

Activity Code 17741	Post Award Accounting System Audit at Nonmajor Contractors
Version 2.5, dated June 2012	
B-1	Planning Considerations
<p>To provide general guidance for the audit of the adequacy and suitability of nonmajor contractor accounting systems and practices for accumulating and billing costs under Government contracts. An accounting system is adequate if its procedures are adequate to protect the Government's interest, and is suitable if it is in substantive compliance with CAS (This is true whether or not the contractor is CAS-covered since CAS 401, 402, and 405 are incorporated into FAR). This program is intended to be used for the performance of accounting system audits at nonmajor contractors subsequent to contract award. Accounting system surveys performed at the request of a contracting officer to determine the adequacy of the accounting system for a prospective contract should be performed under Preaward Surveys at Nonmajor Contractors.</p>	
<p>The audit should be directed to determining the adequacy of the accounting system for segregation and billing of costs as required by the contractor's contracts. Update the internal control questionnaire (ICQ) as appropriate. Audits of accounting system internal control for nonmajor contractors are generally not required, unless the risk warrants an audit. The audit steps performed in this audit program are not sufficient to provide a basis to opine on the key control activities and objectives that comprise an audit of internal control, i.e., completion of this program will generally NOT justify a control risk assessment of less than maximum. If the auditor determines that an audit of internal control is required, DMIS Activity Code 11010 should be used for a billing system audit and 11070 for an accounting system audit.</p>	
<p>The major objective of the post award accounting system audit is to determine if the contractor's accounting system is adequate for accumulating and billing costs on Government contracts. Obtaining determinations of whether the contractor's financial condition is adequate for the performance of the contract is the responsibility of the contracting officer. If auditors are alerted to information that may indicate unfavorable or adverse financial conditions that could impede a contractor's ability to perform on Government contracts, they should immediately communicate those concerns/risk factors to the appropriate administrative contracting officer and adjust the audit scope and associated audit procedures accordingly.</p>	
<p>This audit program can be used for effort expended to audit accounting systems at contractors who have no flexibly priced contract work, but do have a significant price proposal workload. This audit program should be tailored based on the risk assessment to evaluate the contractor's system for adequacy and determine if the accounting system provides for reliable historical cost data (e.g., reasonably compliant with FAR and CAS) to support contractor estimates for forward pricing. When appropriate, the auditor may wish to include additional audit tests to determine the effectiveness of the contractor's controls. This may involve only the system that pertains to particular cost elements, or to all cost elements, depending on the significance of the cost. Audit programs for activity codes 11070 and 24010 may be referenced for assistance in developing appropriate tailored audit steps.</p>	

References
1. CAM 6-1007.3, “Criteria for Adequate Billing Systems – Nonmajor Contractors”
2. FAR 31.2, “Contracts with Commercial Organizations”
3. FAR 52.216-16, “Quarterly Limitation on Payments Statement” (FPI contracts); FAR 52.232-20, “Limitation of Cost;” FAR 52.232-22(b), “Limitation of Funds.”
4. CAM 14-300, “Assessing A Contractor’s Financial Capability”
5. CAM 5-200, “Preaward Surveys of Prospective Contractor Accounting Systems and Post Award Accounting System Audits”

B-1	Preliminary Steps	
Version 2.5, dated June 2012		<u>WP Reference</u>
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”		
2. Review audit request, if applicable, for matters of particular interest to acquisition officials. Contact the contracting officer to ascertain any known concerns that will impact the audit and adjust the audit scope and associated audit procedures accordingly. During this discussion, auditors are to obtain financial condition information from the CO for risk assessment purposes. In those situations where information regarding the contractor’s financial condition is not available from the CO, the auditor, at a minimum, should perform a trend analysis of the contractor’s key financial statement elements following the guidance in CAM 14-300 when documenting consideration of inherent risk.		
3. 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.		
4. Review permanent files and consider the impact of the following on the scope of this audit:		

a. prior accounting system reports/surveys,	
b. results of other related audits (e.g., proposal audits, financial condition risk assessment/audit, etc.),	
c. currency of labor and material audits,	
d. Internal Control Questionnaire (ICQ) data, (and relevant business systems information) if applicable.	
e. The amount of Government contracts by contract type.	
5. 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.	
6. Obtain a current organization chart.	
7. Obtain a current Chart of Accounts with descriptions of charges, which can be made to each account (Text of Accounts).	
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. 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:	

<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>	
<p>9. Conduct and document the results of the entrance conference as outlined in CAM 4-302, with particular emphasis on:</p>	
<p>a. Any changes in the accounting system processing job stream since the last audit.</p>	
<p>b. The contractor’s monitoring process to ensure that established manual and computerized controls are functioning as intended.</p>	
<p>c. Any identified weaknesses or reported internal control deficiencies and related follow-up actions taken by the contractor.</p>	
<p>d. Issue a notification letter to the contractor regarding the audit in accordance with CAM 4-302.3.</p>	
<p>10. Using the information obtained in the above steps, prepare an initial risk assessment to determine the scope of the audit (W/P B).</p>	

C-1	Adequacy of Accounting System for Accumulating and Segregating Costs	
	<u>WP Reference</u>	
<p>Version 2.5, dated June 2012</p> <p>To determine that the contractor’s accounting system is adequate for accumulating and segregating costs, use the following steps (expand as necessary depending on the risk assessment).</p>		
<p>1. Generally Accepted Accounting Principles. Verify that the contractor’s accounting system is in accordance with GAAP. Determine if the contractor has an accrual basis accounting system.</p>		
<p>2. Proper segregation of costs. Verify that controls exist to preclude direct charging of indirect expense and indirect charging of direct contract costs.</p>		
<p>3. Direct costs by contract. Verify that the contractor has either a subsidiary job cost ledger or account receivable ledger which accumulates costs by contract.</p>		
<p>4. Accumulation of costs under general ledger control. Verify that the contractor’s job cost ledger and other books of account are reconcilable and currently posted to the general ledger control</p>		

accounts.	
5. Interim determination of costs. Determine that the contractor posts contract costs at least monthly to books of account	
6. Direct Labor. To the extent possible, the auditor should rely on the results of a floor check audit in determining the effort needed to be performed under steps (a) through (c) below. If a floor check audit is scheduled for the current fiscal year, the auditor should consider performing it concurrently with this audit. The auditor should consider performing the following steps in conjunction with audit step D.3. (i.e., tracing costs billed to source documentation).	
a. Document the understanding of the contractor's procedures for accumulating and billing labor costs. This includes the procedures for timekeeping, and processing payroll and labor corrections/transfers.	
b. Timekeeping system. Verify that labor is charged to intermediate and final cost objectives based on timekeeping documents (paper or electronic timecards) completed and certified by employees and approved by employee supervisors.	
c. Labor distribution. Verify that labor cost distribution records are reconcilable to payroll records and that labor distribution records trace to and from the cost accumulation records in labor subsidiary or general ledger accounts.	
7. Direct Material. To the extent possible, the auditor should rely on the results of a Purchase Existence and Consumption audit in determining the effort needed to be performed under steps (a) through (e) below. If a Purchase Existence and Consumption audit is scheduled for the current fiscal year, the auditor should consider performing it concurrently with this audit. The auditor should consider performing the following steps in conjunction with audit step D.3. (i.e., tracing costs billed to source documentation).	
a. Document the understanding of the contractor's procedures for accumulating and billing direct material.	
b. Verify that direct material is charged to final cost objectives. Trace a sample of direct material charges to supporting documentation (e.g., purchase order, receiving report, invoice, and payment.)	
c. Verify that direct material is needed for the contract. Trace sampled items to supporting documentation that identifies the contract to which the sampled items will be charged (e.g., bill of material.)	
d. Evaluate procedures in place for assuring prompt payment to vendors; accounting for discounts taken/lost; and calculating the accounts payable turnover in days (or other procedures which	

ensure obligations are paid when due).	
<p>e. Evaluate the procedures on items issued from inventory:</p> <p>(1) Can they be traced to issuance documents?</p> <p>(2) Are they priced in accordance with contractor's disclosed practices?</p> <p>(3) Are they issued for current use rather than for intermediate holding?</p>	
<p>8. Indirect Costs.</p> <p>a. Document the understanding of the contractor's procedures for accumulating and billing indirect costs.</p> <p>b. Verify that indirect costs are accumulated in logical groupings and determine that the groupings are allocated based on benefits accrued to intermediate and final cost objectives.</p> <p>c. Verify that interim indirect expense rates can be readily calculated from the books of accounts, and that the interim rates are routinely monitored.</p> <p>d. Verify that the cost accounting system is formally documented, with a written description of the contents of bases and pools.</p>	
<p>9. Exclusion of unallowables. Verify that the cost ledgers identify expense categories in sufficient detail to isolate unallowable costs. Evaluate the adequacy of the contractor's procedures for identification and exclusion of unallowable cost (FAR 31.201-6).</p>	
<p>10. Costs by contract line item. Verify that the contractor's accounting system accumulates costs at the requisite level of detail, as required by the contract terms and conditions.</p>	
<p>11. Pre-production costs (applies primarily to manufacturing contracts). Verify that these costs are routinely segregated to assist in repricing or follow-on contract pricing.</p>	
<p>12. Verify that the contractor's system produces cost information at a sufficient level of detail for use in pricing follow-on contracts.</p>	

D-1	Adequacy of Billing System for Preparing Reimbursement Claims	
Version 2.5, dated June 2012		<u>WP Reference</u>
To determine that the contractor's billing system procedures for preparing cost-reimbursement claims are adequate (CAM 6-1006), use the following steps (expand as necessary depending on the risk assessment).		
1. Limitation of costs. Verify that total contract expenditures against		

contract limitations on price or cost are monitored and updated on a periodic basis. Verify that controls are in place to ensure compliance with the reporting requirements of FAR 52.216-5, -6, -7, -16, and -17 or FAR 52.232-20 and -22.	
2. Verify that the contractor is up to date on its submission of incurred cost proposals in accordance with contract terms. (FAR 52.216-7(d)(2)).	
3. Verify indirect costs are billed at approved rates (or rates specified in the contract) at the time of voucher/invoice submission by evaluating a sample of vouchers/invoices (public vouchers and progress payment requests) submitted within the past year and evaluating a current contractor billing. (CAM 6-1006) If the contractor does not have indirect billing and/or bidding rates, obtain a submission. If the rates have not been approved (FAR 42.704), evaluate the reasonableness of the submitted rates.	
a. Verify that the rates are acceptable for billing purposes. Reference the working paper package where the rates were evaluated.	
b. Verify that the rates have been adjusted for voluntary deletions and historic unallowable costs.	
c. Verify that the rates are consistent with:	
(1) The contractor's budgetary data (if supported by cost element detail)	
(2) The actual rates for the last completed fiscal year	
(3) The year-to-date experienced rates in the current year	
d. Verify that the contractor adjusts billing rates to reflect actual yearend allowable rates. At the end of the contractor's fiscal year, the contractor should compare the recorded allowable rates to the billing rates to determine if billing rates should be adjusted. If there is a significant difference, billings should be adjusted to reflect either the additional amount due the contractor or credit due the Government.	
e. If billing rates are not consistent with c(1)-(3) and d above:	
(1) Determine whether the differences can be explained.	
(2) If the differences are both significant and unexplained, the contractor has a billing system deficiency which should be reported, and the auditor should develop appropriate rates.	
4. Verify/test that interim billings are either prepared directly from the cost accounting records or from other records which are reconciled to the cost accounting records by cost element for all cost-reimbursable	

<p>work. (For time and material and labor hour contracts, total labor costs billed will not reconcile to the contractor’s cost accounting records. Consequently, verify that (a) direct labor hours billed reconcile to the cost accounting records and (b) direct labor has been billed at appropriate contract rates.)</p>	
<p>5. Verify that billings can be reconciled to the cost accounts for both current and cumulative amounts claimed.</p>	
<p>6. Verify that the contractor has procedures to ensure compliance with FAR 52.216-7(b)(1)(ii)(A). Ensure that subcontractor and vendor costs are only included in billings if payment to the subcontractor or vendor will be made in accordance with the terms and conditions of the subcontract or invoice and ordinarily within 30 days of the contractor’s payment request to the Government. The contractor’s aging of accounts payable may be a key part of its procedures. To test the effectiveness of the contractor’s procedures, trace selected significant current costs on vouchers (e.g., material, subcontract, or ODC, etc) to cancelled checks or other evidence that identifies the date that the payment was made, or is planned to be made and the risk that contractor will not make the payment in the normal course of business is low. If the contractor is delinquent on payment, discuss with the contractor and require the contractor explain the circumstances. The contractor should be required to submit adjustment vouchers to deduct significant costs not paid from current billings. If the contractor does not submit adjustment vouchers, the auditor should issue a DCAA Form 1 in accordance with CAM 6-900 to suspend the costs and recover the overpayment.</p>	
<p>7. Determine that billings are based on current contract provisions. The total amount billed should not exceed any contract, work order, funding limitation, or any other contract ceiling amount. Identify controls which provide for review of contract billing provisions (see CAM 3-2S1), including but not limited to:</p>	
<p>a. Restriction of billing frequency.</p>	
<p>b. Special withholding provisions.</p>	
<p>c. Contractual unallowable costs.</p>	
<p>8. Verify that the contractor has procedures in place to ensure that interim vouchers include fixed fee and cost withholds in accordance with FAR 52.216-8 and 52.232-7, when appropriate.</p>	
<p>a. Verify that for cost-reimbursement type contracts, if required, the contractor withholds the fixed fee in accordance with contract terms until a reserve is set aside to protect the Government’s interest. The reserve should not exceed 15 percent of the total contract fixed fee or \$100,000 whichever is less. See FAR 52.216-8.</p>	

<p>b. Verify that for time and material and labor hour contracts, if required by the contract, the contractor withholds 5 percent of billable labor costs, not to exceed a total of \$50,000 per contract. See FAR 52.232-7.</p>	
<p>9. Test the contractor’s reconciliation of booked to billed costs. If the contractor’s reconciliation schedule shows significant overbilling at either the total or individual contract level, discuss with the supervisor the actions needed to resolve overbilling.</p>	
<p>10. Perform the following additional steps:</p>	
<p>a. From the sample of vouchers reviewed in step 3, determine that the vouchers are mathematically correct and error free. Verify that all columns have accurate totals showing the computation of the billed quantities and unit prices.</p>	
<p>b. Determine that the contractor is submitting final vouchers within 120 days after settlement of applicable final indirect costs rates as required by FAR 52.216-7(d)(5).</p>	
<p>11. If the contractor has been authorized to direct bill, determine whether the contractor should continue to be authorized to direct bill (see CAM 6-1007.3 for Criteria for Adequate Billing Systems – Nonmajor Contractors). Document in this audit the contractor’s continued eligibility for direct billing in accordance with CAM 6-1007.6 Contractor Continued Participation in the Direct Billing Program.</p>	

E-1	Internal Control Questionnaire (ICQ)	
Version 2.5, dated June 2012		<u>WP Reference</u>
<p>If applicable, complete/update the Internal Control Questionnaire (ICQ). Based on this update, identify other audit areas requiring evaluation to determine if the contractor’s accounting system is adequate for accumulating and segregating costs. Discuss the additional risk areas with the supervisor; add audit steps to address those risk areas, if appropriate.</p>		

A-1	Concluding Steps	
Version 2.5, dated June 2012		<u>WP Reference</u>
<p>1. Discuss results with supervisor.</p>		

2. Discuss findings and recommended corrective action with contractor representatives. Hold and document the exit conference.	
3. Follow up and resolve open or partially completed items and summarize audit results.	
4. Complete, index, and cross-reference W/Ps.	
5. Take appropriate action to effect correction of noted deficiencies. This may include additional evaluation under an assignment in another audit area, noncompliance or system deficiency reports, cost suspension or disapproval, etc.	
6. If the contractor has EVMS-covered contracts, provide comments in the audit report on whether any findings are likely to impact the contractor's EVMS (10-408.2f). Discuss findings and recommendations relating to the EVMS with the Contract Administration Office EVMS Monitor prior to issuance of the report. Immediately evaluate the impact of these findings on specific EVMS-covered contracts and provide the details in flash EVMS surveillance reports (11-203.5).	
7. Update the permanent file.	
8. If unsatisfactory conditions were noted, follow the guidance in CAM 4-800.	
9. Prepare draft report incorporating the contractor's comments and audit rejoinder.	