

**AUDIT OF  
INDIRECT AND OTHER DIRECT COST SYSTEM CONTROLS**

<u>CONTROL OBJECTIVES</u>	<u>CONTROL ACTIVITIES</u>	<u>AUDIT PROCEDURES</u>
1. <u>CONTRACTOR COMPLIANCE REVIEWS</u> Management should periodically perform independent reviews of the Indirect/ODC System policies and procedures to ensure that they comply with applicable laws and regulations, have been implemented, and are working effectively.	Periodically evaluate and update indirect/other direct cost policies and procedures to ensure that they comply with applicable laws and regulations.	a. Evaluate the contractor's policies and procedures to determine if periodic management reviews occur to ensure that they comply with applicable Federal laws and regulations.
		b. Evaluate the nature and extent of management's most recent review of established policies and procedures to determine if it complies with established review policies and procedures.
	Periodically evaluate actual indirect/other direct cost system practices to determine if established policies and procedures have been properly implemented and are operating effectively. The following areas warrant special consideration: <ul style="list-style-type: none"> <li>• Employee knowledge and compliance with policies and procedures.</li> <li>• Composition of indirect cost pools and the bases over which they are allocated.</li> <li>• Expense accounts should be periodically sampled to ascertain if unallowable costs are properly identified.</li> <li>• Consistency in the classification of costs as allowable and unallowable.</li> <li>• Treatment of miscellaneous income, credits, rebates, and discounts.</li> </ul>	c. Evaluate the contractor's policies and procedures to determine if they require periodic management review of actual Indirect/ODC System practices.  d. Evaluate recent management review activity to determine if the contractor is performing reviews in accordance with time frames and guidelines established in the policies and procedures.  e. Identify any reviews which may have an impact on this audit and evaluate the audit reports and supporting working papers to determine if any system deficiencies were noted and the extent to which we can rely on the work performed (see CAM 4-1000).
	Provide for action and follow-up on recommendations resulting from management reviews.	f. Evaluate the contractor's policies and procedures to determine if they provide for adequate follow-up on management review findings and recommendations.
		g. For reviews identified in step 1.e. above: <ol style="list-style-type: none"> <li>(1.) Determine if reported findings and recommendations were resolved in accordance with established policies and procedures.</li> <li>(2.) If deficiencies have been identified and not resolved, evaluate the contractor's calculation of the cost impact and actions taken to ensure that appropriate adjustments were made to government contract billings.</li> </ol>
2. <u>TRAINING</u> Ensure that assigned personnel have sufficient training, experience, and guidance to perform Indirect/ODC functions in accordance with established policies and procedures.	Provide training to employees involved in the indirect/other direct cost system on the provisions contained in CAS and FAR relating to allowability, allocability, and reasonableness of costs and on how to prepare the annual incurred cost submission.	a. Evaluate the contractor's policies and procedures to determine if they require periodic training of all employees involved in the indirect/ODC system.

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	This training should include both new hire training and periodic updates for experienced employees.	b. Evaluate records of completed training, or other evidence, indicating that appropriate employees have been trained in accordance with established policies and procedures.
<p><b>3. <u>PREPARATION OF INDIRECT/OTHER DIRECT COST SUBMISSIONS</u></b> Ensure that indirect/other direct costs proposed, billed, or claimed on U.S. Government contracts are consistent with applicable FAR and CAS requirements.</p>	<p>Establish and maintain policies and procedures covering the preparation of indirect/other direct cost proposals, billings, and claims on U.S. Government contracts. These policies and procedures should provide for:</p> <ul style="list-style-type: none"> <li>• Reconciliation with actual indirect/other direct costs where applicable, including appropriate explanations for any adjustments.</li> <li>• Appropriate documentation and explanations for how applicable unallowable costs have been segregated from amounts proposed, billed, or claimed.</li> </ul>	a. Evaluate the contractor's policies and procedures to determine if they adequately cover the preparation of indirect/ODC proposals, billings, and claims on U.S. Government contracts.
		b. Selectively test recent indirect/ODC proposals, billings and claims to determine if they were proposed in accordance with established policies and procedures.
<p><b>4. <u>ALLOWABILITY OF SELECTED INDIRECT/ODCs</u></b> Ensure that Indirect/ODCs for year(s) under audit are properly identified as allowable or unallowable, including directly associated cost, for U.S. Government contract costing, billing, and pricing purposes (CAS 405/FAR 31.201-2 and 31.201-6).</p>	<p>Establish policies and procedures to ensure that unallowable indirect/other direct costs, including directly associated costs, can be segregated from allowable costs at some point in time between incurrence of the costs and their submission in any proposal, billing, or claim to the U.S. Government. The method and timing of such cost segregation is discretionary; however, documentation should exist which will provide the means of verifying that proper segregation of costs has been accomplished.</p>	a. Check the most recently completed CAS 405 compliance audit to determine if the contractor's policies and procedures for segregating unallowable costs are in compliance with applicable CAS requirements, have been implemented, and are working effectively. Follow-up on previously reported instances of noncompliance. (Note: Effective with MRD 98-PAC-133, dated 30 September 1998, separate assignments will no longer be established for compliance testing of CAS 405)
		b. At least every third year, test selected transactions during incurred cost/ODC audits to determine that the internal controls are functioning as prescribed (see CAM 5-108). The transaction testing should include both indirect and other direct costs, unless the other direct costs were considered immaterial and excluded from the internal control audit. Simultaneously with transaction tests, the auditor should periodically trace transactions through the system to obtain reasonable assurance that there are no significant internal controls weaknesses.
<b>5. <u>ALLOCABILITY OF INDIRECT/ODCs</u></b>		

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<ul style="list-style-type: none"> <li>• Ensure that Indirect/ODCs for year(s) under audit are classified consistently between direct and indirect (CAS 402/FAR 31.202 and 31.203(a)) and properly allocated to cost objectives in accordance with applicable FAR and CAS requirements.</li> <li>• Ensure that the contractor is in compliance with CAS 406, "Cost Accounting Period."</li> </ul>	<p>Policies and procedures are established which provide that indirect/other direct costs are properly allocated in accordance with applicable FAR and CAS requirements.</p>	<ul style="list-style-type: none"> <li>a. Evaluate the most recently completed CAS 403, 410 and 418 compliance examinations to determine if the contractor's policies and procedures for allocating indirect/other direct costs are in compliance with applicable FAR and CAS requirements, and were working effectively. Follow-up on any reported instances of noncompliance.</li> <li>b. Determine if the indirect rate structure to accumulate actual costs is consistent with the indirect rate structure used to prepare forward pricing indirect rates for the same year (CAS 401/FAR 31.201-1 and 31.203(d)).</li> <li>c. Determine if the contractor has accounting policies and procedures which provide that all items of other direct cost are readily identifiable with the contract to which they have been charged.</li> <li>d. Determine that the contractor followed consistent practices in selecting the cost accounting period(s) in which any types of expense and any types of adjustment to expense are accumulated and allocated and that the same cost accounting period is used for indirect pools and allocation bases (CAS 406/FAR 31.203(e)) (Note: Effective with MRD 98-PAC-133, dated 30 September 1998, separate assignments will no longer be established for compliance testing of CAS 406.)</li> </ul>
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