

Activity Code 17740	Post Award Accounting System Audit at Nonmajor Contractors
Version 4.6, dated June 2009	
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>	
References	
<ol style="list-style-type: none"> 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, "Contractor Financial Capability Audits and Reporting" 	

B-1	Preliminary Steps
Version 4.6, dated June 2009	
	<u>WP Reference</u>
1. Review audit request, if applicable, for matters of particular interest	

to acquisition officials.	
2. 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 ICAPS information) if applicable.	
e. The amount of Government contracts by contract type.	
3. If the evidential matter to be obtained during the audit is highly dependent on computerized information systems, document on working paper B-2 the audit work performed that supports reliance on the computer-based evidential matter. Specifically, document or reference one or more of the following in working paper B-2:	
a. the audit assignment(s) where the reliability of the data was sufficiently established in other DCAA audits.	
b. the procedures/tests that will be performed in this audit to evaluate the accounting system that will also support reliance on the evidential matter, and/or	
c. the tests that will be performed in this audit that will be specifically designed to test the reliability of the computer based data.	
4. Obtain a current organization chart.	
5. Obtain a current Chart of Accounts with descriptions of charges, which can be made to each account (Text of Accounts).	
6. In planning and performing the audit, consider fraud risk indicators specific to the audit being performed. The principal sources for the applicable fraud risk indicators are:	
<ul style="list-style-type: none"> Handbook on Fraud Indicators for Contract Auditors, Section II (IGDH 7600.3, APO March 31, 1993) located at http://www.dodig.mil/PUBS/igdh7600.doc. 	
<ul style="list-style-type: none"> CAM Figure 4-7-3 	
Document in working paper B any identified fraud risk indicators and your response/actions to the identified risks (either individually, or in combination). This should be done at the planning stage of the audit as well as during the audit if risk indicators are disclosed (see CAM 4-702). If no risk indicators are identified, document this in working	

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

C-1	Adequacy of Accounting System for Accumulating and Segregating Costs	
	Version 4.6, dated June 2009	<u>WP Reference</u>
	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).	
	1. Proper segregation of costs. Verify that controls exist to preclude direct charging of indirect expense and indirect charging of direct contract costs.	
	2. Direct costs by contract. Verify that the contractor has either a subsidiary job cost ledger or account receivable ledger which accumulates costs by contract.	
	3. 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 accounts.	
	4. Interim determination of costs. Determine that the contractor posts contract costs at least monthly to books of account	
	5. 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.	
6. 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).	
e. Evaluate the procedures on items issued from inventory: (1) Can they be traced to issuance documents? (2) Are they priced in accordance with contractor's disclosed practices? (3) Are they issued for current use rather than for intermediate holding?	
7. Indirect Costs. a. Document the understanding of the contractor's procedures for accumulating and billing indirect costs.	

<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>8. 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). Update Appendix 1 of Internal Control Questionnaire, FAR Cost Principle Assessment.</p>	
<p>9. 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>10. 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>11. Verify that the contractor's system produces cost information at a sufficient level of detail for use in pricing follow-on contracts.</p>	
<p>12. Financial Capability. Determine if a financial capability risk assessment or audit has been performed at this contractor in the last year. If so, evaluate the results and assess its potential impact on the contractor's accounting system. If not performed and one is required (CAM 14-300), discuss with the supervisor the option of concurrently performing a financial capability risk assessment with this audit. If the auditor and supervisor decide that a financial condition risk assessment should be performed, set up a separate Code 17600 – Financial Capability.</p>	

D-1	Adequacy of Billing System for Preparing Reimbursement Claims	
		<u>WP Reference</u>
<p>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).</p>		
<p>1. Limitation of costs. Verify that total contract expenditures against contract limitations on price or cost are monitored and updated on a</p>		

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) by evaluating a sample of current invoices (public vouchers and progress payment requests) 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 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.)	
5. Verify that billings can be reconciled to the cost accounts for both current and cumulative amounts claimed.	
6. Verify that the contractor has procedures to 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 condition of the subcontract or invoice and ordinarily within 30 days of the contractor's payment request to the Government.	
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:	
a. Restriction of billing frequency.	
b. Special withholding provisions.	
c. Contractual unallowable costs.	
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.	
a. Verify that for cost-reimbursement type contracts, if required, the contractor withholds fixed fee after payment of 85 percent of contract fixed fee until a reserve is set aside in accordance with contract terms. The reserve should not exceed 15 percent of the total contract fixed fee or \$100,000 whichever is less. See FAR 52.216-8.	
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 / DFARS 232.111(b).	
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. 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).	
10. If the contractor is authorized to direct bill, perform the following additional steps, if applicable, to test the contractor's continued eligibility for direct billing as part of this audit. 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.	
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.	
b. If applicable, 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).	

E-1	Internal Control Questionnaire (ICQ)	
	Version 4.6, dated June 2009	<u>WP Reference</u>
	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.	

A-1	Concluding Steps	
	Version 4.6, dated June 2009	<u>WP Reference</u>
	1. Discuss results with supervisor.	
	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.	