



**DEFENSE CONTRACT AUDIT AGENCY  
DEPARTMENT OF DEFENSE  
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IN REPLY REFER TO

PPD 730.5.17.1

October 20, 2008  
08-PPD-036(R)

**MEMORANDUM FOR REGIONAL DIRECTORS, DCAA  
DIRECTOR, FIELD DETACHMENT, DCAA  
HEADS OF PRINCIPAL STAFF ELEMENTS**

**SUBJECT: Audit Alert on Current Economic Conditions and Financial Condition Risk Assessments**

This audit alert is being issued to emphasize existing Agency guidance requiring auditors to be alert to conditions that may indicate unfavorable or adverse financial conditions that could impede a contractor's ability to perform on Government contracts (CAM 14-300). If auditors become aware of these unfavorable financial conditions, auditors should immediately commence a financial capability risk assessment/audit.

Due to the current conditions with our financial markets, the contractor's ability to maintain a favorable cash flow and sustain performance on Government contracts becomes a higher risk. Contractor cash flow or other financial difficulties may disrupt production schedules, cause inefficient use of resources, and result in contract nonperformance. These conditions may also result in monetary loss to the Government based on progress payments. Therefore, auditors need to be continuously alert to any indication of unfavorable financial conditions in any audit being performed. When performing audits or reviews that directly impact cash flow (e.g., progress payments audits, annual testing of contract eligibility for direct billing, billing systems, interim voucher reviews), auditors should be alert for situations where the contractor may try to inappropriately accelerate billing costs to the Government in order to improve its cash flow.

Examples of indicators of possible unfavorable financial conditions may include, but are not limited to, any of the following:

- Increase in the aging and amounts of accounts payables
- Defaults on loan/line-of-credit agreements
- Denial of usual trade credit from suppliers
- Restructuring of debt with higher interest rates
- Noncompliance with loan/line-of-credit covenants
- Loss of principal customers/suppliers
- Unpaid or late payment of state, local, and federal tax liabilities

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Assessments

- Deteriorating bond ratings
- Failure to fund pension plans
- Loans from employees or issuing stock to employees in lieu of salary
- Significant unpaid debts and/or liabilities
- Unusual progress payments or other billing concerns
- Poor physical condition of the work facilities

If the auditor discloses indicators of financial distress, a financial condition risk assessment should be initiated (CAM 14-304). Early detection and reporting of contractors in financial distress allows maximum flexibility for the Government to avoid financial loss. The Government may initiate actions to adjust interim financing payments; protect Government property and inventory; and alert the contractor of Government concerns so extraordinary actions can be taken early to avoid financial loss.

FAO personnel should direct questions to their regional offices, and regional personnel should direct any questions to Policy Programs Division, at (703)-767-2270 or e-mail at [DCAA-PPD@dcaa.mil](mailto:DCAA-PPD@dcaa.mil).

/Signed/  
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