

Master Document – Audit Planning

Activity Code 17610	Financial Capability, Modified Financial Condition Risk Assessment
Version 3.3, dated August 2010	
B-1	Planning Considerations
Purpose and Scope	
<p>The purpose of the modified financial condition risk assessment is to determine if there are any significant indicators of financial distress that would warrant performance of a detailed financial condition risk assessment or financial capability audit. A modified risk assessment consists of analyzing the trends of the contractor’s key financial statement elements, analyzing any significant events which would impact the contractor’s financial condition, and determining whether the contractor is paying its payroll taxes timely. FAOs will perform annually either a detailed or modified financial condition risk assessment for all contractors with Government sales over \$15 million in accordance with CAM 14-303. FAOs will perform an annual modified financial condition risk assessment for contractors with Government sales between \$1 million and \$15 million, in conjunction with other field visits (CAM 14-303b).</p>	
References	
<ol style="list-style-type: none"> 1. FAR 9.104-1, General Standards 2. DFARS 232.072, Financial Responsibility of Contractors 3. SAS 59, The Entity's Ability to Continue as a Going Concern 4. CAM 14-304, Financial Condition Risk Assessment Procedures 	

B-1	Preliminary Steps	
Version 3.3, dated August 2010		WP Reference
1. Research and Planning		
<p>a. Financial condition risk assessments/financial capability audits are generally performed at the parent company. If this is a risk assessment covering a contractor segment, ensure that an exception for performing the risk assessment at the segment level applies (CAM 14-302).</p>		
<p>b. Contact the contract administrative office to determine if there are any specific areas of concern. Request the details of any financial</p>		

Master Document – Audit Planning

<p>analyses already performed by their offices to avoid duplication (i.e., financial ratio analyses, bond rating analyses, etc.).</p>	
<p>c. Conduct an entrance conference. Ask the contractor if there are any significant events that have occurred (sale of a division, loss of a contract, large layoff, new contract, buying larger plant, etc.).</p>	
<p>d. Document any significant or unfavorable events that would impact the contractor’s financial status (loss of a contract, major layoff, sale of a division, etc.). The existence of this type of information may be contained within the permanent files, audit lead sheets, ICAPS/ICQ, or local newspaper articles or obtained through discussions with the contractor, supervisor, or auditor that normally works at the contractor location.</p>	
<p>2. Risk Assessment</p>	
<p>a. <u>Trend Analysis of Key Financial Statement Elements.</u> Review the trends of the following financial statement elements for the most recently completed fiscal year and the previous two fiscal years. (CAM 14-304f). If the financial statements are unaudited, the auditor should consider additional steps to verify the financial information prior to analyzing the trends, [e.g., compare key financial statement amounts (total assets, total liabilities, etc.) to the general ledger or tax returns to validate data in the unaudited financial statements]. If consistent unfavorable or adverse trends are noted, obtain and verify any explanation from the contractor and any actions being taken to improve the conditions.</p>	
<p>(1) Analyze the trends of the following financial statement elements:</p> <ul style="list-style-type: none"> • Profit/loss • Sales • Cash Flow from: <ul style="list-style-type: none"> ○ Operating activities ○ Investing activities ○ Financing activities • Working Capital (Current assets minus current liabilities) • Net Worth (Total assets minus total liabilities) • Long-term Liabilities 	
<p>(2) The notes to the financial statements and/or the SEC filings (10K and 10Q) should be reviewed for any conditions or statements that may indicate financial risk requiring further inquiry/review. Determine if there is a going concern comment</p>	

Master Document – Audit Planning

<p>in the most recent financial statements. If so, this is a high risk indicator that requires further analysis.</p>	
<p>b. <u>Timely Payment of Payroll Taxes</u>. Determine if the contractor is paying its payroll taxes on a timely basis (CAM 14-304h). [Note: Contractor delays or the nonpayment of payroll taxes may affect the allowability of claimed and billed costs and should be promptly discussed with the Supervisory Auditor.]</p>	
<p>c. Document whether there are any (1) significant unfavorable or adverse trends or (2) issues relating to the payment of payroll taxes that would have a detrimental impact on the contractor’s financial condition that would require the performance of a detailed financial condition risk assessment.</p>	

A-1	Concluding Steps	
Version 3.3, dated August 2010		WP Reference
<p>1. Summarize the results of the modified risk assessment in a Memorandum for Record (MFR) if no significant indicators of financial distress were disclosed. [If results of this assessment indicate that a detailed financial condition risk assessment needs to be performed, close this assignment with an MFR, and begin a new APPS Working Paper Assignment using a 17600 code for Financial Capability Audit.]</p>		
<p>2. Coordinate the results of the modified risk assessment with the Supervisory Auditor.</p>		
<p>3. Hold an exit conference with the contractor and disclose that we are closing our financial condition evaluation without performing any additional risk assessment procedures, and that a report will not be issued.</p>		
<p>4. If the modified risk assessment is performed at a parent or a corporate office, distribute the memorandum to all cognizant DCAA offices. Include a transmittal letter advising that the memorandum contains sensitive information and should not be released outside of DCAA.</p>		
<p>5. Update permanent files.</p>		