

Master Document – Audit Program

Activity Code 11070	Accounting System Audit
Version 1.7, dated April 2016	
B-01	Planning Considerations
Audit Specific Independence Determination	
<p>Members of the audit team and internal specialists consulting on this audit must complete the Audit Specific Independence Determination (w/p 34) prior to starting any work on this assignment.</p> <p><i>(Note: Because staff is sometimes added to on-going audits, supervisors should ensure that all individuals who are directing, performing audit procedures, or reporting on this audit as a member of the audit team who are performing as a consultant have signed this work paper. For example, an FAO may add additional auditors (e.g. FAO technical specialist) to the audit assignment or may need to consult with an internal specialist (e.g., industrial engineers, and operations research specialists) as the audit progresses.)</i></p>	
<p>1. The objective of this audit is to examine the contractor’s compliance with the system criteria for an acceptable accounting system as prescribed in DFARS 252.242-7006, Accounting System Administration. As a part of that objective auditors will:</p> <ul style="list-style-type: none"> • Obtain and document an understanding of relevant portions of the accounting system internal control over compliance sufficient to plan the audit and to assess control risk for compliance with the system criteria in DFARS 252.242-7006. • Report significant deficiencies/material weaknesses identified during the audit related to the contractor’s compliance with the system criteria in DFARS 252.242-7006, Accounting System Administration. 	
<p>2. Although, the objective of this audit is to determine the contractor’s compliance with the DFARS criteria and to report significant deficiencies based on the DFARS definition of a significant deficiency, GAGAS require auditors to include in the audit report material weaknesses based on the auditing standards definitions. A significant deficiency based on the DFARS definition will also generally represent a material weakness in internal control as defined in the auditing standards. Therefore, the term significant deficiency/material weakness as used throughout the audit program refers to a deficiency meeting the DFARS definition of a significant deficiency and the auditing standards definition of a material weakness.</p>	
<p>3. GAGAS also require auditors to report, based on the work performed, deficiencies, or a combination of deficiencies, in internal control that are less severe than material weaknesses (and, hence, also less severe than a significant deficiency as defined by the DFARS), yet important enough to merit the attention of those charged with governance (i.e., responsible contractor management officials). Auditors are not required to design audit procedures to identify these less severe deficiencies. However, if they are disclosed during the audit they should be included in the audit report. The accounting system audit report shell includes the appropriate language and presentation.</p>	

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	<p>4. <u>Controlling Assignment:</u> This assignment will serve as a controlling assignment for the audit of the contractor’s compliance with all 18 DFARS 252.242-7006 system criteria for an acceptable accounting system. Some of those criteria relate to sub-systems of the overall accounting system, such as billing and labor/timekeeping systems. Therefore, compliance with some of the criteria will be examined in separate assignments established specifically for that purpose (e.g., the Control Environment Audit covers DFARS 252.242-7006(c)(1) and 11010 Billing Audit covers DFARS 252.242-7006(c)(15)(i) and (16)). Other separate assignments, not established solely for that purpose, will also include procedures that can be used to test compliance with some of the criteria (e.g., labor (MAAR 6), material (MAAR 13), and other audits that test indirect and other direct cost transactions). To the extent possible, the applicable audit program steps refer to the other relevant audits. Those portions of this audit that are covered in other assignments will be referenced and/or incorporated at the appropriate place in this master assignment.</p>
	<p>5. This program can be used at major or non-major contractors. The steps in the program should be discussed by the audit team and tailored as applicable for your contractor/location. If the entity is a Non-profit, Federally Funded Research and Development Center (FFRDC) (excluding those operated by Educational Institutions), or State and Local Government, the auditor should modify the program below to include specific procedures in accordance with the OMB Circulars applicable to that entity. However, before performing this audit at one of these types of entities, coordinate with the cognizant agency for audit to determine the need for the audit.</p>
	<p>6. This program is designed to use a teaming approach that includes discussions among the audit team members regarding, for example, potential kinds of fraud and other noncompliances, and the major aspects of the audit (e.g., major accounting areas, understanding of the system, etc.). These discussions should generally include auditors from the offsite accounting locations. Due to the complexities of this audit, significant upfront coordination with the contractor is required. Therefore, the program also includes a planning meeting with contractor personnel prior to the formal entrance conference to notify the contractor of the upcoming audit and to inquire about the locations of the various accounting functions to determine if coordination with other DCAA offices is necessary. The planning meeting is also used to schedule the entrance conference and request that the contractor provide a general overview of the system at the entrance conference. Another important aspect of this audit is that the contractor provides detailed walk-throughs/ demonstrations of its system. The details of these meetings are presented in the preliminary steps of the audit program.</p>
	<p>7. Because of the importance of timely communication of deficiencies, in some cases, it may be appropriate to issue a deficiency report on a significant deficiency/material weakness on a real-time basis prior to completion of the audit. In those cases, a separate assignment should be set up using the Deficiency Report activity code. The Deficiency Report Assignment should not be established until there is sufficient evidence that a significant deficiency/material weakness exists and the elements of a finding for the deficiency are fully developed in this assignment (see CAM 10-409). Whether to issue a deficiency report during the course of the audit is a matter of auditor judgment, depending on the specific circumstances.</p>
	<p>8. This audit should generally be performed every three years (preferably in the first quarter of the fiscal year) or more often if risk warrants.</p>
	<p>9. Contractors that do not have DoD contracts (i.e., contractors that are 100 percent reimbursable)</p>

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<p>are not contractually required to comply with the DFARS criteria. Nevertheless, the DFARS criteria are suitable standards to use in determining the acceptability of any Government contractor’s system for the accumulation and billing of cost under Government contracts. If this audit program is used for contractors that have only non-DoD contracts, the language in the audit report shell will be need to be tailored accordingly. FAOs needing assistance in tailoring the audit report should coordinate with the region and Headquarters PAS.</p>	
Other Planning Considerations	
<p>Prior to commencing the audit, review guidance that may impact the audit and adjust the scope and procedures appropriately. Guidance to review includes CAM, open MRDs, FAQ training material, guidebooks, etc. available on the DCAA Intranet.</p>	
References	
DFARS 252.242-7006, Accounting System Administration	
CAM 5-100, Obtaining an Understanding of a Contractor’s Internal Controls and Assessing Control Risk	
CAM 5-300, Audit of Internal Controls – Control Environment and Overall Accounting Controls	
CAM -10-200, Audit Report Format and Contents	
CAM 10-409, Statement of Condition and Recommendations	

B-01	Preliminary Steps	W/P References
Version 1.7, dated April 2016		
1. Research and Planning		
<p>The audit report will report on the contractor’s compliance with the system criteria <u>during a period of time</u>, consistent with the attestation reporting standards (AT 601.55b). The audit should be planned and transactions selected accordingly. This planning must also consider the timing and period covered by other audits that will be incorporated into this assignment. The period covered should be selected so as to limit the elapse of time between the period of transactions tested and the issuance of the report to the extent possible. For example, the audit team may decide to wait until it has obtained and documented the understanding of the system before finalizing the period covered by the audit. The timing of some of the planning steps below may have to be adjusted accordingly.</p>		
a. Review permanent file and document:		
1) Audit leads and other issues impacting this assignment; e.g, Form 1s and fraud referrals (DCAA Form 2000) which have been made or are in		

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<p>process.</p>	
<p>2) Other relevant information to include environmental factors, the nature of the entity, and changes from the prior period. This information may be available in the contractor’s annual Form 10-K report, quarterly Form 10-Q report, Interim Form 8-K reports (if applicable - to cover special material events that occur between 10-K and 10-Q filings), and its annual report to shareholders.</p> <p>Note – (Not all of the following examples will be relevant in each audit. Auditors should document information relevant in the specific circumstances based on a review of the permanent files and the sources discussed in the paragraph above.) Environmental factors include industry conditions, such as the competitive environment, supplier and customer relationships, and technological developments; the regulatory environment encompassing among other matters, relevant accounting pronouncements, the legal and political environment, and environmental requirements affecting the industry and the entity; and other external factors, such as general economic conditions. The nature of the entity refers to the entity’s operations, its ownership, governance, and the way the entity is structured. An understanding of the nature of an entity enables the auditor to understand the classes of transactions, and account balances. Identifying significant changes in the environment and entity from prior periods is important in gaining a sufficient understanding of the entity to identify and assess risks of material misstatements and noncompliances.</p> <p>Note: Similar information may have been obtained in other audits (e.g., billing audit). To avoid duplication of effort, auditors should incorporate any current and relevant information from those audits into this section.</p>	
<p>3) Review prior accounting system audits, (e.g., Control Environment and Overall Accounting System Audit (11070), Post Award Accounting System Audit at Nonmajors Contractors (17740 and 17741), flash reports, and limited scope audits related to the accounting system, etc.) and if applicable, the Survey of Contractor’s Organization, Accounting System and System of Internal Controls (ICQ) and document the impact to this audit.</p>	
<p>4) Determine if a Control Environment Audit for the period covered by this audit has been performed. If so, incorporate the MFR documenting the results of that audit so that it can be referenced in the applicable steps of this audit. If not, discuss with the supervisor. An audit of the contractor’s control environment must be performed in order to determine the contractor’s compliance with DFARS 252.242-7006(c)(1).</p>	
<p>5) Determine if a 11010 Billing Audit for the period covered by this audit has been performed. If so, incorporate the MFR documenting the results of that audit so that it can be referenced in the applicable steps of this audit. If not, discuss with the supervisor. An audit of the contractor’s</p>	

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<p>billings and related processes must be performed in order to determine the contractor’s compliance with DFARS 252.242-7006(c)(15)(i) and (16).</p>	
<p>6) Determine if a 11510 IT General System Controls Audit for the period covered by this audit has been performed. If so, consider the results of that audit in developing the procedures for this audit. If not, discuss with the supervisor the need to perform a separate assignment.</p>	
<p>7) Document results and impact of any other relevant audits on this audit.</p>	
<p>8) Document, if applicable, any CAS noncompliances that may impact the processes and internal control related to compliance with the DFARS criteria.</p>	
<p>9) Review permanent file to determine if previous audits included findings and recommendations that impact the subject matter under audit (GAGAS 5.06). If there were findings, auditors should document this information in the risk assessment and perform the following procedures:</p> <ul style="list-style-type: none"> a. During the entrance conference, ask contractor management if corrective actions were taken to address findings and recommendations reported in previous DCAA audits (e.g., questioned costs, business system deficiencies, CAS audits) that are relevant to the subject matter of audit. If yes, have contractor explain corrective actions taken and determine if additional audit procedures should be included in the fieldwork to test the corrective actions. b. Document the results of the inquiry and the impact of the corrective actions to the subject matter under audit. (Note: The purpose of this question is to follow up with contractor on relevant prior DCAA audit findings that could have a material effect on the subject matter of audit.) 	
<p>10) Review permanent file to determine if the contractor has previously provided other studies or audits (e.g., summary listing of internal audits or external audit reports) that directly relate to the subject matter under audit (GAGAS 5.06). If there are no other studies or audits, document that information in the work papers and perform the procedures below. (If you do not perform the following procedures, you must document your justification for the departure.)</p> <ul style="list-style-type: none"> a. During the entrance conference: <ul style="list-style-type: none"> • Ask contractor management if internal audits were performed. If yes, request contractor provide a summary listing of the internal audits that would assist us in understanding and evaluating the efficacy of the internal controls relevant to the subject matter of the audit. • Ask contractor management if other types of audits or studies were performed by other than DCAA (e.g., other 	

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<p>Government agencies, consultants, Independent Public Accountants, etc.) that would impact the subject matter under audit. If yes, have contractor explain what type of audits or studies were performed, if there were any related findings or recommendations, and any contractor corrective actions taken as a result.</p> <p>b. If the review of the perm file or the contractor identifies relevant internal audits:</p> <ul style="list-style-type: none"> • Determine if access to these reports is necessary to complete the evaluation of the relevant internal controls to support the risk assessment or audit procedures related to the subject matter of the audit. There must be a nexus between the internal audit reports and the scope of this specific assignment. • Document the results of the determination in writing. • If assignment is at a major contractor location, coordinate with the CAC or FAO point of contact (POC) for internal audit reports to request the contractor provide access to the reports. • If assignment is at a non-major contractor and the FAO does not have a designated POC, the auditor should request the contractor provide access to the internal audit reports. • The request, issued by the CAC, FAO POC or auditor, should include information on how the internal audit report is relevant to the DCAA audit. Place a copy of the request in the assignment administrative work papers. <p>c. If the review of the perm file or the contractor identifies relevant other audits or studies:</p> <ul style="list-style-type: none"> • Obtain publicly available information for the relevant other Government agency audits (e.g., websites for DoD IG or other IGs, service audit agencies, etc.). • Make appropriate adjustments to your risk assessment and planned procedures based on the reported findings. <p>d. Document the results of the inquiries including the response received from contractor’s for any request for access to internal audit reports. (If access was not granted this should include the contractor’s rationale or justification for not granting access).</p> <p>e. Determine if additional audit procedures are needed to address any identified risk. (Note: The purpose of this question is to discover any new audit leads that could affect the scope of current audit.)</p>	
<p>2. Coordination with Contracting Officer</p>	
<p>a. Contact the contracting officer to discuss and obtain their concerns related to the contractor’s accounting system and compliance with the DFARS criteria. The FAO should also invite the contracting officer to the contractor system demonstrations. The results of this coordination should be documented and</p>	

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<p>considered during audit planning.</p>	
<p>b. Electronically transmit an acknowledgement/notification letter to the appropriate contracting officer notifying them of the commencement of the audit and expected completion date. The acknowledgement/notification letter should be issued in accordance with the procedures in CAM 4-104.</p>	
<p>3. Planning Meeting with Contractor - Hold a planning meeting with the contractor to provide notification of the upcoming audit, inquire about the locations of the accounting departments to determine if coordination with other DCAA offices is necessary, to schedule the entrance conference, and to request the contractor prepare a general overview of their system for presentation at the entrance conference.</p>	
<p>4. During the entrance conference, or other appropriate meeting, make inquiries of contractor management regarding knowledge of any fraud or suspected fraud affecting the subject of this audit, managements awareness of allegations of fraud or suspected fraud affecting this audit, and management’s understanding about the risks of fraud relevant to this audit. Note: This discussion and any data submitted should be documented in the working papers.</p>	
<p>5. Initial Team Discussion</p>	
<p>Based on the team's understanding of the criteria, subject matter, and the contractor and its environment, hold a planning meeting with the audit team (at a minimum, Supervisor and Auditor) to discuss and identify potential noncompliances, due to error or fraud, that could materially affect the subject matter.</p> <p>The discussion should include:</p> <ul style="list-style-type: none"> • relevant prior audit experience (e.g., questioned cost, relevant reported estimating or accounting system deficiencies), • relevant aspects of the contractor and its environment, • risk of material noncompliance due to fraud (e.g., the extent of incentives, pressures and opportunities to commit and conceal fraud, and the propensity to rationalize misstatements), • other known risk factors, • the audit team’s understanding of relevant internal controls, • inquiries to the contractor regarding its fraud management plans and controls. <p>Document fraud risk factor/indicators (see - Sources of Fraud Risk Factors below) that are present and could materially affect the subject matter. If fraud risk factors are present, document specific audit procedures designed to address the increased risk of material noncompliance due to fraud.</p> <p>Communication among audit team members about the risk of material misstatement due to error or fraud should continue as needed throughout the audit.</p>	

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<p>Sources of Fraud Indicators:</p> <ul style="list-style-type: none"> • GAGAS Appendix Section A.10 – Examples of Indicators of Fraud Risk (http://gao.gov/products/GAO-12-331G) • AU-C 240.A75 (Appendix A)- Consideration of Fraud in a Financial Statement Audit, Examples of Fraud Risk Factors (http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-C-00240.pdf) • DoDIG’s Contract Audit Fraud Scenarios and Resources website (http://www.dodig.mil/resources/fraud/resources.html) <p>(To access the Sources of Fraud Indicators, copy and paste the web address shown above into the address block in Internet Explorer.)</p>	
<p>6. Coordination with other FAOs - In cases where this examination covers accounting systems at multi-segment contractors, follow the guidance in CAM 5-103.2 and 5-110e. Auditing accounting systems at multi-segment contractors requires effective coordination among cognizant auditors to identify the audit responsibilities at each location to ensure appropriate audit coverage when contractor locations share components of system, such as policies and procedures, common technologies (e.g., software) or common management. FAOs cognizant of segment locations should initiate assist audits from off-site locations as necessary. FAOs cognizant of off-site locations should not self-initiate audits of accounting systems. Coordinate effort needed with other DCAA offices (e.g., CAC, Corporate offices, assist audit offices, FD) as necessary.</p>	
<p>7. Entrance Conference and System Demonstrations</p>	
<p>a. Preparation of the Contractor Notification Letter. Draft the Contractor Notification Letter using the shell at working paper 11b. The proforma Contractor Notification Letter contains a list of information needed from the contractor to perform the audit and identifies the key areas of the accounting system that should be addressed during system demonstrations.</p>	
<p>b. Entrance Conference. The purpose of this meeting is to:</p> <ol style="list-style-type: none"> (1) Provide the Contractor Notification Letter and discuss the information being requested from the contractor; (2) Discuss the purpose of the audit and expectations such as the accounting system demonstration requirements, the level of detail that should be covered in the demonstrations, who should participate in the meetings, the length and location of the meetings, and other pertinent information; (3) Have the contractor provide a general overview of the accounting system and processes; and (4) Set up the dates for demonstrations on the key processes. The 	

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<p>demonstrations should be held within approximately two weeks of the entrance conference.</p> <p>(5) Follow up with contractor management on corrective actions that address previous DCAA audit findings and recommendations.</p> <p>(6) Follow up with contractor management regarding other studies or audits (e.g., internal auditors, consultants, Independent Public Accountants) that impact the subject matter under audit.</p>	
<p>c. System Demonstrations/Documenting an Understanding of the Accounting System. (The entire team should attend the demonstrations if possible.)</p> <p>The purpose of the contractor demonstrations is to obtain and document an understanding of the contractor’s accounting system internal controls related to compliance with the DFARS criteria. During the demonstrations the audit team should make detailed notes on the contractor’s system descriptions, policies, and procedures, etc. as needed to document their understanding of the system and should take full advantage of the demonstrations to ask questions to ensure that they have a sufficient understanding. The documentation will be finalized in section B-01 step 7 below.</p> <p>Note - <u>Inquiry alone is not sufficient to obtain an understanding of the contractor’s internal controls.</u> Procedures to obtain an understanding of accounting system internal controls include inquiries of contractor personnel, observing the application of specific controls, inspecting documents and reports, and performing walk-throughs of the system (including tracing transactions through the various processing steps).</p> <p>As requested in the contractor notification letter, the contractor should provide and walk the audit team through the requested information and demonstrate how each of the key accounting processes/functions are accomplished and how the contractor ensures compliance with the DFARS 252.242-7006 system criteria. (See W/P B-02 for the areas that should be addressed. The Accounting Audit Information Request included with the Contractor Notification Letter (W/P 11b) provides additional information regarding what the contractor should demonstrate for each area.)</p> <p>Note: It may be necessary to conduct additional one-on-one demonstrations with the process owners at their work site to gain a full understanding of the processes. One of the controls that the contractor should generally demonstrate for each of the key accounting processes/functions is adequate segregation of duties. (A lack of adequate segregation of duties without other compensating controls is a fraud indicator.)</p>	
<p>d. Document any risks the audit team identified during the entrance conference or contractor demonstrations.</p>	
<p>8. Finalizing/Summarizing the Understanding of the Accounting System</p>	
<p>This step will complete the accomplishment of the first objective of the audit. It is critical since the documented understanding will serve as a basis for planning the audit, to identify types of potential noncompliances, to consider factors that affect</p>	

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<p>the risk of material noncompliances and to design audit procedures to test contractor compliance with DFARS 252.242-7006.</p>	
<p>a. Using the information obtained during the entrance conference and system demonstration, finalize and document your understanding of the contractor’s accounting system in W/P B-02, and cross referenced it to detailed descriptions and information obtained and documented during the contractor’s demonstrations (e.g., flowcharts, policies and procedures, desk procedures, screenshots, etc.). As reflected on the W/P B-02 framework, the documented understanding should address each of the 18 DFARS criteria as well as the five internal control components described in CAM 5-102c as identified below.</p>	
<p>(1) <u>Control Environment</u> –The understanding of the control environment should be documented in the MFR for the separate control environment audit. That MFR should be incorporated into this assignment and referenced in the applicable section of W/P B-02. (Note: The control environment is also one of the DFARS criteria.)</p>	
<p>(2) <u>Contractor’s Risk Assessment</u>–This information was requested from the contractor in Item 8 of the Accounting System Audit Information Request included with the Contractor Notification Letter (W/P 11b).</p>	
<p>(3) <u>Contractor Monitoring</u> - This information was requested from the contractor in Item 9 of the Accounting System Audit Information Request included with the Contractor Notification Letter (W/P 11b). (Note: Periodic monitoring is also one of the DFARS criteria. See C-01, step 8.)</p>	
<p>(4) <u>Information System and Communication</u> –This information was requested from the contractor in Item 10 of the Accounting System Audit Information Request included with the Contractor Notification Letter (W/P 11b).</p>	
<p>(5) <u>Control Activities</u> –The control activities are generally those processes the contractor uses to ensure compliance with each of the criteria in the DFARS 252.242-7006. This information was requested from the contractor in Item 7 of the Accounting System Audit Information Request included with the Contractor Notification Letter (W/P 11b).</p>	
<p>b. Prepare a high-level summary of your understanding contractor’s accounting system to provide to the contractor for confirmation of accuracy. After the detailed (W/P B-02) and summary understanding of the contractor’s accounting system (W/P 11c) have been documented and reviewed by your supervisor, provide the summary to the contractor and obtain written confirmation from the contractor that the understanding is accurate. A draft confirmation letter with a sample framework for the summary understanding is located at working paper 11c.</p>	
<p>c. Summarize the high risk areas identified during the demonstrations and other preliminary steps so that they can be addressed during the team discussion</p>	

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below.	
9. <u>Interim Team Discussion</u>	
a. Hold an interim planning meeting with the audit team (e.g., RAM, Manager, Supervisor, and Auditors) and discuss results of preliminary planning, entrance conference information, and risks identified, and the understanding of the system and areas of potential impact (preliminary steps performed in section B-01 steps 1 through 7). This should be a detailed discussion and include specifics on the period to be covered by the audit, the timing of other audits that will be incorporated into this assignment, areas to test, what attributes to test for, how much testing should occur based on risk , and how to select the applicable samples and test each area.	
b. The team should revisit relevant sections of the IG Handbook on Fraud Indicators for Contractors and discuss risk factors identified subsequent to the initial team discussion that indicate potential fraud, illegal acts, or violations of contracts that could have a material effect on government contracts, and develop audit steps in response. If no risk factors are identified, document this in working paper B.	
c. The team should also consider the need for specialist assistance, if any, and that should be documented on working paper B-03.	
d. Document the results of the team discussion (e.g., risk identified, areas to test based on risk, what attributes to test for, generally how many transactions to test and how to select sample and test each area, etc.).	
10. Initial Risk Assessment. Document on W/P B, the risk factors and any fraud indicators identified during the team discussions and other risk assessment procedures and design audit procedures to address those risks 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 audit. This involves tailoring (lining-out/modifying) the detailed audit program steps and/or developing additional steps to address areas of risk identified above. (Note: The accounting system internal control matrix (available on the DCAA Intranet) identifies audit procedures and may assist in the preparation of detailed audit program steps.)	

C-01	Compliance with DFARS 252.242-7006 Criteria	
Version 1.7, dated April 2016		W/P References
In section B-01, the auditor gained an understanding of the key processes in the accounting system related to compliance with the DFARS criteria and determined that certain controls existed and were implemented. In section C, the auditor will test those key processes and controls to determine if the contractor’s accounting system complies with the system criteria in DFARS 252.242-7006.		

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<p>(The auditors should have tailored (added, lined-out, modified) the following audit steps as necessary based on their understanding of the contractor’s processes and related internal controls and the risk identified in the risk assessment.)</p> <p>Since contractor accounting system structures vary, the steps for testing compliance with the criteria are provided in this single lead working paper section. However, auditors may break the following procedures into additional lead working paper sections based on the contractor’s accounting system structure and the FAO’s needs and preferences.</p>	
<p>1. DFARS 252.242-7006(c)(1) requires the contractor’s accounting system to provide for a sound internal control environment and an appropriate accounting framework and organizational structure adequate for producing accounting data that is reliable and cost that are recorded, accumulated, and billed on Government contracts in accordance with contract terms. An audit of the control environment and the contractor’s compliance with DFARS Criterion 1 will be performed in a separate assignment and the MFR documenting the results of that audit should be incorporated in this audit and referenced here.</p>	
<p>2. Determine if the contractor’s accounting system provides for identification and accumulation of direct costs by contract. (DFARS 252.242-7006(c)(3))</p>	
<p>a. Verify that the contractor has either a subsidiary job cost ledger or accounts receivable ledger which accumulates direct costs by contract.</p>	
<p>b. Perform steps to verify that the contractor’s system properly identifies direct costs by contract. The steps performed will be based on your understanding of the contractor’s processes for complying with the criterion. They will generally include:</p>	
<p>(1) Verify that the contractor has controls in place to preclude mischarging costs of one contract to another contract. (Note: Generally, this will be accomplished through your observations and inquiry during the walk-through and that should be referenced here.)</p>	
<p>(2) For the significant direct costs identified during the risk assessment, trace a selection of those costs for the period covered by this audit from the accounting records through the system to documentation supporting that the costs have been identified and charged to the appropriate contract. For example, you might first trace it to the</p>	

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<p>purchase order indicating that it was purchased for that contract and then to documentation supporting that it is needed for the contract (e.g., bill of materials, statement of work).</p> <p>Note: If the contractor uses different processes for identifying and recording various categories of direct costs to contracts (e.g. material, ODC, travel, purchases above a dollar threshold, subcontracts, etc.), auditors should generally test significant direct cost transactions for each separate or different process.</p>	
<p>(Note: The test for direct labor charges will be performed as part of the labor timekeeping and labor distribution criteria below (DFARS 252.242-7006(c)(9) and (10)).</p>	
<p>Note: To the extent possible, the auditor should rely on the results of a purchase existence and consumption (MAAR 13) audit for the period covered by this audit in determining the effort needed to be performed in step 2b (2) above.</p>	
<p>3. Determine if the contractor’s accounting system provides for proper segregation of costs of direct costs from indirect costs (DFARS 252.242-7006(c)(2)).</p>	
<p>a. Verify that the contractor has controls in place to ensure proper segregation of direct cost from indirect costs. (Generally, this will be accomplished through your observations and inquiry during the walk-through and that should be referenced here.)</p>	
<p>b. Perform a nomenclature review of accounts in the trial balance. Determine if there are any indirect accounts which appear to be of a direct nature. Determine if there are any direct accounts which appear to be of an indirect nature. Perform tests of details, if appropriate (e.g., by tracing transactions to documentation supporting that they are properly classified).</p>	
<p>c. Analyze types of costs which are charged both direct and indirect. (Those types of cost generally would have been identified in the system demonstrations.) If the direct charges to fixed price contracts for a particular type of cost have decreased significantly while indirect costs have increased significantly, this may indicate that the contractor is shifting costs from fixed price contracts to indirect pools which would result in mischarging to flexibly price contracts. Perform tests of details, if appropriate.</p>	

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<p>Note: To the extent possible, the auditor should rely on the results of the floor check (MAAR 6), and purchase existence and consumption (MAAR 13) audits for the period covered by this audit in determining the effort needed to be performed in step 3b-c above.</p>	
<p>4. Determine if the contractor’s accounting system provides for a timekeeping system that identifies employees’ labor by intermediate or final cost objective (DFARS 252.242-7006(c)(9)).</p>	
<p>a. 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 the employees’ supervisors.</p>	
<p>b. Verify that the contractor has segregation of duties and responsibilities in its timekeeping system (e.g., division of duties between personnel responsible for preparation of time and attendance records, and those responsible for the preparation and distribution of the payroll.)</p>	
<p>Note: To the extent possible, the auditor should rely on the work performed under the floor check (MAAR 6) for the period covered by this audit. However, if sufficient testing was not performed in that audit, additional testing should be performed in this audit.</p>	
<p>5. Determine if the contractor’s accounting system provides for a labor distribution system that charges direct and indirect labor to the appropriate cost objectives (DFARS 252.242-7006(c)(10)).</p>	
<p>a. The majority of the work for this criterion should have been accomplished during the floor check(s) (MAAR 6) for the period covered by this audit. However, as a part of your observations and inquiry during the walk-through for this audit, you should have verified and documented that the contractor has controls in place to ensure the labor distribution system charges direct and indirect labor to the appropriate cost objectives and you should reference that documentation here. (For example, the contractor should have demonstrated its procedures and controls related to the accumulation and recording of labor cost to cost objectives. These procedures should include controls over the issuance of work authorizations and provide for work descriptions that are sufficiently detailed to track the effort to the appropriate intermediate or final cost objective and to identify the effort as allowable, unallowable, direct or</p>	

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<p>indirect.)</p>	
<p>b. The detailed testing of the controls for this criterion should have been accomplished in the floor check(s) (MAAR 6) for the period covered by this audit and that audit or those audits should be referenced here.</p>	
<p>Note: If the MAAR 6 was not completed for the period covered by this audit or if the work was not sufficient to determine the contractor’s compliance with this criterion, the auditor will need to develop applicable procedures in this audit to test the criterion to the extent possible.</p> <p>For example, the auditor might:</p> <ul style="list-style-type: none"> • Use the information obtained during the risk assessment procedures (e.g., walkthroughs) to assist in identifying high risk areas. • Evaluate labor distribution documents for the period covered by this audit to identify employees charging labor effort to the identified risk areas. • Select a sample of employee labor charges from the labor distribution report and request the applicable timesheets. • Trace the labor hours and job numbers reflected in the labor distribution report to the selected timesheets. • Trace employee hourly rates reflected in the labor distribution report to payroll records. • Verify the labor cost distribution records reconcile to the cost accumulation records in labor subsidiary and to the general ledger accounts, if applicable. • Using the timesheets obtained above, compare the job numbers on the timesheets to the applicable work authorization documents. • Verify that the work authorizations are in sufficient detail to determine the appropriate cost objective and if the cost is allowable or unallowable and should be charged direct or indirect. <p>These are examples; however, auditors should perform the necessary procedures in the circumstances to determine compliance with the criterion.</p> <p>Since employee interviews were not completed for the period covered under this audit, also include the following statement in the audit report:</p>	

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<p>The concurrent employee interviews for verification of labor were omitted in this examination.</p>	
<p>6. Determine if the contractor’s accounting system provides for the accumulation of costs under general ledger control (DFARS 252.242-7006(c)(5) and reconciliation of subsidiary cost ledgers and cost objectives to the general ledger (DFARS 252.242-7006(c)(6)).</p>	
<p>a. Determine if the contractor maintains a chart of accounts which is updated in a timely manner.</p>	
<p>b. Verify that the contractor’s policies and procedures require that job cost ledger and other books of account are reconciled and currently posted to the general ledger control accounts. (Generally, this will be accomplished through your observations and inquiry during the walk-through and that should be referenced here.)</p>	
<p>c. Selectively test the contractor’s reconciliations for the period covered by this audit to verify that the subsidiary cost ledgers and cost objectives reconcile to the general ledger accounts. If this is a computerized function, selectively test to verify that it is occurring properly.</p>	
<p>d. Obtain evidence that costs from the job cost ledger and other books of account have been regularly posted to the general ledger control accounts for the period covered by this audit.</p>	
<p>7. Determine if the contractor’s accounting system provides for approval and documentation of adjusting entries (DFARS 252.242-7006(c)(7)).</p>	
<p>a. Verify that the contractor has controls in place to ensure that adjusting entries are properly approved and documented. This should include a division of duties between personnel responsible for authorizing journal entries and those responsible for posting journal entries in the ledger. (Generally, this will be accomplished through your observations and inquiry during the walk-through and that should be referenced here.)</p>	
<p>b. Test a selection of adjusting entries (e.g., correcting, transferring, closing, and credit) for the period covered by the audit to verify that they were appropriately approved and that the basis for the adjustment was adequately documented.</p>	
<p>c. For any unusual or sensitive items identified in the step above that warrant further review, request and review</p>	

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<p>information from the contractor to determine if the adjustments are appropriate.</p>	
<p>8. Determine if the contractor’s accounting system provides for management reviews or internal audits of the system to ensure compliance with the contractor’s established policies, procedures, and accounting practices (DFARS 252.242-7006(c)(8)).</p> <p>Note: The contractor’s monitoring of its accounting system should include considering whether controls are operating as intended and that they are modified as appropriate for changes in conditions. The contractor’s monitoring process may include, in addition to management reviews or internal audits, other forms of monitoring such as personnel performing similar activities and can be accomplished through ongoing monitoring activities (which are built into the contractor’s normal recurring activities), separate evaluations, or a combination of the two. Auditors should consider all monitoring activities in determining compliance with Criterion 8. What is sufficient will depend on the circumstances (e.g., size and complexity of the contractor’s operations). Ongoing management review/monitoring activities of small and midsized contractors are more likely to be informal.</p>	
<p>a. Determine if the contractor’s policies and procedures require management reviews/monitoring of its accounting system and that the timeframes and/or guidelines appear sufficient given the complexity and size of the contractor’s operations to determine that controls are operating as intended and that they are modified as appropriate. (Generally, this will be accomplished through your observations and inquiry during the walk-through and that should be referenced here.)</p>	
<p>b. Evaluate management review and other monitoring activities for the period covered by the audit to determine if the contractor is performing reviews in accordance with time frames and guidelines established in the policies and procedures.</p>	
<p>9. Determine if the contractor’s accounting system provides for interim (at least monthly) determination of costs charged to a contract through routine posting of books of account (DFARS 252.242-7006(c)(11)).</p>	
<p>a. Obtain evidence that, for the period covered by the audit, the contractor determined and recorded costs to contracts at least monthly (generally to the job cost ledger).</p>	
<p>10. Determine if the contractor’s accounting system provides for a logical and consistent method for the accumulation and</p>	

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allocation of indirect costs to intermediate and final cost objectives (DFARS 252.242-7006(c)(4)).	
a. Verify that the contractor indirect rate structure is formally documented, with a written description of the make up of pools and bases. (Generally, this will be accomplished through your observations and inquiry during the walk-through and that should be referenced here.)	
b. Verify that the practices in the contractor’s CAS Disclosure Statement related to CAS 403 (Part VIII), CAS 410 (Part IV) and CAS 418 (Part IV) have been determined compliant.	
c. Evaluate the circumstances regarding any outstanding CAS 403, 410 and 418 noncompliances to determine whether they indicate that the contractor’s system fails to meet this requirement.	
11. Determine if the contractor’s accounting system provides for cost accounting information as required to readily calculate indirect cost rates from the books of accounts (DFARS 252.242-7006(c)(15ii)).	
a. Verify that interim and final indirect expense rates can be readily calculated from the books of accounts. (Generally, this will be accomplished through your observations and inquiry during the walk-through and that should be referenced here.)	
b. Verify that, for the period covered by this audit, the contractor provided timely provisional indirect rates (both billing and forward pricing, if applicable) and monitored the rates for any significant variances. If not, you should consider whether, in the given circumstances, this indicates that the contractor’s accounting system does not provide cost accounting information needed to readily calculate indirect cost rates.	
12. Determine if the contractor’s accounting system provides for exclusion from costs charged to Government contracts of amounts which are not allowable in terms of FAR Part 31, Contract Cost Principles and Procedures, and other contract provisions (DFARS 252.242-7006(c)(12)).	
a. Verify that that the contractor has controls in place to ensure unallowable costs are identified and excluded from costs charged to Government contracts (FAR 31.201-6). (Generally, this will be accomplished through	

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<p>your observations and inquiry during the walk-through and that should be referenced here.)</p>	
<p>b. Verify that the detail and depth of records maintained by the contractor as backup support for proposals, billings, or claims are adequate to establish and maintain visibility of identified unallowable costs, including directly associate unallowable costs (CAS 405). (This may have been at least partially accomplished through your observations and inquiry during the walk-through. You should also consider other recently completed audits that provide evidence regarding the adequacy of the contractor records supporting proposals, billings, or claims to establish and maintain visibility of identified unallowable costs.)</p>	
<p>c. Perform procedures to test the contractor’s controls for identifying and excluding unallowable costs from costs charged to Government contracts. (Appropriate steps should be developed based on your understanding of the contractor’s processes and related controls for this criterion.) Work performed in and the results of other recently completed audits (e.g., audits of price proposals or incurred costs) should be used to the extent possible. For example, if those audits have identified significant costs that are not allowable under FAR Part 31, consider whether, in the given circumstances, this indicates that the contractor’s system fails to comply with this criterion, especially if the costs are expressly unallowable.</p>	
<p>13. Determine if the contractor’s accounting system provides for identification of costs by contract line item and by units (as if each unit or line item were a separate contract) if required by the contract (DFARS 252.242-7006(c)(13)).</p>	
<p>a. Verify for a selection of contracts that during the period covered by the audit the contractor’s system accumulated and identified costs at the requisite level of detail as specified in the contract terms and conditions (e.g., by contract line item and units if required by the contract). (If the evidence obtained through your observations and inquiry during the walk-through was sufficient to accomplish this step, that work should be referenced here.)</p>	
<p>14. Determine if the contractor’s accounting system provides for segregation of pre-production costs from production costs (DFARS 252.242-7006(c)(14)).</p>	

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<p>a. Verify that pre-production costs are routinely segregated from production costs to assist in re-pricing or follow-on contract pricing (applies primarily to manufacturing costs). (Appropriate steps should be developed based on your understanding of the contractor’s processes and related controls for this criterion.)</p>	
<p>15. Determine if the contractor’s accounting system provides for cost accounting information as required by contract clauses concerning limitation of cost (FAR 52.232-20), limitation of payments (FAR 52.232-22), or allowable cost and payment (FAR 52.216-7) (DFARS 252.242-7006(c)(15i)).</p>	
<p>16. Determine if the contractor’s accounting system provides for billings that can be reconciled to the cost accounts for both current and cumulative amounts claimed and comply with contract terms (DFARS 252.242-7006(c)(16)).</p>	
<p>Note: The contractor’s compliance with Criteria 15i and 16 should be covered in a separate 11010 Billing Audit and the MFR documenting the results of that audit should be incorporated in this audit and referenced for steps 15 and 16 above.</p>	
<p>17. Determine if the contractor’s accounting system provides for adequate, reliable data for use in pricing follow-on acquisitions (DFARS 252.242-7006(c)(17)) .</p>	
<p>a. Verify that the contractor’s system produces cost information at a sufficient level of detail for use in pricing follow-on contracts.</p>	
<p>Note: Auditors should consider the experience obtained in current proposal activity to assist in determining compliance with Criterion 17. In addition, if it is determined that the contractor does not comply with Criteria 13 and/or 14, you should consider whether, in the given circumstances, this indicates that the contractor also does not comply with Criterion 17.</p>	
<p>18. Accounting practices in accordance with the standards promulgated by the Cost Accounting Standards Board, if applicable, otherwise, Generally Accepted Accounting Principles (DFARS 252.242-7006(c)(18)).</p>	
<p>a. Verify that the contractor’s cost accounting system which provides for accounting practices in accordance with standards promulgated by the Cost Accounting Standards Board, if applicable, otherwise, Generally Accepted Accounting Principles is documented. (This will be the CAS disclosure statement for contractors that are required to submit one. For other contractors,</p>	

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<p>the documentation will be less formal, depending on the size and complexity of the operations and systems. Generally, this step will be accomplished through your observations and inquiry during the walk-through and that should be referenced here.)</p>	
<p>b. Verify that the contractor’s CAS Disclosure Statement, if applicable has been determined compliant with CAS.</p>	
<p>c. Evaluate the circumstances regarding any outstanding CAS noncompliances to determine whether they indicate that the contractor’s system fails to meet this requirement.</p>	
<p>19. Summarize results of fieldwork and evaluate whether noncompliances with the DFARS criteria identified during the audit are significant deficiencies/material weaknesses or are less severe than significant deficiencies/material weaknesses, but important enough to merit the attention of the responsible contractor management officials.</p>	

A-1	Concluding Steps	
	Version 1.7, dated April 2016	W/P References
	<p>1. Team discussion. Hold a meeting with the audit team (e.g. RAM, Manager, Supervisor, and Auditors) and discuss the issues identified in the audit and the impact on the conclusions and opinion to be included in the audit report.</p>	
	<p>2. Summarize results and draft the audit report. The audit report should include all significant deficiencies/material weaknesses, even those reported in deficiency reports issued on a real-time basis under a separate assignment number during the course of the audit. For any such deficiencies, note the deficiency report number and date and the status of the deficiencies in the condition statement. If the audit disclosed deficiencies that are less severe than significant deficiencies/material weaknesses, but important enough to merit the attention of the responsible contractor management officials those should be included in a report appendix, Other Matters Required to Be Reported under GAGAS. Obtain supervisory review.</p>	
	<p>3. After obtaining DCAA management approval, hold and document the exit conference in accordance with CAM 4-304. Obtain the contractor’s reaction regarding all deficiencies included in the report, including any that are less severe than significant deficiencies/material weaknesses.</p>	

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A-1	Concluding Steps
4.	Auditors should document and communicate with the contracting officers upon the completion of our audit:
a.	Brief the contracting officer on significant questioned, unsupported, unresolved costs or other significant and/or complex findings/issues, and/or
b.	Coordinate with the contracting officer to find out and determine if inclusion of detailed explanatory notes in our report would serve a useful purpose when there are no findings.
5.	Finalize the audit report and incorporate the contractor’s reaction and auditor’s response.
6.	Update the permanent file in accordance with CAM 4-405b. A copy of the documented understanding of the accounting system should be filed in the perm file.