes inventory/work-in-process, determine if a subordination agreement is necessary.	

F-1 Bankruptcy	
Version 7.1, dated June 2012	**W/P Reference**
Determine if the contractor has filed a petition for reorganization with the Bankruptcy Court or if any legal proceedings have been initiated by vendors for payment. [This condition gives rise to significant uncertainty as to the contractor's ability to adequately perform on Government contracts.] If the contractor has filed for bankruptcy:	
1. Determine if the ACO has been notified of any petition for bankruptcy. If not, provide written notification to the ACO immediately, and provide copies to the Regional Special Programs Office and Headquarters, Attention PPD.	
2. Determine what legal provisions exist and obtain the required financial information to ascertain the company's continuing financial capability.	
3. Determine if the installment payment amount is included in the bankruptcy reorganization plan.	
4. If the installment plan is not included in the bankruptcy reorganization plan, determine the contractor’s ability to make the installment plan payments.	
5. Consider qualifying the audit report regarding the bankruptcy	

proceedings.	

G-1	**Other Potential Conditions**	
Version 7.1, dated June 2012		**W/P Reference**
1. Determine what the contractor did with the overpayment and why it is currently not available to return it to the Government.		
2. Determine where the money owed to DFAS is recorded and when it was recorded. Ensure that a portion of the debt is recorded as a long term liability if the installment agreement is for greater than 12 months.		
3. Other potential conditions that must be considered include:		
• Litigation		
• Unusual agreements with the Internal Revenue Service		
• Vendor requirements for Cash or Delivery payments		
• Production delays		
• Contract overruns		
• Labor disputes, etc.		

H-1	**Financial Flexibility**	
Version 7.1, dated June 2012		**W/P Reference**
If the above steps do not disclose financial distress, completion of this section is not required.		
1. Determine if the contractor has any plans to minimize the effects of a forecasted insufficient cash flow. Such extraordinary management actions may involve any or all of the following:		
• Company reorganization/downsizing • Restructuring of debt • Liquidation of assets • Additional borrowings • Reduced or delayed expenditures • Increased ownership equity		

• Reduced dividends • Sale of a portion of the company	
2. Review the following indicators in order to determine the extent of the contractor's ability to obtain additional cash:	
a. Net worth (Assets - Liabilities). Companies with no or little net worth have a difficult time attracting additional investment. Lines of credit or additional borrowings are often guaranteed by officers' and/or shareholders' personal assets.	
b. Current Outside Ratings. Companies with high debt/bond/stock ratings may be able to raise additional cash through the issuance of additional debt, bonds, or stock. However, it should be noted that such ratings are only for existing debt, bonds, and stock. The company's ability to meet new interest, principal and/or dividends must be evaluated.	
c. Liquidation of Assets. In order to raise cash, a company may sell existing assets. It is important to determine that such assets are not secured and are not pertinent to the continued operations of the company. Determine any direct or indirect effects of any planned disposition on Government contracts. The sale of assets that are secured often does not provide additional cash. However, it may favorably impact the debt to equity ratio, the cash flow to debt ratio, and reduce debt service costs.	
d. Bank Line of Credit/Loan Covenants. Covenants should be reviewed to determine if the contractor is in compliance with the terms of the agreement, including maintenance of established minimum account balances and ratios. Determine if the credit line is guaranteed by another individual or corporation. If operating losses continue, such guarantees may be withdrawn, thereby eliminating existing lines of credit. Also, determine the amount of credit currently outstanding, amounts available, and terms of repayment on current balances.	

A-1	**Concluding Steps**	
Version 7.1, dated June 2012		**W/P Reference**
1. Summarize the results. Select and use an opinion paragraph verbatim from CAM 14-307a. Following the opinion, it may be appropriate to include additional detail that addresses the specific contractor situation. For example, there may be improving or worsening conditions. There also may be mitigating		

circumstances such as the lack of progress payments. Prepare and submit a draft audit report for review, based upon the format in CAM 10-1200.	
2. Obtain, as necessary, regional approval of draft report.	
3. Report separately, in flash report format, any internal control deficiency found during the audit.	
4. After supervisory review, coordinate preliminary results with DFAS and the ACO. If the issues warrant, invite the ACO to attend the exit conference.	
5. Hold an exit conference with contractor and provide a draft copy of the audit results for contractor written comment. Significant issues should have already been discussed with the contractor during the audit. Allow a reasonable time for the contractor's written response. Top level contractor management should be involved in the exit conference if sensitive issues are going to be discussed or the draft report states there is some doubt regarding the contractor's ability to perform on Government contracts or to make its installment payments.	
6. Prepare final report incorporating the contractor's response.	
7. The report should be addressed to the requestor at DFAS thru the DCMA FCG. Include on distribution the DCAA FLA at DFAS Columbus, and all cognizant DCAA offices. Include a transmittal letter advising that the report contains sensitive information and should not be released outside of DCAA.	
8. Update permanent files (MAARs #1, #3, and #4 (if applicable)).	